**In The Arbitration**

**between**

**BAYVIEW IRRIGATION DISTRICT ET AL.,**

**CLAIMANTS/INVESTORS,**

**and**

**THE UNITED MEXICAN STATES,**

**RESPONDENT/PARTY.**

ICSID Case No. ARB (AF)/05/1

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# Supplemental Memorial of Bayview Irrigation District et al. in Support of Jurisdiction

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Claimants respectfully provide their observations and responses to questions posed by the Tribunal in its letter dated November 16, 2006 as follows:

## 1. Observations Concerning the United States' Submission Regarding Territoriality Under NAFTA Articles 1102 and 1105

The United States' effort to insert a territoriality requirement into articles 1102 and 1105 of NAFTA, despite the Parties' choice not to include such language in the text of the Treaty, is wrong-headed for three reasons. First, this interpretation is contrary to the plain text of Articles 1102 and 1105, both of which omit language referencing a territoriality requirement (although other provisions of the Treaty, such as Article 1110 do contain such language). Second, such a narrow interpretation of Articles 1102 and 1105 is inconsistent with the broad purposes of NAFTA "to eliminate barriers to trade in, and facilitate the cross border movement of, goods and services between the territories of the parties . . . ." North American Free Trade Agreement (NAFTA), art. 102(1)(a), U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993). This interpretation does not take account of the business reality that modern business investments are not always neatly categorized as located in the territory of one country. Finally, the United States refers to Article 1101 as the "gateway" to Chapter 11, but Article 1101(a) imposes no territoriality requirement on the protections afforded to investors.

### A. Plain Language of Articles 1102 and 1105

Simply put, neither Article 1102 nor 1105 contain a territoriality requirement. The United States argues in its submission that the drafters of NAFTA based Chapter 11 on the Canada-United States Free Trade Agreement, which limits its protections to investments made "within or into its territory by an investor of the other Party," and the United States Model Bilateral Investment Treaty, which limits its protections to

investments that are made "in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party." (Submission of U.S. ¶13.) NAFTA, however, was intentionally drafted differently.[1] Moreover, Articles 1102 and 1105 were intentionally drafted differently from Article 1110, which does contain a territoriality requirement.

Such drafting differences were not inadvertent; the Party nations knew how to include territoriality requirements when they chose to do so, and considered, but ultimately rejected, language that would have imposed a territoriality requirement throughout the Chapter:

> **B. Negotiation History of Chapter Eleven**
>
> - December 1, 1991

The scope of Chapter 11 was originally drafted to protect only investments located within the territory of the Party that enacted the contest measure. This is the draft that the United States now asks this Tribunal to adopt.

> Article 2101: Scope and Coverage
> 1. Subject to paragraphs 2, 3 and 4, this Chapter shall apply to any measure of a Party affecting investment *in its territory* by an investor of the other Parties (emphasis added).

[1] In *Methanex Corp. v. United States*, the investors had asked the Tribunal to interpret Article 1102 in the light of international laws and multilateral treaties, and contrary to the plain language of the text and history of NAFTA. *Methanex Corp. v. United States*, In the Matter of an Arbitration Under Chapter 11 of the North American Free Trade Agreement and the UNCITRAL Arbitration Rules, Final Award of the Tribunal at 19, Aug. 9, 2005. The Tribunal refused, holding instead that "[t]he issue here is not the relevance of general international law . . . or the theoretical possibility of construing a provision of NAFTA by reference to another treaty of the parties . . . . International law directs this Tribunal, first and foremost, to the text; here, the text and the drafters' intentions, which it manifests, show that trade provisions were not to be transported to investment provisions." *Id.* The Tribunal concluded that the drafters of NAFTA intentionally did not follow the international trend to recognize the "like products" term at issue in that arbitration. *Id.* at 17-18.

NAFTA Negotiating Texts, Dec. 1991, *available at* http://www.naftaclaims.com/Papers/01-December1991.pdf (last visited Dec. 14, 2006).

The scope of the Chapter was narrowly stated to include only the investors of any other party with respect to measures of a party affecting investments in its territory.

> Article 401 Scope.
> 1. This part shall apply to any measure of a Party affecting investors, services providers, or other persons of any other Party in respect of:
>    a. the establishment;
>    b. the acquisition;
>    c. the conduct and operation; or
>    d. the sale, of business enterprises *in or into its territory*. (emphasis added).

NAFTA Negotiating Texts, Dec. 1991, *available at* http://www.naftaclaims.com/Papers/01-December1991.pdf (last visited Dec. 14, 2006).

- January 16, 1992

The draft still limited the protection to investments located within the territory of the Party that took the measure, and investors with enterprises located in the territory of the Party that took the measure.

> CHAPTER 21 - INVESTMENT
> Chapter XX - Investment
> PART 4 - INVESTMENT AND CONDUCT OF BUSINESS OPERATIONS
> SCOPE, COVERAGE AND DURATION
> Article Y01: Scope USA[and Post Termination Coverage]
> 1. MEX[Subject to paragraphs 3, 4, and 5,] CDA MEX[this MEX[Chapter] CDA[Part] shall apply to any measure of a Party affecting] MEX[investment in its territory by an investor of the other Parties] CDA[investors or service providers of any other Party in respect of:
>    a) the establishment;
>    b) the acquisition;
>    c) the conduct and operation; or
>    d) the sale; of business enterprises *in or into its territory*. (emphasis added).

NAFTA Negotiating Texts, Jan. 16, 1992, *available at* http://www.naftaclaims.com/Papers/02-January161992.pdf (last visited Dec. 14, 2006).

