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**BEFORE THE HONORABLE TRIBUNAL ESTABLISHED PURSUANT TO
CHAPTER XI OF THE NORTH AMERICAN FREE TRADE AGREEMENT**

**BAYVIEW IRRIGATION DISTRICT AND OTHERS,
CLAIMANTS**

v.

**UNITED MEXICAN STATES,
RESPONDENT**

ICSID CASE NO. ARB(AF)/05/1

POST-HEARING SUBMISSION ON JURISDICTION

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I. INTRODUCTION

1. Mexico herewith gives its comments on the submission that the United States submitted on 27 November under NAFTA Article 1128 and also responds to the questions that the Tribunal asked the contending parties.

2. Mexico wishes to emphasize that the U.S. submission is consistent with Mexico's position regarding the necessity that Claimants prove that they have sought to make, are making, or have made an investment in the territory of another NAFTA Party. Because Article 1101 defines the scope and coverage of the investment chapter, which applies only to measures relating to investments "in the territory of the Party" that adopted those measures, Mexico agrees with the United States that the obligations of Articles 1102 and 1105 cannot be interpreted as extending beyond that principle of territoriality.

3. With regard to rivers, the concept of water as a good in commerce does not exist under either Mexican or Texas law. Specifically, Article 27 of the Mexican Constitution provides that ownership of the waters belongs to the Nation. Although such water may be used for specific purposes, it is only through concessions granted under the Law of National Waters that the federal government sets the terms and determines what property rights may be transferred and the requirements that must be met. Under Texas law, water is "State water," i.e., property of the state. Any transfers of water or water rights must either be notified to, or actually approved by, the Texas Commission on Environmental Quality. They cannot be freely traded.

4. Mexico addresses these issues as well as the Tribunal's other questions regarding Texas state law in this submission.

II. THE ISSUE OF TERRITORIALITY UNDER ARTICLES 1102 AND 1105.

5. The Tribunal should note that the U.S. submission completely agrees with the position that Mexico has maintained throughout the proceeding. The United States declares:

... [A]ll of the protections afforded by the NAFTA's investment chapter extend only to investments that are made by an investor of a NAFTA Party in the territory of another NAFTA Party, or to investors of a NAFTA Party that seek to make, are making, or have made an investment in the territory of another NAFTA party.¹

6. The shared position of the two pertinent NAFTA Parties makes it clear that the Claimants' assertion that they can submit a Chapter XI claim to arbitration without having made an investment in Mexico simply cannot be supported. The United States explains that Article 1101 defines the scope and coverage of Chapter XI and concludes that "[a]ll other Articles in Chapter XI must be interpreted within the confines of that scope and coverage"². Thus, the United States specifies that "the only measures relating to investments that are within the scope of NAFTA

1. United States Submission, ¶ 3.

2. Id., ¶ 4.

Chapter XI are those relating to ‘investments of investors of another party *in the territory of the Party*’ that has adopted or maintained those measures” (emphasis in the original)³.

7. As Mexico indicated in its briefs and in its oral arguments, Article 1101(1) contains various defined terms:

Article 1101. Scope and Coverage

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.

[Emphasis added.]

8. The terms “measures” and “territory” are defined in Article 201 for the purposes of the entire treaty⁴, while the terms “investment”, “investor of another Party”, and “investment of investors of another Party” are defined in Article 1139 for the purposes of Chapter XI exclusively. Some of those defined terms, in turn, contain other defined terms:

investment of an investor of a Party means an investment owned or controlled directly or indirectly by an investor of such Party;

investor of a Party means a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment ...

[Emphasis added]

3. Id., ¶ 5.

4. Article 201 establishes:

For the purposes of this Agreement:

measure includes any law, regulation, procedure, requirement or practice;

territory means for a Party the territory of that Party as set out in Annex 201.1

For Mexico, Annex 201.1 incorporates the definition of territory considered in the Mexican Constitution:

For purposes of this Agreement, unless otherwise specified:

territory means:

- (a) with respect to Mexico:
 - (i) the states of the Federation and the Federal District;
 - (ii) the islands, including the reefs and keys, in adjacent seas;
 - (iii) the islands of Guadalupe and Revillagigedo situated in the Pacific Ocean;
 - (iv) the continental shelf and the submarine shelf of such islands, keys and reefs;
 - (v) the waters of the territorial seas, in accordance with international law, and its interior maritime waters;
 - (vi) the space located above the national territory, in accordance with international law; and
 - (vii) any areas beyond the territorial seas of Mexico within which, in accordance with international law, including *the United Nations Convention on the Law of the Sea*, and its domestic law, Mexico may exercise rights with respect to the seabed and subsoil and their natural resources....

Of course, the definition of investment in the section that the Claimants identify as the type of investment involved is also relevant:

investment means:

- (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...

9. The definitions in the treaty are a convention that the editors use to simplify and harmonize the use of the terms. Chapter II contains definitions applicable to the entire treaty and, with the exception of Chapters I and XXII that contain the objectives and final resolutions, each chapter has its own article with definitions. Some annexes and appendices, and even some articles of the treaty, also have their own definitions⁵.

10. The Tribunal will observe that:

- a. With regard to investments, Article 1101 states that the chapter applies only to investments of investors of another Party located in the territory of the Party.
- b. With regard to investors, given that “investors of another Party” incorporate the term “investment”, because of the operation in Article 1101(1) of the defined terms, the chapter only applies to the nationals or enterprises of the Party that seek to make, are making, or have made an investment in the territory of another Party since only those are covered by the chapter.

[Emphasis added]

11. Thus, it is incorrect, as the Claimants had alleged (a position that, nevertheless, they have abandoned, as was made clear in the hearing⁶), that the chapter applies to “investors of a Party” independent of whether they have investments in the territory of another Party since in all cases the term “investment” is connected with the territory of a NAFTA Party different from the one of which the investor is a national or enterprise. The United States explains that such an interpretation would result in, for example, an obligation to grant national treatment to a national, but not to his investment, and adds: “[s]uch an interpretation of the national treatment obligation in the NAFTA would make no sense and would be contrary to the Treaty’s object and purpose”⁷.

12. Thus, in relation to this subject, the chapter applies to nationals or enterprises of the United States that seek to make, are making, or have made an investment in Mexican territory, and likewise to the investments that they seek to make, are making, or have made in Mexican territory.

5. Cf., for example, Article 303 (Restriction on Drawback and Duty Deferral Programs) in paragraph 9 and paragraph 26 of section A of Annex 703.2, and paragraph 27 of Appendix 300-A.2.

6. See Mexico’s allegations during the hearing, Vol. 2, pp. 265-267 of the Spanish transcript. The Claimants did not come back to this question in their rebuttal presentation.

7. United States Submission, ¶ 10.

13. Article 1101 establishes the scope and coverage of the entire chapter, such that all of its provisions, including Articles 1102 and 1105, are subject to this rule of territoriality. It is clearly noted if, as was done previously, the defined terms are substituted for the definitions:

- Article 1102 requires that a Party accord national treatment to both the investors of another Party and to its investments. In accordance with Article 1101, it is clear that the obligation only extends to the investments of investors of another Party located in the territory of the obliged Party. Regarding the investors, a Party is obliged to grant national treatment to the nationals or enterprises of another Party that seek to make, are making or have made an investment in its territory.
- Paragraph 1 of Article 1105 only applies to investments of investors of another Party clearly located in the territory of the Party, as has already been demonstrated, but it does not apply to the investors themselves.

14. The United States explains that the obligations contained in Articles 1102 and 1105 are limited by Article 1101. It states that the contents of Article 1102 only apply to investments, or investors related to investments, that are “*in the territory* of the Party that has adopted or maintained the measures at issue”⁸. It likewise declares that “[t]he obligation of Article 1105(1), therefore, applies only to treatment resulting from measures relating to investments of one Party that are *in the territory* of the Party that has maintained the measures at issue”. As the United States indicates, any other conclusion would be “absurd”⁹.

15. In support of its position, the United States made a reference in its Submission to both its Statement of Administrative Action and Canada’s Statement on Implementation of the NAFTA, two contemporaneous documents on the conclusion of the treaty that each country presented to its respective legislative body with the purpose of explaining the contents of the treaty and the necessary actions for each one to implement it in their territory. Mexico did not need to prepare a similar document. However, on the basis of a report produced by competent committees, the Mexican Senate approved the treaty in 1993, and that report agrees with the two Statements. It begins the analysis of Chapter XI by explaining the global situation of investment flows:

En una época de acelerado cambio tecnológico como la que se está viviendo en este fin de siglo, las necesidades de inversión son muy grandes en todo el mundo. Esto ha propiciado una fuerte competencia internacional por atraer inversiones. En dicha competencia participan por igual naciones muy industrializadas y naciones en vías de desarrollo.

Los recursos disponibles para financiar tales necesidades de inversión son escasos, y por ello puede afirmarse que la mayor parte de los países disputan entre sí por allegarse el ahorro internacional. La relativa escasez de recursos internacionales de capital determina que el ahorro fluya hacia las naciones más competitivas y mejor colocadas en los mercados mundiales.

La parte de esos recursos internacionales que fluye entre los países industrializados representa en la actualidad el 85% del total, lo cual pone de relieve la marginación

8. United States Submission, ¶¶ 7-8.

9. Id., ¶ 8.

creciente del conjunto de los países en vías de desarrollo en lo que respecta a su capacidad para captar esa clase de recursos.

Para que México consolide el proceso de cambio y modernización de su economía, es indispensable que la inversión se recupere del fuerte descenso que experimentó en el decenio pasado. De un coeficiente de inversión que durante mucho tiempo se mantuvo alrededor del 22% del producto interno bruto (PIB), pasamos a partir de 1983 a 16% en promedio.

It then explains Mexico's position:

Por razones estratégicas, México persigue fomentar de manera general y sostenida un flujo de inversión extranjera cuyo monto sea suficiente para complementar el ahorro interno ante la necesidad de fincar una base más sólida hacia la capitalización del país, es decir el fortalecimiento que la economía requiere atender las necesidades de empleo remunerativo y fomentar transferencias de tecnología que permitan modernizar la planta productiva del país. Sólo de esta manera podrá México ir cerrando la brecha que nos separa del mundo desarrollado y participar más y con eficiencia mayor en el mundo tan competido económicamente como el que se anuncia para el siglo XXI.

El curso de acción de la política económica ya ha reportado importantes resultados bajo la forma de una abundante afluencia de recursos externos de inversión. Si el Tratado se adopta, ello permitirá atraer recursos nuevos que, en conjunción con los de origen nacional, nos permitan consolidar la recuperación económica y desarrollada y, sobre todo, con condiciones mejores de bienestar social.

[Emphasis added]

In describing the chapter's structure, it specifies the relevant substantive obligations:

Con respecto al tratamiento que se dé a las inversiones, el Tratado consigna la garantía, por parte de los tres países, de tres niveles aplicables a los inversionistas extranjeros: el trato nacional, el trato de la nación más favorecida y el llamado trato mínimo (o garantía de que en todos los casos los inversionistas extranjeros serán tratados conforme al derecho internacional).

...

Un tema importante de este capítulo es el que se refiere a la expropiación y las compensaciones. Los tres países aceptan que sólo se podrán realizar expropiaciones de inversiones extranjeras, o bien adoptar medidas equivalentes a la expropiación, por causas de utilidad pública, sobre bases no discriminatorias, con estricto apego al derecho y mediante el pago de la indemnización a que haya lugar.

[Emphasis added]

It concludes with the following considerations:

Del análisis de este capítulo se desprende que las disposiciones del Tratado en materia de inversiones son conformes y se apegan a la letra y al espíritu de nuestras leyes fundamentales. De igual manera, dichas disposiciones permitirán seguir fomentando nuestro desarrollo. Son sus características principales:

- *Que mantienen las actividades reservadas al dominio exclusivo del Estado y de*

los mexicanos;

- *Que permitirán generar, mediante un flujo más grande de inversión externa, un número mayor de empleos remunerativos para los mexicanos;*
- *Que con ello se cooperará a la capitalización interna, la modernización tecnológica y el sostenimiento del crecimiento económico general de país;*
- *Que consolidan el clima de certidumbre y confianza necesario para realizar inversiones productivas, tanto nacionales como extranjeras;*
- *Que garantizan a los inversionistas mexicanos que realicen actividades con el Canadá y Estados Unidos el mismo trato que en México se otorgará a los inversionistas que provengan de esos países.*¹⁰

[Emphasis added.]