- August 11, 1992

Negotiators changed the specific requirement that the investment be located in the territory of the Party that enacted the measure to the requirement that the investment be located in another party location. Investors were still required to locate their investments in another Party's territory in order for Chapter 11 to apply.

> INVESTMENT
> Article 2101: Scope and Coverage
> 1. This Chapter shall apply to measures of the Parties affecting:
>
> a) investments of investors of a Party *in the territory of another Party* existing at the time of entry into force of this Agreement as well as to investments made or acquired thereafter by such investors;
> b) investors of a Party in the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments *in the territory of another Party*; and
> c) all investments *in the territory of any Party* as provided in Article 2109.
> (emphasis added).

NAFTA Negotiating Texts, Aug. 11, 1992, *available at* http://www.naftaclaims.com/Papers/17-August111992.pdf (last visited Dec. 14, 2006).

- August 27, 1992

Language was changed to include "all the investors" within the Free Trade Area, not only the investors that had investments in another Party's territory.

> Article 2101: Scope
> 1. This Chapter applies to measures adopted or maintained by a Party relating to:
>
> (a) investments of investors of another Party in the territory of the Party existing at the time of entry into force of this Agreement as well as to investments made or acquired thereafter by such investors;

(b) investors of another Party; and
(c) with respect to article 2108, all investments in the territory of the Party.

NAFTA Negotiating Texts, Aug. 27, 1992, *available at* http://www.naftaclaims.com/Papers/20-August271992.pdf (last visited Dec. 14, 2006).

- August 30, 1992

The negotiators made only cosmetic changes to the Article, and the broad scope given to investments and investors remained intact.

Article 2101: Scope
1. This Chapter applies to measures adopted or maintained by a Party relating to:
(a) investors of another Party;
(b) investments of investors of another Party in the territory of the Party existing at the time of entry into force of this Agreement as well as to investments made or acquired thereafter by such investors; and
(c) with respect to Article 2107, all investments in the territory of the Party existing at the time of entry into force of this Agreement as well as to investments made or acquired thereafter.

NAFTA Negotiating Texts, Aug. 30, 1992, *available at* http://www.naftaclaims.com/Papers/22-August301992.pdf (last visited Dec. 14, 2006).

- September 20, 1992

The final language was ratified by the three Parties.

Article 1101: Scope and Coverage
1. This Chapter applies to measures adopted or maintained by a Party relating to:
(a) investors of another Party; and
(b) investments of investors of another Party in the territory of the Party.

NAFTA Negotiating Texts, Sept. 20, 1992, *available at* http://www.naftaclaims.com/Papers/33-September201992.pdf (last visited Dec. 14, 2006).

Accordingly, as adopted, Article 1102 has two parts. The first part protects investors of another party, while the second part separately protects investments. The United States would have this Tribunal read out the first part of this Article, limiting protection only to investments and eliminating protections for all investors (as set forth in earlier drafts of the provision). Part one of Article 1102 would be superfluous if, under the United States' interpretation, it is limited only to investments:

- NAFTA Article 1102. National Treatment

> 1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
>
> 2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

NAFTA art. 1102.

The kinds of measures encompassed by Article 1102, however, are expansive, addressing measures that impact the investor separately from the investment. The measures encompassed by Article 1102 include "treatment . . . that it accords, in like circumstances, to its own investors" and "treatment . . . that it accords, in like circumstances, to investments of its own investors . . . ." *Id.*

The protected activities are also expansive, including activities which need not take place in the territory: "establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." *Id.*

Likewise, Article 1105 (which covers investments only) does not limit itself to investments while within the territory of another Party. Article 1105 also expansively protects against all measures that deny "treatment in accordance with international law, including fair and equitable treatment and full protection and security." NAFTA art. 1105. The United States has failed to establish that international law principles, including fair and equitable treatment and full protection and security for the investment, apply only so long as the investment is located in the territory. In fact, experience teaches that such measures could certainly affect investments while they are located elsewhere. For example, denying landing rights to airplanes or boats from Canada or the United States, resulting in the grounding of the planes and ships, or denying entry for crops grown in the United States or Canada but intended for the Mexican market.

- NAFTA Article 1105. Minimum Standard of Treatment

> 1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.
>
> 2. Without prejudice to paragraph 1 and notwithstanding Article 1108(7)(b), each Party shall accord to investors of another Party, and to investments of investors of another Party, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife.

NAFTA art. 1105.

In sharp contrast, Article 1110 does contain a territoriality requirement; that provision protects "an investment of an investor of another Party in its territory . . . ." NAFTA art. 1110(1).

The United States offers no explanation for why, under its theory of how articles 1102 and 1105 should be construed, the drafters of Chapter 11 would choose to include

language imposing a territoriality requirement in Article 1110, but would leave it up to Tribunals to read the requirement into Articles 1102 and 1105. Article 1110, however, teaches that the drafters did know how to include a territoriality requirement when one was desired.

Accordingly, this Tribunal should decline Respondent's invitation that it stand in the shoes of the drafters and insert a territoriality requirement in Articles 1102 and 1105. The only appropriate avenue for adding new terms to NAFTA provisions is through the amendment process, not by Tribunal decision-making, nor by means of Section 1128 submissions. *See United Parcel Service of America, Inc. v. Canada*, An Arbitration Under Chapter 11 of the North American Free Trade Agreement, Award on Jurisdiction at 31, Nov. 22, 2002 ("[T]he NAFTA Parties have now submitted to a number of NAFTA tribunals that the 'additive' interpretation is not available to the tribunals.").