16. As stated in the hearing on jurisdiction, the NAFTA is a broad agreement that regulates the liberalization of the flow of goods and services, capital, and business persons. However, it is clear that the jurisdiction of each Party extends only to the borders of its territory. The principle of territoriality permeates the entire agreement. For example:

- In matters of goods, under Article 300 national treatment can only be extended to goods once they have entered into its territory, that is to say, once they have been formally imported. If a Party blocks the imports or exports (which it can only do within its territorial jurisdiction), it can create restrictions prohibited by Article 309. In each of the cases, the agreement only applies to goods that have entered into the territory of the importing Party or are seeking to be admitted into it.
- In matters of services, Chapter XII applies only to cross-border trade and excludes the provision of services in a Party's territory by foreign investments since these are regulated by Chapter XI (Investment)¹¹. In a similar manner, a Party can only extend national treatment to persons who seek to provide or provide cross-border services¹².
- In matters of mobility of business persons, because of the favored trade relationship caused by the NAFTA, Chapter XVI aims to facilitate the temporary entry of such

10. Senate of the Republic. North American Free Trade Agreement, *Dictamen de las Comisiones Unidas de Comercio y Fomento Industrial, de Relaciones Exteriores, de Hacienda, de Desarrollo Económico y Social, de Planeación Democrática de Desarrollo, de Puntos Constitucionales de Asentamientos Humanos y Ecología, y del Sector Social del Trabajo*, November 18, 1993. Exhibit R-42 (contains only the pages relating to NAFTA Chapter XI)

11. Article 1213 defines:

cross-border provision of a service or **cross-border trade in services** means the provision of a service:

- from the territory of a Party into the territory of another Party;
- in the territory of a Party by a person of that Party to a person of another Party, or
- by a national of a Party in the territory of another Party,

but does not include the provision of a service in the territory of a Party by an investment, as defined in Article 1139 (Investment Definitions), in that territory;

12. Article 1213 also defines:

service provider of a Party means a person of a Party that seeks to provide or provides a service...

persons, without compromising border security, but protecting the national work force and the permanent employment in their respective territories¹³.

17. The examples that were given during the hearing clearly illustrate the interaction between the different types of cross-border flows and the distinct manner in which the NAFTA regulates them. In the case of the cross-border transport services to which the Claimants referred:

- paragraph 25(b) of section B of Appendix 300-A.2 (of Annex 300-A – Trade and Investment in the Automotive Sector) regulates (in the case of Mexico) the importation on a temporary basis of autotransportation vehicles for the provision of cross-border services for land transportation services under Chapter XII, and paragraph 4(b) of section B of Annex 301.1 regulates the importation on a temporary basis of trailers and semi-trailers;
- Chapter III (Trade in Goods), in general terms, together with Chapters IV (Rules of Origin) and V (Customs Procedures), regulates the importation of the goods that they transport;
- Chapter XII (Cross-Border Trade in Services) regulates the provision of cross-border land transportation services, with regard to which Mexico and the United States adopted reciprocal reservations¹⁴;
- Chapter XVI (Temporary Entry for Business Persons) regulates the entry of transportation operators (i.e. the drivers), defined in the Appendix 1603.3-A.1 under the heading “Distribution”.

18. The ferry scenario that the President of the Tribunal proposed is not different (except because the ferry would not enter the territory of the importing Party). In no case is there an investment, in spite of the fact that in the case of a truck, having been imported temporarily, it certainly continues to be the property of the foreign transporter (whether a national or an enterprise); the goods will be property of the importer, the exporter, the producer or other persons, in accordance with the international transfer of merchandise that has been made; and the operator of the truck will simply be a business visitor.

19. In the same scenario, the corresponding reservations of Mexico and the United States contained in Annex I illustrate the differences between cross-border services and investment, specifically the principle of territoriality applicable to the obligation of national treatment, since both Mexico and the United States adopted reservations to Articles 1102 and 1202. In the case of Mexico, the reservation is described in the following manner:

Description:

Cross-Border Services

1. A permit issued by the Secretaría de Comunicaciones y Transportes is required to

13. See Articles 1601 and 1602.

14. See Annex I, pp. I-M-68 to I-M-71, in the case of Mexico, and I-E-18 to I-E-21, in the case of the United States.

provide inter-city bus services, tourist transportation services or truck services for the transportation of goods or passengers to or from the territory of Mexico.

2. Only Mexican nationals and Mexican enterprises with a foreigners' exclusion clause may provide such services.

3. Notwithstanding paragraph 2, a person of Canada or the United States will be permitted to provide international charter or tour bus services to or from the territory of Mexico.

4. Only Mexican nationals and Mexican enterprises with a foreigners' exclusion clause, using Mexican-registered equipment that is Mexican-built or legally imported and drivers who are Mexican nationals, may provide bus or truck services for the transportation of goods or passengers between points in the territory of Mexico.

...

Phase-Out:

Cross-Border Services

A person of Canada or of the United States will be permitted to provide:

- (a) three years after the date of signature of this Agreement, Cross-Border truck services to or from the territory of border states (Baja California, Chihuahua, Coahuila, Nuevo León, Sonora and Tamaulipas), and such a person will be permitted to enter and depart Mexico through different ports of entry in such states;
- (b) three years after the date of entry into force of this Agreement, Cross-Border scheduled bus services to or from the territory of Mexico; and
- (c) six years after the date of entry into force of this Agreement, Cross-Border truck services to or from the territory of Mexico. Three years after the date of signature of this Agreement, only Mexican nationals and Mexican enterprises, using Mexican registered equipment that is Mexican-built or legally imported and drivers who are

Mexican nationals, may provide bus or truck services for the transportation of international cargo or passengers between points in the territory of Mexico. For domestic cargo, paragraph 4 of the **Description** element will continue to apply.

...

20. In matters of investment, the reservation provides:

Description:

Investment

5. Investors of another Party or their investments may not own directly or indirectly, an ownership interest in an enterprise established or to be established in the territory of Mexico engaged in bus or truck transportation services as set out in the Industry Classification element.

...

Phase-Out:

Investment

With respect to an enterprise established or to be established in the territory of Mexico providing inter-city bus services, tourist transportation services, or truck services for the transportation of international cargo between points in the territory of Mexico, investors of another Party or their investments may own, directly or indirectly:

- (a) three years after the date of signature of this Agreement, only up to 49 percent of ownership interest in such an enterprise;
- (b) seven years after the date of entry into force of this Agreement, only up to 51 percent of the ownership interest in such an enterprise; and
- (c) ten years after the date of entry into force of this Agreement, 100 percent of the ownership interest in such an enterprise.

Investors of another Party or their investments may not own, directly or indirectly, an ownership interest in an enterprise providing truck services for the carriage of domestic cargo....¹⁵

15. Id., pp. I-M-68 to I-M-71.

III. THE CONCEPT OF WATER AS A GOOD IN COMMERCE

A. Mexican law

21. The Tribunal requested comments from the disputing parties on the concept of water in commerce in Mexico and Texas.

22. In its Memorial, Mexico explained the legal system to which the waters of the rivers flowing through national territory are subject and it refers the Tribunal to section III.E of that submission. As explained, control of the waters belongs to the Nation and is inalienable. Therefore, the water of the rivers, as such, is not a good in commerce.

23. Nonetheless, the waters are susceptible to exploitation, use and enjoyment by private individuals by means of concessions granted by the Mexican federal government, and these are transferable according to the terms of the National Water Law, as Mexico explained in its Reply¹⁶. The transfer of rights is not unrestricted. It is subject to the authorization of the Mexican authorities¹⁷.

24. One of the Claimants' main arguments is that they are the owners of the waters located in Mexico that the 1944 Bilateral Treaty allocated to the United States of America. They argue that the 1944 Treaty transferred ownership of those waters to the United States and that, although it could have retained title, it granted those rights to the Claimants¹⁸. The Claimants state that the water is bought and sold in a so-called "thriving market"¹⁹ and that Texas farmers easily could sell to Mexican farmers the rights to the water that eventually is allocated to them so that they could use it in Mexico²⁰.

16. See Reply, ¶ 30 and the footnote No. 52.

17. The Mexican authority is the *Comisión Nacional del Agua* (CNA, the National Water Commission) or the *Organismos de Cuenca* (the Organizations of the Basin), respectively. The latter are specialized units of the CNA entrusted with the administration and management of the water resources in the water basins, water regions, and administrative water regions of the country.

18. Ms. Marzulla, for example, stated during the hearing: "...the Treaty of course which serves to convey the water rights have now been themselves conveyed. The rights to the water on the Rio Grande river have all been adjudicated. Every drop of water in the Rio Grande river, at least on the United States side, is owned by somebody. The Claimants own the vast majority of the adjudicated water under -- that was allocated to the United States under the 1944 Treaty... That the private ownership of the water rights that were allotted conveyed under the 1944 Treaty, those water rights which are now privately owned are the subject of this dispute..." (Vol. 1, pp. 144, lines 4-13 and 145, lines 1-4 of the English transcript).

19. Mr. Marzulla stated: "It [water] is both bought and sold. Water Districts sell water to individuals. They sell water between themselves. Individual water right owners can sell water between themselves. And, indeed, subject to certain regulations, it is conceivable that one of these Claimants could sell his water to the very Mexican farmer who is currently getting it for free because Mexico is diverting the water upstream and giving it to that farmer. There is, in short, a thriving market in the sale of these water rights, and the sale of the water and the right to receive that water, and that thriving market is an indicia of property." (Vol. 1, pp. 190, lines 18-22 y 191, lines 1-5 of the English transcript).

20. Mr. Marzulla added: "...conceptually there should be no reason why a Mexican recipient of water from the Colorado River could not sell that water upstream to some upstream user, and, as he put it, receive the cash and go do something else. And it's so far from disapproving our suggestion that that could as easily be done with the water

25. That is clearly incorrect in light of the regulations on water matters, as only the Mexican authority may grant rights for the exploitation, use and enjoyment of water in its territory and authorize its transfer; but even on the assumption – which is not admitted – that the United States were the owner of the waters of the Mexican tributaries, it also could not do so. Obviously, the United States, as a sovereign, may relinquish the volume of water that belongs to it in accordance with the 1944 Bilateral Treaty, but in that case the ownership of the waters would pass to Mexico and, for the same reason, would remain subject to Mexican law. It is evident that the United States cannot establish a water market in Mexican territory and, if the sovereign State cannot do it, it is axiomatic that its nationals also cannot.

26. Nevertheless, for the purposes of the NAFTA, the issue about whether the water of the Rio Bravo and its tributaries is in commerce has been definitively resolved by the three treaty Parties in the 1993 Joint Statement²¹, which provides: “Water in its natural state in lakes, rivers, reservoirs, aquifers, water basins and the like is not a good or product, is not traded” (emphasis added). It is evident that the water that flows through the Mexican tributaries of the Rio Bravo (and even that which is stored in reservoirs or dams, as specified in the Joint Statement) is in its natural state.

27. Under their argument, the Claimants must prove that the water that runs through the Mexican tributaries of the Rio Bravo is in commerce, to demonstrate they have ownership of that water because it was transferred to them by the United States of America in order to support that they “have” an investment in Mexico (although they have not “made” an investment in Mexico). However, setting aside for a moment the question of whether the water that flows through the Mexican tributaries of the Rio Bravo is property of the Mexican Nation or of the United States of America, there is no doubt that when the Bilateral Water Treaty refers to the ownership or property of the waters, this is held only by the sovereign States: Mexico and the United States, respectively. There is no evidence that the United States has relinquished the ownership of the waters that belong to it and to which the 1944 Treaty refers, nor that it has transferred it to any individual, while they run through the river beds²². In order to prove that the United States did so at the international level, a simple affirmation from the claimants is not enough, nor is it sufficient to prove that, under the regulations of the state of Texas, the claimants were awarded water rights. There would have to be an unequivocal declaration from the United States. There is not.