Moreover, other Tribunals that have applied Articles 1102 and 1105 have not concluded that these provisions contain a territoriality requirement. For example, in *ADF Group, Inc. v. United States*, the Tribunal expressly observed that Article 1102 is a provision of broad application, but did not state that it contained a territoriality requirement:

> 152. The beneficiaries of Article 1102(1) and (2) are both investors and their investments. The broad scope of application of Article 1102 is indicated by the breadth of the definitional scope of the critical term "investment." Article 1139 defines "investment" as embracing not just the more familiar "enterprise," and the traditional "equity security" or "debt security" of an "enterprise," but also the following:
> . . .
> (g) real estate or other property, tangible or intangible acquired in the expectation or used for the purpose of economic benefit or other business purposes;
> (h) interest 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 the remuneration depends substantially on the production, revenues or profits of an enterprise;
>
> *ADF Group, Inc. v. United States*, In the Matter of an Arbitration Under Chapter Eleven of the North American Free Trade Agreement, Award at 70, Jan. 9, 2003.

Likewise, and notably, the Free Trade Commission in its Notes of Interpretation made no mention of any territoriality requirement in its discussion of Article 1105. *See* Notes of Interpretation of Certain Chapter 11 Provisions, NAFTA Free Trade Commission, Jul. 31, 2001, *available at* http://www.naftaclaims.com/files/NAFTA_Comm_1105_ Transparency.pdf (last visited Dec. 15, 2006).

**C. Plain Language of Article 1101**

The United States argues that Article 1101, which defines the scope and coverage of Chapter 11, limits all of the protections in Chapter 11 to investments located in the territory of another party. In point of fact, neither the plain language of Article 1101, nor as previously noted, of Articles 1102 and 1105, limit the protections set forth in Chapter 11 exclusively to investments in the territory of another Party. Article 1101 provides:

> 1. This Chapter applies to measures adopted or maintained by a Party relating to:
> (a) investors of another Party;
> (b) investments of investors of another Party in the territory of the Party; and
> (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party.

NAFTA art. 1101(1). Article 1101(1)(a), thus, explicitly applies to "investors of another Party," and contains no territoriality requirement. In contrast, Article 1101(b) plainly applies to "measures adopted or maintained by a Party relating to . . . investments of investors of another Party in the territory of the Party." Again, Respondent fails to

explain why the drafters would choose to put an explicit territoriality requirement in (b) and (c), but not in (a), if they intended one to apply.

However, as Claimants have explained in prior submissions, both (a) and (b) are satisfied here. A "measure" is "any law, regulation, procedure, requirement or practice." NAFTA art. 201. Mexico, a NAFTA Party, has adopted measures that have expropriated Claimants's investment (water), in violation of Articles 1110 and 1101(b). Claimants are investors of the United States, another NAFTA Party. An "investment" is "real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes." NAFTA art. 1139(g). Claimants' water rights are "other property." Thus, under Article 1101(b), Mexico took a measure by refusing to release water, relating to the Claimants water rights, and this investment owned by these Claimants. This investment is and was in the territory of Mexico. Indeed, if the water were not in the territory of Mexico, Mexico's actions could not have "related to" it.

By taking Claimants' water and giving it, for use, to Claimants' competitors, farmers in Mexico, Respondent has adopted measures that give farmers in Mexico an unfair competitive advantage over farmers in the United States, in violation of Articles 1102 and 1105. Accordingly, Mexico has adopted measures "relating to . . . investors of another Party." NAFTA art. 1101(1)(a).

Thus, both Article 1101(a), which has no territoriality requirement, and 1101(b), which does have a territoriality requirement, apply to these claims. Therefore, the United States' submission arguing that Articles 1102 and 1105 should be read to contain

a territoriality requirement has no application to these claims, which are well within the scope of Chapter 11 of NAFTA.

### D. The Position of the United States Is Inconsistent with the Expansive Purpose of NAFTA and with Modern Business Realities

The absence of a territoriality requirement in Articles 1101(1)(a), 1102, and 1105 is consistent with the design and purpose of NAFTA, which is to eliminate economic boundaries between Mexico, Canada, and the United States. NAFTA art 102(1)(a). As previously noted, the drafters of NAFTA plainly rejected the notion of merely creating incentives and protections for foreign investments in another Party's territory. According to its Preamble and Objectives, NAFTA is intended to foster the creation of a Free Trade Area with regional obligations and rights.

- **NAFTA Preamble**

> The Government of Canada, the Government of the United Mexican States and the Government of the United States of America, resolved to:
>
> ***
>
> CONTRIBUTE to the harmonious development and expansion of world trade and provide a catalyst to broader international cooperation;
>
> CREATE an expanded and secure market for the goods and services produced in their territories;
>
> ***
>
> ESTABLISH clear and mutually advantageous rules governing their trade;
>
> ENSURE a predictable commercial framework for business planning and investment;
>
> ***
>
> ENHANCE the competitiveness of their firms in global markets.

NAFTA Preamble

- **NAFTA Article 102. Objectives**

> 1. The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency, are to:
>
> > a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
> > b) promote conditions of fair competition in the free trade area;
> > c) increase substantially investment opportunities in the territories of the Parties;
> >
> > ***
> >
> > f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

NAFTA, art. 102.

- **NAFTA Free Trade Commission Joint Statement - "A Decade of Achievement"**- July 16, 2004

> Ten years ago, our countries launched a bold initiative: to create the world's largest free trade area, one that would knit our countries together through freer trade and investment.[2]

NAFTA is designed to facilitate and protect the "cross border movement of goods . . . between the territories of the Parties . . . ." NAFTA art. 102(1)(a).