28. It is evident that the claim concerns the natural water resources of Mexico and the United States and, precisely to “correct false interpretations” the three Parties of the NAFTA declared in 1993 that “The NAFTA creates no rights to the natural water resources of any Party to the Agreement”. The Statement specifies, as stated, that water in its natural state in the rivers and reservoirs (among others) does not constitute a good or a product and is not marketable. It adds

in the Rio Conchos, I think it demonstrates that that’s why this water right is property.” (Vol. 2, p. 318, lines 14-22 of the English transcript).

21. See section IV of the Reply of Mexico.

22. In fact, as the Respondent has stated, Article 4 of the 1944 Treaty is careful to preserve the sovereignty of each country and the principle of territoriality in providing that the allocation of a third of the volume of water that flows in the rivers that are located in the Mexican part is done, only and exclusively, when the waters flow into the “main channel” of the Rio Bravo, that is to say, in no part of the 1944 Treaty is the transfer of property recognized, but rather the volume of the rivers is allocated when those rivers flow into that main current.

that “[u]nless 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 the NAFTA” and reiterates that it “is not and never has been subject to the terms of any trade agreement”. Lastly, it states that “international rights and obligations respecting water in its natural state are contained in separate treaties and agreements negotiated *for that purpose*”, for example the “United States-Canada Boundary Waters Treaty of 1909 and the 1944 Boundary Waters Treaty between Mexico and the United States” [emphasis added].

29. Thus, the water of the Rio Bravo and its tributaries are not only not in commerce, but the NAFTA also does not impose any obligation for Mexico, whether it is regarding Article 1102 (national treatment), Article 1105 (minimum standard of treatment in accordance with international law), Article 1110 (expropriation), section B of Chapter XI of the NAFTA, or any other provision. The claim is not only outside the scope and coverage of Chapter XI defined by Article 1101, but is also, as expressed by the three NAFTA parties, completely outside the scope and coverage of the treaty itself.

B. Texas Law

30. Although holders of water rights in Texas are allowed to sell to others those rights and water acquired under them, the state exercises continuing control over those rights and the water itself. For example, Texas has created a water “bank” under the auspices of the Texas Water Development Board to facilitate transactions between buyers and sellers, but Texas law requires that the Board administer the water bank specifically to “facilitate water transactions to provide sources of adequate water supplies for use within the State of Texas.”²³ If a water right or portion thereof is sold otherwise exchanged, Texas law requires that the owner of the water right “promptly inform” the TCEQ of “any transfer of water right or change of the owner’s address.”²⁴ If the sale also involves a change to the “place of use, purpose of use, point of diversion, rate of diversion, acreage to be irrigated” or other aspect of a water right, Texas law requires that an application first be submitted to the TCEQ.²⁵ Notably, a reference document on water marketing issued by the Texas Water Development Board provides:

Transactions that require a change in purpose or place of use of surface water are subject to significant administrative oversight, because they alter the grant of authority from the State in a fundamental way. Surface water right permit amendments require approval of TCEQ and the approval process involves a substantive review of the proposed change.²⁶

31. This is even more so in the lower Rio Bravo area, where the Claimants are located. As Mexico explained in the Memorial, in the region from Fort Quitman to the Gulf of Mexico, all water is stored in either the Amistad or Falcon reservoirs and every request for water has to be approved by the Watermaster, which controls its release.

23. Tex. Water Code § 15.702. Exhibit R-31, folio 0562. Thus, the Claimants’ suggestion at the hearing that a Texas water rights holder could sell its water to a Mexican farmer is incorrect.

24. Tex. Admin. Code § 297.82. Exhibit R-32, page 0567.

25. Tex. Water Code § 11.122. Exhibit R-31, page 0557.

26. A Texan’s Guide to Water and Water Rights Marketing, p. 11, *available at* <http://www.twdb.state.tx.us/assistance/WaterBank/waterbankMain.asp>. Exhibit R-33, page 0578.

32. In Mexico's view, the extent to which water and water rights may be sold by the Claimants within Texas does not assist the Tribunal in determining whether the Claimants have a property interest within Mexican territory; that issue can be resolved only by reference to Mexican law.

IV. CITY OF SAN MARCOS CASE

33. The case *City of San Marcos et al. v. Texas Commission on Environmental Quality*, 128 S.W.3d 264 (Tex. Ct. App. 2004) involved a permit issued by the TCEQ to the City of San Marcos to release partially treated sewage water into the San Marcos River and then divert an equal amount of water from the river three miles downstream, so that it could be transferred to a waste water treatment facility. The city originally had obtained the water from an underground aquifer. It had been established that the sewage water was not of the same quality as the water flowing in the river.

34. The court discussed that under Texas law, water retrieved from underground aquifers could be privately owned, while river water is owned by the state:

Diffuse surface water belongs to the owner of the land on which it gathers, so long as it remains on that land prior to its passage into a natural watercourse.... By contrast, water in a watercourse is the property of the State, held in trust for the public. See Tex. Water Code Ann. § 11.021(a)....²⁷

35. In particular because it found that sewage water was not fungible with the water already in the river, the court held that the city had forfeited its ownership in its groundwater when it discharged it into the river:

By intentionally discharging its effluent into the river, where it eventually commingles with the State's water, the City effectively abandons its control over the identifying characteristics of its property. This physical reality suggests that the City is voluntarily and intentionally abandoning its ownership rights over the effluent. See *Domel*, 6 S.W.3d at 360; *Bieri*, 247 S.W.2d at 272-73. Only after it abandons its effluent does it seek to remove water from the San Marcos River. Despite the City's declaration of intent to reuse its effluent, our conclusion that the effluent is not fungible with the river water proves that the City's discharge of *effluent* into a state watercourse constitutes abandonment as a matter of law.²⁸

36. The *City of San Marcos* case underlines the point that water flowing in rivers is owned by the State of Texas. Otherwise, because the case dealt with underground water (which is subject to a different legal regime than surface water) as well as a region of the state different from the one in which the Claimants are located²⁹, it appears to be of limited relevance to this arbitration.

27. *City of San Marcos et. Al. v. Texas Commission on Environmental Quality*, 128 S.W.3d 264 (Tex. Ct. App. 2004), p. 272.

28. *Id.*, p. 277. The court noted that the Texas legislature had enacted a new law that would authorize the city to recapture water from the river, but stated that the city should reapply for a permit under the new law rather than trying to manipulate the pre-existing Texas common law. *Id.*, p. 279.

29. The San Marcos River runs through the general vicinity of Austin and San Antonio toward the Gulf of Mexico in the southeastern part of the state.

V. CONTINGENT NATURE OF WATER RIGHTS IN TEXAS

37. As already stated, surface water is “state water,” i.e., property owned by the state.³⁰ The state’s water is appropriated only to users within the state that have a water rights permit.³¹ Texas only grants such permits on the condition that the water be used in at least one of the enumerated activities it considers to qualify as a “beneficial use.”³² As Mexico explained during the hearing, the water rights permits themselves (certificates of adjudication) specify the exact place and purpose for which the appropriated water may be used.³³ Thus, holders of water rights must adhere to the State’s requirements and are not free to use the water as they please.

38. Texas law also includes as a “general principle” that a water right permit may be canceled if the water is not put to beneficial use.³⁴ In fact, Texas actually has cancelled water rights. For example, in January 2003, the TCEQ cancelled the water rights of 70 individuals and entities located in the lower and middle parts of the Rio Bravo, where the Claimants are also located. Specifically, the order of the TCEQ stated in the relevant part:

8. With certain exceptions, a water right is subject to cancellation in whole or in part if it has not been used for a beneficial purpose for 10 years, to the extent of that non-use. Water Code §§ 11.172 and 11.173.

9. Based on the above Findings of Fact, the water right holders listed in Finding of Fact No. 1 have not used any portion of their water rights for ten years preceding the filing of the petition.

...

12. Based on the above Findings of Fact, the water right holders listed in Finding of Fact No. 1 have not used reasonable diligence in applying any portion of the water under their right to an authorized beneficial use.

13. Based on the above Findings of Fact, the water rights holders listed in Finding of Fact No. 1 are unjustified in the non-use of their water rights in these cases.

14. Based on the above Findings of Fact and Conclusions of Law, the water rights of the water rights holders listed in Finding of Fact No. 1 should be cancelled³⁵

39. In addition, the State is authorized to impose fines and undertake enforcement actions against those who take water without a permit or holders who misuse their allocated water by violating the terms of their permit. For example, the Texas Water Code provides that a person who “willfully takes, diverts, or appropriates state water” without a permit is liable for a civil penalty of up to \$5,000 for each day the violation continues.³⁶ The TCEQ can also assess an

30. Tex. Water Code § 11.021. Exhibit R-17, page 0255.

31. Tex. Water Code §§ 11.022, .121. Exhibit R-31, pages 0547, 0556.

32. Tex. Water Code § 11.023. Exhibit R-31, page 0548.

33. Tex. Water Code § 11.135. Exhibit R-31, page 0558.

34. Tex. Water Code §§ 11.172, .173. Exhibit R-31, pages 0559-0560.

35. Water Rights Cancellation Order, TCEQ Docket No. 2002-1090-WR, 29 January 2003, pp. 6-7. Exhibit R-34, pages 0598-0599.

36. Tex. Water Code § 11.082. Exhibit R-31, page 0549.

administrative penalty of up to \$5,000 per day for violation of the terms of a permit or certificate of adjudication.³⁷

40. The TCEQ routinely conducts inspections and responds to complaints, both of which can lead to the commencement of a formal process concluding in an assessment of the penalties discussed above. Texas exercises particular vigilance over the use of state water in areas such as the lower Rio Bravo region, where the claimants are located. Texas has institutionalized regulated use of the water through the Watermaster program. As described by the TCEQ:

The TCEQ's watermaster programs ensure compliance with water rights by monitoring stream flows, reservoir levels, and water use. They also coordinate diversions in the basins which are managed by their programs. The watermaster regulates reservoirs as needed to prevent the wasting of water or its being used in quantities beyond a user's right.

Before diverting, a water-right holder must notify the watermaster of the intent to divert at a specific time and the specific amount of water to be diverted. Assuming that the water is available and that the water-right holder has not exceeded, or will not exceed, the annual authorized appropriation of water, the watermaster then authorizes the diversion and records this against the right. The two watermaster programs include staff "deputies" who daily, weekly, or monthly make field inspections of authorized diversions to insure compliance with the water right (e.g., that the diversion rate is not exceeded).

If a water-right holder does not comply with his or her water right or the rules of the Commission, the executive director may direct the watermaster to adjust the control works to prevent the owner from diverting, taking, storing, or distributing water until he or she complies.³⁸

The fact that Texas actively prevents the taking water against the interests of the State further confirms that contingent nature of water rights in Texas.

VI. STANDING OF IRRIGATION DISTRICTS TO BE NAFTA CLAIMANTS

41. Although the Claimants asserted at the end of the hearing that the Irrigation Districts are "special purpose corporations" rather than subdivisions of the state, Texas law indicates otherwise. For example, the Texas Water Code provides that irrigation districts have the authority to assess and collect taxes and that they have the power of eminent domain, both of which are distinctly governmental functions.³⁹ As Mexico pointed out in its Reply, the TCEQ itself states that "[a] water district is a local, governmental entity" and that most have the authority to, among other things, "levy taxes" and "condemn property."⁴⁰ In 1996, the Texas Natural Resource Conservation Commission (the predecessor to the TCEQ) issued a handbook to

37. Id., § 11.0842. Exhibit R-31, page 0552.

38. What Watermasters Do, Texas Commission on Environmental Quality, available at http://www.tceq.state.tx.us/compliance/field_ops/wmaster/wmaster.html. Exhibit R-35, page 0602.