Claimants' investment at issue in this arbitration similarly involves the movement of goods across the border between Mexico and the United States. Agricultural production along the United States/Mexico border is a fully integrated economic activity, with goods and services freely traversing the border between the two countries. The same kinds of crops are grown and sold on both sides of the border and use the same water supply. In fact, crops move back and forth across the border depending upon the availability of water. The Claimants here own and operate farms in Texas, which

[2] Joint Statement, U.S. Mex.- Can., NAFTA Free Trade Comm'n, Joint Statement – "A Decade of Achievement" (Jul. 16, 2004) *available at* http://www.ustr.gov/Document_Library/Press_Releases /2004/July/NAFTA_ Free_Trade_Commission_Joint _Statement_-_A_Decade_of_Achievement.html (last visited Dec. 15, 2006).

annually generate millions of dollars of agricultural products that are sold across the border in Mexico, again depending on the availability of water.

The irrigation water used on these farms to grow these crops comes from the tributaries located in Mexico, which feed the Rio Grande River. This water, which is itself recognized as an investment under Article 1139 (g) of NAFTA, is an essential resource in the Claimants' production of grain (such as sorghum), corn, and cotton, all of which is exported to Mexico for sale. The Claimants' entire production of grain, corn, and cotton is exported to Mexico for sale; none is sold within the United States. Indeed, Mexico's demand for these products far outstrips Claimants' current ability to produce these crops. When Claimants are deprived of the water they need to grow these crops, as they were during 1992 – 2002, Mexico turns elsewhere to satisfy its demand. During the relevant years of these claims, lacking water to grow their crops, many farmers went bankrupt.

In short, access to irrigation water to grow crops to sell in the Mexican marketplace generates the cash supporting Claimants' agricultural businesses. Without access to irrigation water, Claimants can neither participate in the Mexican market nor maintain their economic viability. The availability of their water supports thriving agricultural businesses, and allows them to market their products to buyers in Mexico. Mexico's importation of these crops, grown principally with water coming from Mexico, in turn generates economic activity in Mexico, including processing the grain for bread and other baked goods, and processing cotton into cloth.

In *Pope & Talbot Inc. v. Canada*, Canada argued that "the ability to sell lumber to the U.S. market is not an investment within the meaning of NAFTA." *Pope & Talbot*

*Inc. v. Canada,* In the Matter of an Arbitration Under Chapter Eleven of the North American Free Trade Agreement, Interim Award by Arbitral Tribunal ¶96, June 26, 2000. The Tribunal disagreed, holding instead that "the Investment's access to the U.S. market is a property interest subject to protection under Article 1110 and that the scope of that article does cover nondiscriminatory regulation that might be said to fall within an exercise of a state's so-called police powers." *Id.*

**2. Observations Concerning the United States' Submission Regarding the Standing of the Irrigation Districts as Claimants under NAFTA**

On November 16, 2006, the Tribunal invited the NAFTA parties to file a submission by November 27, 2006 on the question of the standing of the irrigation districts as Claimants under NAFTA. Neither Canada nor the United States responded to this invitation. Claimants have nothing to add on this issue, other than to note that the irrigation districts do have standing to file these claims.

The 17 irrigation districts here are investors within the meaning of Article 1139.[3] Therefore, they do have standing under Chapter 11 to bring these claims. Article 1139 defines a "disputing investor" as "an investor that makes a claim under Section B." NAFTA art. 1139. All of the irrigation districts own investments, or property that was "acquired in the expectation or used for the purpose of economic benefit or other business purposes." NAFTA art. 1139(g).

The irrigation districts sell water to water users or other irrigation districts. They have invested millions of dollars in the construction of water delivery and storage

[3] Likewise, the irrigation districts are investors under the ICSID Convention, which uses the phrase "national of another Contracting State" to describe an investor, in a similar context to that found in the Additional Facility Rules. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, (ICSID Conv.), art. 25(1),Oct. 14, 1966.

facilities, including, but not limited to, canals and pumps, in order to supply this water to their water users. They have also invested heavily in employees and facilities of operation. The water supplied by these irrigation districts is used on the approximately 400,000 acres of valuable and productive agricultural land in this arbitration.

Although irrigation districts are creatures of Texas law, they do not act as agents for the state of Texas or the federal government.[4] Rather, irrigation districts have express and implied powers granted to them by the Texas legislature, which relate exclusively to the delivery and supply of water to the water users in their district. *See, e.g., Harlingen Irrigation Dist. Cameron County No. 1 v. Caprock Commc'ns Corp.*, 49 S.W.3d 520, 536 (Tex. App. 2001); *see generally* TEX. WATER CODE ANN. §§ 58.011-58.836.

Thus, the irrigation districts operate much like the privately owned water supply company in this arbitration, North Alamo Water Supply Corporation ("Alamo").[5] Like Alamo, the irrigation districts' fiscal and corporate management is under the direction of a Board of Directors. Landowners who own at least one acre of irrigable land and who are entitled to receive irrigation water from the district are eligible to vote in elections of an irrigation district. TEX. WATER CODE ANN. § 58.222 (Vernon). Such voting procedures are comparable to shareholder voting in a corporation. For example, landowners may vote by proxy. *Id.* § 58.225. Finally, irrigation districts can enter into

[4] The drafters of the ICSID Convention specifically considered the issue of whether investors were required to be private entities. *See* Christoph H. Schreuer, *The ICSID Convention: A Commentary,* 159-61 (2001). According to commentator Aron Broches, for purposes of the ICSID Convention, a mixed economy company or government-owned corporation should not be disqualified as a "national of another Contracting State" unless it is acting as an agent for the government or is discharging an essentially governmental function. A. Broches, *The Convention on the Settlement of Investment Disputes, Some Observations on Jurisdiction*, 5 Colum. J. Transnat'l L. 263, 354-5 (1966), *reprinted in* Schreuer, *supra*, at 160.

[5] Alamo's website is http://www.nawsc.com.

contracts; sue and be sued; and, acquire property to extend, enlarge or improve the district or its facilities and services. *Id.* § 58.122; *see id.* § 58.121, which states:

> The board [of directors of an irrigation district] may institute and maintain any suit or suits to protect the water supply or other rights of the district, to prevent any unlawful interference with the water supply or other rights of the district, or to prevent a diversion of its water supply by others.

Thus, the irrigation districts bring these claims on their own behalf, and are properly viewed as private, non-profit enterprises entitled to bring these claims under Chapter 11 of NAFTA.

### 3. Observations on the Notion of Water as a Good in Commerce

The Tribunal has also asked the parties to comment on the issue of water as a good in commerce. Claimants contend that the water at issue in this arbitration has been taken out of its natural state and has been placed in commerce, and is within the scope of Chapter 11.[6] Water is increasingly viewed as a commodity that is bought, sold, and

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[6] In 1993, the NAFTA Parties agreed that water that is taken out of its natural state has entered into commerce, and falls under NAFTA's provisions. Respondent, together with the United States and Canada, issued a joint statement on December 2, 1993, recognizing that water that has entered into commerce (as contrasted with water in its natural state) is within the provisions of NAFTA:

> The governments of Canada, the United States and Mexico, in order to correct false interpretations, have agreed to state the following jointly and publicly as Parties to the North American Free Trade Agreement (NAFTA):
>
> The NAFTA creates no rights to natural water resources of any Party to the Agreement.
>
> Unless water, in any form, has entered into commerce and become a good or product, it is not covered by the provisions of any trade agreement including NAFTA. And nothing in the NAFTA would oblige any NAFTA Party to either exploit its water for commercial use, or to begin exporting water in any form. Water in its natural state in lakes, rivers, reservoirs, aquifers, water basins and the like is not a good or product, is not traded, and therefore is not and never has been subject to the terms of any trade agreement.

Statement, Can.-Mex.-U.S., 1993 Statement by the Governments of Can., Mex. and the U.S., (1993), *available at* http://www.scics.gc.ca/cinfo99/83067000_e.html#statement (last visited Dec. 15, 2006); *see also* David Johansen, *Water Exports and the NAFTA*, (Mar. 8, 1993), http://dsp-psd.communication.gc.ca/Collection-R/LoPBdP/EB/prb995-e.htm#(12)txt (last visited Dec. 15, 2006).

traded. As noted NAFTA scholar, Dr. Al-Assar, observed at a conference on NAFTA that took place in Canada, commenting on water as an article in trade:

> Whereas in the past, water was viewed as a common good of mankind, it is now more and more viewed as a tradable good, something for sale. This privatization of water service that is taking place on a global scale has opened the door for the concept of water as a service or commodity for which one has to pay. Whether or not water will become like oil one day, I have no doubt about it. Water is essential for life, whereas oil is not. Oil is fungible and can be replaced, but water cannot.
>
> I definitely believe that due to the provisions of the General Agreement on Tariffs and Trade, no country can prohibit the export of its water once it has been "commoditized" (which means taken out of its natural state and diverted or transferred into containers of any size). This is why the Canadian Federal Government has enacted legislation that prohibits diversions and removal of large quantities of water from the Great Lakes Basin. Water in a lake, a river or an aquifer is protected from bulk-water export as long as it remains in its natural state.

Isabel Al-Assar, Future Trading of Waters as a Commodity, Waterbank (Aug. 25, 2006) *available at* http://waterbank.com/newsletters/nws42.htm (last visited Dec. 14, 2006); *see also* Howard Mann, *Inter. Econ. Law: Water for Money's Sake?* at 4 (Sept. 22, 2004), http://www.iisd.org/pdf/2004/investment_water_economic_law.pdf ("[F]irst and foremost, it is clear that if water has entered into commerce and become a good or a product it is covered by NAFTA. This is so even, for example if it is sold through a water diversion project."); *Sun Belt Water, Inc. v. Canada*, In the Matter of the North American Free Trade Agreement, Notice of Claim and Demand for Arbitration, Oct. 12, 1999 (claim filed against Canada under Articles 102, 1102, 1105, and 1110 for failure to honor fresh water export licensing agreement).

The River Grande River has long since ceased to be a naturally flowing river. Rather, the flow of the River is strictly controlled, with releases made only at the request

of water rights holders. The River is fully, and indeed over, adjudicated. *See* Valley Water Summit White Paper, *Rio Grande Water Rights & Allocation* (Jan. 2005) (since the late 1960s, the U.S portion of the Rio Grande below Amistad has been a fully adjudicated river), http://www.valleywatersummit.org/downloads/WaterRightsNew.pdf. Water that flows into the River is captured, carefully monitored, and stored in internationally controlled reservoirs. Water from the Rio Grande River is bought, sold, traded, and stored for use in the agricultural commercial activities of farmers on both sides of the River. *See* Texas Center for Policy Studies, *The Dispute Over Shared Waters Of The Rio Grande/Rio Bravo: A Primer,* at 8 (Jul. 2002), *available at* http://www. texascenter.org/borderwater/waterdispute.pdf (last visited Dec. 14, 2006) ("[A]ccording to the Delicias office of Mexico's agricultural finance authority, FIRA, during the last decade of water scarcity, many small farmers have stopped growing wheat or corn, but are instead renting or selling their water rights to other farmers who are growing alfalfa, peanuts or chiles."). Indeed, Mexico itself recognizes tradable water rights in these very waters. *See* Mark W. Rosegrant and Renato Gazmuri S., *Reforming Water Allocation Policy Through Markets in Tradable Water Rights: Lessons from Chile, Mexico, and California,* at 10, Int'l Food Policy Research Institute (Oct. 1994), *available at* http://www.ifpri.org/divs/eptd/dp /papers /eptdp06.pdf (last visited Dec.15, 2006) ("[A]long with general economic reform, Mexico began the process of implementing fundamental changes in its water policy with respect to water rights, water management, and allocation of water, with the passage of a new Water Law in December 1992, which, among other important features described below, created tradable water rights, and

initiated the process of turning over the operation and maintenance of irrigation systems to farmers.").