39. Tex. Water Code §§ 49.212, .222. Exhibit R-31, pages 0564-0565.

40. Texas Water Districts: A General Guide, Texas Commission on Environmental Quality, Dec. 2004 revision, p. 1-2, available at http://www.tceq.state.tx.us/comm_exec/forms_pubs/pubs/gi/gi-043.html. Exhibit R-36, page 0605.

guide district board members in which it stated “[s]ince a district is political subdivision, most of the responsibility for defining objectives, setting policy and providing management oversight is under local governmental control.”⁴¹ Thus, Texas law, as interpreted by the agency administering its water districts, confirms the districts are subdivisions of the state.⁴²

42. The governmental nature of irrigation districts has also been confirmed by the courts. For example, Texas law provides that a “suit for contract damages may be brought against a district only on a written contract of the district approved by the district’s board,” i.e., that otherwise a district would not be deemed to have waived its governmental immunity from suit.⁴³ In 2003, a Texas appeals court interpreting this provision denied a plaintiff’s claim for damages to her property when the district flooded it with water. The court stated “[i]n Texas, a governmental unit is immune from suit and liability unless the state consents.” Because the plaintiff did not have a written contract with the district, the court ruled that the district “remains immune from suit.”⁴⁴

43. The Texas irrigation districts are not commercial businesses; they are financed, at least in part, through tax assessments, and are limited in their functions by statute, “to deliver untreated water for irrigation and to provide for the drainage of lands and such other functions as are incidental to the accomplishment of such limited purposes”⁴⁵. Due to the limited nature of their purpose, the irrigation districts could not make investments in a foreign country since such an activity is beyond their statutory authority. It would also be difficult for public utilities such as irrigation districts to show that their property is “used for the purpose of economic benefit or other business purposes” within the meaning of Article 1139 when the sole purpose of the irrigation districts, as established by Texas law, is to provide governmental services.

41. A Handbook for Board Members of Water Districts in Texas, 4th Edition, June 1996, p. 3, *available at* http://www.tceq.state.tx.us/comm_exec/forms_pubs/pubs/rg/rg-238.html. Exhibit 37, page 0620.

42. Irrigation districts are one of several types of water districts.

43. Tex. Water Code § 49.066(a). Exhibit R-31, page 0563.

44. *Maverick County Water & Improvement Dist. No. 1 v. Reyes et. al.*, 2003 Tex. App. LEXIS 10297. In an earlier case, *Engelman Irrigation District v. Shields Brothers*, 960 S.W.2d 343 (Tex. Ct. App. 1997), Exhibit R-38, page 0689, the plaintiffs alleged that an irrigation district had failed, in accordance with its own regulations, to deliver water on a “first come first served” basis “within a reasonable time” consistent with “good economics” to them even though they had properly complied with the district’s requirements. The particular complaint was that the district had delivered water to other users out of order. The court determined that the plaintiff’s application for and receipt of permits to use water (known as “water tickets”), in combination with the district’s rules and regulations, were evidence of an agreement to deliver water in accordance with the district’s rules and regulations. The defendant irrigation district argued that it was immune from suit as a governmental entity, but the court held that the Texas Water Code provided that an irrigation district may sue and be sued in the courts of Texas, and therefore that the Texas legislature had waived the district’s immunity. *Id.* at 348. The Texas Supreme Court declined the irrigation district’s petition for review, but in doing so stated that it “expresses no opinion on whether an irrigation district’s obligation to deliver water under Chapter 58 of the Texas Water Code ... can be deemed to be a “contract” waiving the district’s sovereign immunity from liability.” 989 S.W.2d 360 (1998). The version of the “sue and be sued” provision in the Texas Water Code cited in the *Engelman* case subsequently was deleted, and the currently applicable provision at Texas Water Code § 49.066(a), last amended in 1999, appears to have adopted stricter requirements that would prevent a court from finding that simply issuing a permit could be construed as creating a contractual obligation of an irrigation district. See discussion of *Maverick County* case above. It is especially important to note that, even in the *Engelman* case, the suit related to how the irrigation district had allocated water it had already received.

45. Texas Water Code § 58.121. Exhibit R-31, page 0566.

44. Moreover, given their functions as public utilities that simply deliver the water that is transferred to them from the state, Mexico does not believe that the irrigation districts could show they suffer any loss or damages.

VII. POTENTIAL ABILITY OF WATER USERS TO SUE IRRIGATION DISTRICTS

45. Mexico already answered this question in relation to the question about the legal status of the irrigation districts. As discussed above, under the current Texas law the irrigation districts are governmental entities that can be sued for breach of contract only when there is a written contract that has been specifically approved by its board of directors. This requirement seems to preclude the possibility that a water user could sue a district simply on the basis that it has a right to receive water.

46. Mexico has not found any cases in which a plaintiff has attempted to sue the Texas Water Commission (now the TCEQ) for not delivering water.⁴⁶

47. Mexico reaffirms its position that regardless of the rights and obligations of the Claimants under Texas law, those rights are irrelevant to determining whether they have an investment in property interests within Mexican territory.

VIII. IRRIGATION DISTRICT BOARD RESOLUTIONS

48. The Claimants stated they would submit with their post-hearing submission documents that demonstrate that the irrigation district boards authorized Messrs. Marzulla and Wallace to legally represent them in these proceedings. Consequently, Mexico reserves the right to comment after receiving the documents and having the chance to review them.

46. A water user in Texas would lack standing to sue the U.S. federal government for the manner in which it releases water to the State of Texas or administers the 1944 Water Treaty. The Federal Government has waived its immunity from suit from damages only with respect to contracts into which it has entered and within the limited conditions established by the Federal Tort Claims Act, 28 U.S.C. §§ 2671 et seq. The courts cannot issue injunctions directing the how the federal government manages water. In *Hudspeth County Conservation & Reclamation District No. 1 et al. v. Robbins et al.*, 213 F.2d 425 (5th Cir. 1954), the plaintiffs alleged that the federal Bureau of Reclamation had improperly cut off deliveries of water to their district in violation of its statutory authority, and sought a declaratory judgment establishing their rights to the water. The court rejected the suit, stating:

These dams, reservoirs and all other project facilities are owned by the United States, which operates them through the Bureau of Reclamation. See 43 U.S.C.A. § 498. Their operation depends upon the flow of water. Whatever may be the merits of the plaintiffs' contentions, the court would have no jurisdiction by declaratory judgment ... or by injunction against Government officers to substitute itself in any part of the management and operation of the dams, reservoirs and facilities for the agency designated by Congress. In a case involving this same project, the Tenth Circuit arrived at the conclusion that the action was in essence a suit against the United States to which it had not consented and that it, therefore, must fail.

Id. at p. 432. The *Hudspeth* case involved a different region of Texas than the one in which the Claimants are located and specific statutes and contracts under which the federal government was obliged to deliver water to the plaintiff district. The U.S. federal government has not entered into any contracts obliging it to deliver water to the Claimants, so the Claimants could not have even a contract claim against the federal government.

IX. COSTS

49. In response to the last paragraph of the letter from the Tribunal dated 16 November 2006, Mexico reports that the costs incurred in these proceedings add up to a total of \$542,482.82 dollars⁴⁷, calculated in the following way⁴⁸:

- \$200,000 dollars for payments to the ICSID;
- \$392,505.34 pesos⁴⁹ corresponding to the hours of work invested by the lawyers of the Secretariat of Economy in the defense⁵⁰;
- \$101,323.82⁵¹ pesos for travel and travel-related expenses incurred by the Secretariat of Economy⁵²;
- \$296,968.62 dollars for fees and travel-related expenses of external counsel⁵³;

The costs of the Mexican government are reasonable and necessary for the adequate defense of the case⁵⁴. Mexico reiterates its request that it be reimbursed for all the costs which it has incurred in these proceedings, including the fees and costs of its outside counsel.

50. Mexico notes that the Claimants repeatedly delayed in providing proof of nationality and, to date, proof that the irrigation district boards have authorized Messrs. Marzulla and Mr. Wallace to represent them in this proceeding. These delays have caused Mexico a considerable loss of time and resources.

51. Moreover, the Claimants have frequently changed their theory of the claim. For example:

- The Claimants originally argued that, among other measures, the actions of Mexico in building dams violated NAFTA Chapter XI. Later, after Mexico pointed out that every single measure about which the Claimants were complaining was beyond the limitations period established by Article 1116(2), the Claimants shifted to arguing in their Rejoinder that the measure on which the case was based was the alleged failure

47. U.S. dollars.

48. The supporting documents that detail the costs are available to the Tribunal in case it requires them.

49. This sum equals \$36,175.60 dollars at an exchange rate of \$10.85 pesos for one dollar.

50. See official document No. 500.DGAA.1061.06 dated 14 December 2006, from the *Dirección General Adjunta de Administración de la Subsecretaría de Negociaciones Comerciales Internacionales de la Secretaría de Economía* which is included as an exhibit to this submission. Exhibit R-41.

51. This sum equals \$9,338.60 dollars at an exchange rate of \$10.85 pesos for one dollar.

52. See official document No. 500.DGAA.1061.06 dated 14 December 2006, from the *Dirección General Adjunta de Administración de la Subsecretaría de Negociaciones Comerciales Internacionales de la Secretaría de Economía* which is included as an exhibit to this submission. Exhibit R-41.

53. See affidavit of Mr. Stephan E. Becker of Pillsbury Winthrop Shaw Pittman LLP and Mr. James Cameron Mowatt of Thomas & Partners, which is an exhibit to this submission. Exhibit R-41.

54. The expenses and costs that the Secretariat of Foreign Affairs and the National Water Commission incurred are not included.

by Mexico to deliver all of the water owed under Cycles 25 and 26 by the end of Cycle 26⁵⁵. During the hearing, however, the Claimants seemed to go back to their original claim that pre-2002 actions by Mexico were the basis of their claim⁵⁶.

- Initially the Claimants stated that each irrigation district was presenting a claim in its own name and in the name of the users of that district⁵⁷. However, in the Counter-Memorial, they indicated that, in fact, the claim was only presented by and in the name of the 42 claimants, specifying that they were not intending to bring a class action nor to initiate a claim in the name of unidentified parties.⁵⁸

The Claimants' continuing changes in position have also increased the expense of the arbitration for Mexico.

52. Due to the significant number of claimants whose claims have been consolidated in this proceeding, and the risk that some claimants will attempt to disclaim responsibility for authorizing Messrs. Marzulla and Wallace to represent them, Mexico renews its request that any award of costs to Mexico be assessed on a joint and several basis, so that the main responsibility of coordinating the sharing of those costs among the Claimants is placed on the Claimants themselves and not on Mexico.

55. See, for example, the Rejoinder, ¶¶ 29-34 (“The period 1992-1997 is thus designated Cycle 25, and it was only on completion of this Cycle 25 and Cycle 26 that Respondent’s improper diversion of water belonging to Claimants became actionable under NAFTA.”)

56. See, for example, the hearing transcript, Vol. 1, p. 193, lines 14-19 (“First, and most obviously, Mexico’s construction and operation of a series of dams and reservoirs in such a way as to stop the water from flowing downstream is a physical expropriation of that water. Mexico has paid no compensation. That is a violation of NAFTA Section 1110.”).

57. Notice of Intent, p. 1 (“Claimants are 17 Texas irrigation districts serving the Rio Grande Valley, which bring this action on their own behalf and of farmers, ranchers, and landowners, who depend upon the irrigation water...”); Request for Arbitration, p. 2 (which points out, for example: “Claimant Bayview Irrigation District No. 11 brings this action on its own behalf, and on behalf of the water users within the District who actually put this water to beneficial use in their farms and fields.”).

58. Counter-Memorial, footnote No. 23. (“*This proceeding is brought only by and on behalf of the 42 named Claimants; it is not intended to be a class action, nor to assert claims on behalf of any unnamed party*”).

X. RELIEF REQUESTED

53. For the foregoing reasons, the Government of Mexico respectfully requests that the Tribunal dismiss the claim in its entirety with an appropriate award of costs.

All of which is respectfully submitted for
your consideration

(Signed in the original)

Hugo Perezcano Díaz
Legal Counsel and Representative of the
United Mexican States
15 December 2006