Hence, Claimants' water, which originates from tributaries all located in Mexico, is internationally bought, traded, and sold, and delivered through a complex of irrigation works. Water is a good or product in commerce, and it necessarily falls within the scope of NAFTA both as an article in trade and explicitly as an investment, under Article 1139(g). That farmers on both sides of the border utilize water for growing their commercially valuable crops, further underscores waters' status as a good in commerce and its importance as an investment.

**4. Observations on *City of San Marcos v. Texas Comm'n on Envtl. Quality*, 128 S.W.3d 262 (Tex. App. 2004)**

The Tribunal has also invited the Parties to comment on the case, *City of San Marcos v. Texas Comm'n on Envtl Quality*, 128 S.W.3d 264 (Tex. App. 2004); *see also* Tr. at 299:4–20.[7] Claimants submit that this case had no relevance to the issues in this arbitration because that case involved ground water and this case involves surface water. *City of San Marcos* holds that Claimants must have physical control of ground water in order to have any right to it under Texas law. The physical capture rule applied in *City of*

[7] At the jurisdictional hearing, Arbitrator Gomez Palacio, asked:

> I would like to add precisely on the San Marcos, the City of San Marcos case that Professor Lowe was mentioning, that it talks about a matter that I would like to be addressed. It talks about the physical control of the captured waters, properties. I'm reading in what will be page 12 of the version I have, and it reads the paragraph, "[I]ndeed, the common law right to transport captured groundwater, as illustrated in City of Corpus Christi and Dennis, must be based on the physical control of the captured property rather than on subjective intent to maintain ownership over it."
>
> So, it may be interesting for you to address the matter of whether Claimants have this physical control of the water and whether it's necessary for them to claim what they're claiming.

Tr. (Nov. 19, 2006) at 299:4–20.

*San Marcos* only applies to groundwater. *See generally* 45 Tex. Prac., Environmental Law § 14.2 (2d ed.) ("[G]roundwater and the right to capture groundwater is considered property of the owner of the surface estate and treated much like a mineral or oil and gas with some difference.").

Surface water is governed by the doctrine of appropriation under Texas law. *Compare City of Marshall v. City of Uncertain*, --- S.W.3d ----, 2006 WL 1565012 *5 (Tex. 2006) ("[T]he right to use and divert state [surface] water is 'acquired by appropriation in the manner and for the purposes provided in [the Water Code].'") (quoting V.T.C.A., Water Code § 11.022) *with City of San Marcos*, 128 S.W.3d at 270 ("[T]exas has long recognized that a landowner can assert absolute ownership over groundwater by drilling a water well and capturing it."). Thus, physical control is only relevant when discussing a property interest in groundwater.

**5. Actions Available to the State of Texas in the Event of Non-Compliance with the Terms of Claimants' Water Rights**

In response to the Tribunal's request for an explanation of what, if any, action the State of Texas can take in the event of non-compliance with water rights of the kind held by Claimants, Claimants state the following:

Claimants own the majority of the water allocated to the United States under the 1944 Treaty, which specifically contemplated that this water would be allotted to Texas nationals under the law of Texas. *See* Resp. Ex. 14 at 210 (Treaty Respecting Utilization of Waters of the Colorado and Tijuana Rivers and of the Rio Grande, U.S.-Mex., Feb. 3, 1944, 59 Stat. 1219, T.S. 994). That adjudication process is described in detail in several reported decisions of the Texas courts. *See, e.g., Tex. v. Hidalgo County Water Control and Improvement Dist. No. 18*, 443 S.W.2d 728 (Tex. 1969); *In re Adjudication of Water*

*Rights of Upper Guadalupe Segment*, 642 S.W.2d 438 (Tex. 1982). Claimants all possess adjudicated water rights, which are evidenced by certificates from the State of Texas, and are recorded in the Texas Commission on Environmental Quality's Water Rights Database from which ownership of the water rights is easily ascertainable. *See* Claimants' Letter to H. Perezcano, Apr. 4, 2006.

As the former Legal Advisor to the International Boundary and Water Commission wrote:

> The State of Texas regulates, as between competing water users, the allocation of those water resources within its boundaries and the property rights incident to the right to utilize and develop these water resources.
>
> * * *
>
> The traditional basis for state regulation has been ownership of the water resources themselves by the State of Texas in its sovereign capacity. Under statutory declarations, state water "is the property of the state." Decisions of the Texas Supreme Court have consistently cast the State of Texas as the owner of the water resources over which it regulates the allocation.

Darcy Alan Frownfelter, *The Int'l Component of Texas Water Law*, 18 St. Mary's L.J. 481, 490-92 (1986).[8]

Texas law recognizes a vested property right in water where an adjudicated water right exists. *In re Adjudication of the Water Rights of Upper Guadalupe Segment of the Guadalupe River Basin*, 642 S.W.2d at 444 ("[A]ppropriated water rights, like riparian

[8] As Roscoe Pound stated in explaining state ownership of common resources:

> It should be said . . . that while in form our courts and legislatures seem thus to have reduced everything but the air and the high seas to ownership, in fact the so-called state ownership of res communes and res nullius is only a sort of guardianship for social purposes. It is imperium, not dominium. The state as a corporation does not own a river as it owns the furniture in the state house . . . . What is meant is that conservation of important social resources requires regulation of the use of res communes to eliminate friction and prevent waste, and requires limitation of the times when, places where, and persons by whom res nullius may be acquired in order to prevent their extermination. Our modern way of putting it is only an incident of the nineteenth-century dogma that everything must be owned.

ROSCOE POUND, AN INTRODUCTION TO THE PHILOSOPHY OF THE LAW 199 (1922).

rights, are vested."). Owners of vested water rights have had these rights upheld in expropriation cases. In *San Antonio River Auth. v. Lewis*, 363 S.W.2d 444, 449 (Tex. 1962), the court held the San Antonia River Authority liable for an unconstitutional taking. There the River Authority had changed the river channel and diverted the waters. The court held that the plaintiffs had a vested right in the river water, the taking of which entitled the water rights' holders to recover the damages based on the value of their land "as depreciated by loss of their rights to obtain the granted waters from their accustomed channel through the irrigation conduit." *Id.* at 447.

In Texas, the vested water right includes the right to water quantity and quality as originally adjudicated and continuously exploited. *Hale v. Colo. River Mun. Water Dist.*, 818 S.W.2d 537, 541 (Tex. App. 1991) ("[T]exas courts have consistently held that [water] rights may involve not only the quantity of a stream's flow, but also the quality."). Water rights in Texas are governed by the water rights sections of the Texas Water Code, TEX. WATER CODE ANN. §§ 11.001-11.506 (Vernon 2004).

Texas maintains a comprehensive regulatory scheme to ensure the effective use of water, a limited and valuable resource in Texas. The preservation and development of its water resources is the State's duty under its constitution. *See* Vernon's Ann. Tex. Const. art. 16, § 59. A water right is defined as "a right acquired under the laws of [Texas] to impound, divert, or use state water." V.T.C.A., TEX. WATER CODE ANN. § 11.002(5). To effectuate the beneficial use of its water resources, the Texas legislature empowers the Water Commission to issue water rights permits, and adjudicate, cancel, and enforce water rights. TEX. WATER CODE ANN § 5.013. The Water Commission is charged to "actively and continually evaluate outstanding permits and certified filings" and to "carry

out measures to cancel wholly or partially the certified filings and permits that are subject to cancellation." *Id.* § 12.012.

The Water Commission may cancel unused water rights in three circumstances.[9] First, failure to diligently complete a project for taking or storing water can result in forfeiture and cancellation. *Id.* § 11.146.[10] Second, a right to use the State's water is forfeited if willfully abandoned for three successive years. *Id.* § 11.030.[11] Third, a water right is subject to cancellation in whole or in part for ten consecutive years of non-beneficial use. *Id.* §§ 11.173-76.

Texas water law contains a "use it or lose it" provision under which the Water Commission has the duty to initiate cancellation proceedings if its records do not show

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[9] Texas expressly excludes vested private rights to the use of water from the statutes governing water rights. *See* TEX. WATER CODE ANN. § 11.001(a).

[10] Section 11.146 provides:

> (a) If a permittee fails to begin construction within the time specified in Section 11.145 of this code, he forfeits all rights to the permit, subject to notice and hearing as prescribed by this section.
> (b) After beginning construction if the appropriator fails to work diligently and continuously to the completion of the work, the appropriation is subject to cancellation in whole or part, subject to notice and hearing as prescribed by this section.
> (c) If the commission believes that an appropriation or permit should be declared forfeited under this section or any other sections of this code, it should give the appropriator or permittee 30 days notice and provide him with an opportunity to be heard.
> (d) After the hearing, the commission by entering an order of record may cancel the appropriation in whole or part. The commission shall immediately transmit a certified copy of the cancellation order by certified mail to the county clerk of the county in which the permit is recorded. The county clerk shall record the cancellation order.
> (e) Except as provided by Section 11.1381 of this code, if a permit has been issued for the use of water, the water is not subject to a new appropriation until the permit has been cancelled in whole or part as provided by this section.
> (f) Except as provided by Subchapter E of this chapter, none of the provisions of this code may be construed as intended to impair, cause, or authorize or may impair, cause, or authorize the forfeiture of any rights acquired by any declaration of appropriation or by any permit if the appropriator has begun or begins the work and development contemplated by his declaration of appropriation or permit within the time provided by the law under which the declaration of appropriation was made or the permit was granted and has prosecuted or continues to prosecute it with all reasonable diligence toward completion.
> (g) This section does not apply to a permit for construction of a reservoir designed for the storage of more than 50,000 acre-feet of water.

[11] Section 11.030 provides: "[I]f any lawful appropriation or use of state water is willfully abandoned during any three successive years, the right to use the water is forfeited and the water is again subject to appropriation."

that for ten years some portion of water has been used pursuant to a permit, certified filing, or a certificate of adjudication. *Id.* § 11.174. Before cancellation of all or part of the water right, the owner of the appropriation must be afforded notice and hearing. *Id.* §§ 11.175-76.[12] At the hearing, the owner must be given an opportunity to bring forth evidence that the water in question has been beneficially used for the purposes authorized by the permit, filing, or certificate during the ten year period. *Id.* § 11.176. The Water Commission must cancel the appropriation if it finds that (1) any part of the water has not been put to a beneficial use during the prescribed period; and (2) the owner has not used reasonable diligence in applying the water or the unused portion of the water to an authorized beneficial use or is otherwise unjustified in the nonuse. *Id.* § 11.177.[13] The statute then provides what constitutes reasonable diligence or a justified nonuse. *Id.*

[12] Section 11.175 provides:

> (a) At least 45 days before the date of the hearing, the commission shall send notice of the hearing to the holder of the permit, certified filing, or certificate of adjudication being considered for cancellation in whole or in part. Notice shall be sent by certified mail, return receipt requested, to the last address shown by the records of the commission. The commission shall also send notice by regular mail to all other holders of permits, certified filings, certificates of adjudication, and claims of unadjudicated water rights filed pursuant to Section 11.303 of this code in the same watershed.
>
> (b) The commission shall also have the notice of the hearing published once a week for two consecutive weeks, at least 30 days before the date of the hearing, in a newspaper published in each county in which diversion of water from the source of supply was authorized or proposed to be made and in each county in which the water was authorized or proposed to be used, as shown by the records of the commission. If in any such county no newspaper is published, then the notice may be published in a newspaper having general circulation in the county.

Section 11.176 provides:

> (a) Except as provided by Subsection (b) of this section, the commission shall hold a hearing and shall give the holder of the permit, certified filing, or certificate of adjudication and other interested persons an opportunity to be heard and to present evidence on any matter pertinent to the questions at issue.
>
> (b) A hearing on the cancellation of a permit, certified filing, or certificate of adjudication as provided by this chapter is unnecessary if the right to such hearing is expressly waived by the affected holder of a permit, certified filing, or certificate of adjudication.
>
> (c) A permit, certified filing, or certificate of adjudication for a term does not vest in the holder of a permit, certified filing, or certificate of adjudication any right to the diversion, impoundment, or use of water for longer than the term of the permit, certified filing, or certificate of adjudication and shall expire and be cancelled in accordance with its terms without further need for notice or hearing.

[13] Section 11.177 provides:

**6. Can the owner of the water rights sue the Irrigation District under Texas law for non-fulfillment of whatever the obligations of the Irrigation Districts may be, under the relevant legislation?**

In response to the Tribunal's inquiry on this point, Claimants offer the following comment:

Under Texas law, a water user can sue an Irrigation District for non-fulfillment of the district's obligations. In Texas, an irrigation district is classified as a general law district. Lawsuits against general law districts are provided for in Water Code § 49.066: "[A] district may sue and be sued in the courts of [the state of Texas] in the name of the district by and through its board." TEX.WATER CODE ANN. § 49.066.

"[S]uits have been successfully filed for failure to deliver water under a breach of contract theory." *El Paso County Water Improvement Dist. No. 1 v. Grijalva*, 783 S.W.2d 736, 740 (Tex. App. 1990) (suit by farmer for crop loss based on claim of unreasonable delay in delivery of water) (citing *Cameron County Water Improvement Dist. No. 1 v. Daniels*, 269 S.W. 1066 (Tex. Civ. App. 1925); *Bildon Farms, Inc. v. Ward*

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(a) At the conclusion of the hearing, the commission shall cancel the permit, certified filing, or certificate of adjudication in whole or in part to the extent that it finds that:
  (1) the water or any portion of the water appropriated under the permit, certified filing, or certificate of adjudication has not been put to an authorized beneficial use during the 10-year period; and
  (2) the holder has not used reasonable diligence in applying the water or the unused portion of the water to an authorized beneficial use or is otherwise unjustified in the nonuse.

(b) In determining what constitutes reasonable diligence or a justified nonuse as used in Subsection (a)(2), the commission shall give consideration to:
  (1) whether sufficient water is available in the source of supply to meet all or part of the appropriation during the 10-year period of nonuse;
  (2) whether the nonuse is justified by the holder's participation in the federal Conservation Reserve Program or a similar governmental program as provided by Section 11.173(b)(1);
  (3) whether the existing or proposed authorized purpose and place of use are consistent with an approved regional water plan as provided by Section 16.053;
  (4) whether the permit, certified filing, or certificate of adjudication has been deposited into the Texas Water Bank as provided by Sections 15.7031 and 15.704 or whether it can be shown that the water right or water available under the right is currently being made available for purchase through private marketing efforts; or
  (5) whether the permit, certified filing, or certificate of adjudication has been reserved to provide for instream flows or bay and estuary inflows.

*County Water Improvement Dist. No. 2*, 415 S.W.2d 890 (Tex. 1967)). In *Engelman Irrigation Dist. v. Shields Brothers, Inc*., Shields Brothers sued the irrigation district for breach of contract for failing to deliver water, alleging that it suffered extensive losses to its cotton, grain, and watermelon crops because it did not receive irrigation water in a timely manner. *Engelman Irrigation Dist. v. Shields Brothers, Inc*., 960 S.W.2d 343, 347 (Tex. App. 1998). Shields Brothers claimed that the irrigation district did not comply with its own rules and regulations, specifically rules requiring that delivery of water be on a first come, first serve basis. *Id*. at 349–50. The jury found for Shields Brothers and the court of appeals affirmed. *Id*. at 355. In *El Paso County Water Improvement Dist. No. 1*, a farmer sued the water district for crop loss based on a claim of unreasonable delay in delivery of water. *El Paso County Water Improvement Dist. No. 1*, 783 S.W.2d at 737-38. In that case, the landowner did not receive water from the district until after it was too late in the growing season, resulting in the loss of his alfalfa crop. *Id*. The court of appeals held that the district could be sued for such a claim, but remanded the case back to the trial court for a new trial as certain facts were not sufficiently proven. *Id*. at 739–40.

Accordingly, irrigation districts can be sued by water users where the districts have failed to fulfill their obligations to those water users.

**Conclusion**

For all of the reasons set forth herein and in Claimants' prior submissions, Claimants ask this Tribunal to deny Respondent's requests to dismiss these claims, and allow this arbitration to proceed on the merits.

Respectfully submitted,

/signed in the original /
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