

(COURTESY TRANSLATION)

*The Spanish version is the original and prevails over this document in all respects*



**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**

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**REPLY ON JURISDICTION**

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## I. INTRODUCTION

1. The “Counterclaim on Jurisdiction”<sup>1</sup> does not address the main legal arguments contained in Mexico’s Memorial. The Mexican government reaffirms all the arguments it set forth, but considers it unnecessary to repeat them here.

2. The Respondent considers it important to emphasize at the outset that the Claimants recognize that, in accordance with the Water Treaty of 1944, the waters of the Rio Bravo and its tributaries belong to Mexico and the United States, respectively. The Claimants admit: “Following the conclusion of the Treaty, each nation owned the water resources allotted to it...”<sup>2</sup>, and they add: “Other provisions of the 1944 Treaty leave no doubt that such allotted waters belong to the country to which they were allotted.”<sup>3</sup> They admit that the purpose of the Bilateral Water Treaty was to divide among both countries the basin of the Rio Bravo and its tributaries (among others)<sup>4</sup>. They also admit that their claim is based on the allocation of waters to the United States in accordance with that treaty<sup>5</sup>.

3. As indicated by Mexico in its Memorial, under either Mexican or international law (including the Bilateral Water Treaty and the NAFTA), the Claimants do not have ownership rights in Mexico to the waters of the Rio Bravo and its tributaries. Any rights they may have are by virtue of U.S. law, which only applies in U.S. territory, not in Mexico, nor as a matter of international law<sup>6</sup>. In other words, none of the Claimants have property rights in Mexico. In Mexican territory, the waters of such rivers are governed by the applicable Mexican legislation that the Respondent described in detail in the Memorial and the Bilateral Water Treaty itself, not by U.S. law.

4. It should also be noted that, in spite of the fact that the Claimants maintain that “they are not seeking to have this Tribunal rule on the rights and obligations of Mexico and the United States pursuant to the Water Treaty of 1944,”<sup>7</sup> the only support for the present claim is the supposed breach of the 1944 Water Treaty that they allege Mexico committed. In paragraph 60 and the succeeding paragraphs of their request for arbitration, the Claimants maintain that “this water debt arose under the 1944 Treaty.” They state that “Mexico’s water debt became delinquent,” and they accuse Mexico of having “wrongfully withheld and diverted” water from the Rio Bravo and, as a consequence, of having acted “in direct contravention to the 1944 Treaty” and of “flagrantly violating the 1944 Treaty”<sup>8</sup>. In their Counter-Memorial, the Claimants make an

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<sup>1</sup> The Claimants’ submission is not actually a counterclaim, but rather a reply to the objections to competence, but Mexico references the title the Claimants used in the courtesy translation of the Counter-Memorial of Bayview Irrigation District et. al. in Support of Jurisdiction.

<sup>2</sup> Counter-Memorial, ¶ 71.

<sup>3</sup> Id., ¶ 72.

<sup>4</sup> Id., ¶ 70.

<sup>5</sup> Id., ¶ 46.

<sup>6</sup> See ¶¶ 2, 78 and 109 of Memorial.

<sup>7</sup> Counter-Memorial, ¶ 83.

<sup>8</sup> See paragraphs 101 to 105 of Memorial.

effort to avoid making references that Mexico breached the Bilateral Water Treaty. However, the support for their claim is the same: the Claimants insist that the “Respondent’s improper diversion of water”<sup>9</sup> gives rise to the “Respondent’s liability for the water debt under the 1944 Treaty,”<sup>10</sup> which has been settled.

5. Thus, the Claimants effectively are asking the Tribunal to:

- (a) determine the rights and obligations of Mexico and the United States in accordance with the treaty; and
- (b) conclude that Mexico breached its obligations to settle the debt with the United States in accordance with what the treaty prescribes.

6. Mexico already pointed out that the Tribunal lacks the authority to determine if Mexico’s actions violate the terms of the Bilateral Water Treaty and, accordingly, whether Mexico is responsible for any illegal actions in relation to the water debt.

7. The Tribunal should note that, in addition to ignoring this jurisdictional barrier, the Claimants are also asking it to extrapolate the situation of legal rights and international obligations between states, mix it with a supposed applicability of U.S. law in Mexican territory in order to conclude that Mexico affected the supposed water rights of the Claimants, and elevate it to a violation of the NAFTA. With all due respect, the argument is frankly absurd.

8. The Counter-Memorial in addition ignores important aspects of the objections that Mexico put forward. For example:

- There is agreement between the parties in that the 1944 Water Treaty only establishes rights and obligations of Mexico and the United States. Consequently, the exercise of the former and the completion of the latter is a situation that concerns both countries. The Claimants, however, ignore that, in spite of the fact that both countries had a difference of interpretation over the form and terms of the satisfaction of the water deficit caused by the droughts (a situation foreseen in the treaty):
  - The United States never lodged a complaint through the institutional channels against Mexico for the supposed breach of the Bilateral Water Treaty<sup>11</sup>;
  - both countries arrived at an agreement that is consistent with the treaty’s operation; and
  - Mexico covered the water deficit in the agreed-upon terms with the United States.

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<sup>9</sup> Counter-Memorial, ¶ 29.

<sup>10</sup> Id., ¶ 27.

<sup>11</sup> Memorial, ¶¶ 43-44.

- The claimants do not address the fact that, whatever the legal system of the waters may be once they reach U.S. territory (Texas), under Mexican law they can have neither ownership rights nor water use rights in Mexico<sup>12</sup>.
- They also do not address the fact that Texas law only guarantees them a proportional share, not a fixed share, of the available water in Texas<sup>13</sup>.
- They ignore the fact that the government of the United States in the case *Consejo de Desarrollo Económico de Mexicali* declared that the Bilateral Water Treaty does not grant rights to private individuals<sup>14</sup>.
- They also ignore Mexico's arguments concerning the claims of the seventeen irrigation districts. The Counter-Memorial takes no notice of either the argument or the evidence presented by Mexico that the irrigation districts are governed by boards of directors and they did not present documents that demonstrate that the directors are authorized to initiate a claim and be bound according to the terms of the rules that govern this proceeding<sup>15</sup>.

If in their rejoinder the Claimants respond for the first time to the mentioned points or to any other argument, in accordance with the principles of due process, Mexico will request that it be granted

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<sup>12</sup> Memorial, ¶¶ 50, 88 and 89.

<sup>13</sup> Id., ¶¶ 61-65.

<sup>14</sup> Id., ¶¶ 107-111. Subsequent to the filing of the Memorial, the U.S. court hearing the case *Consejo de Desarrollo Económico de Mexicali* dismissed it. With respect to the Bilateral Water Treaty, it stated:

Only parties to a treaty may seek enforcement of the treaty and may do so only through diplomatic means. See, e.g., *The Headmoney Cases*, 112 U.S. 580, 598 (1884); *Botiller v. Dominguez*, 130 U.S. 238, 247 (1889). Moreover, 'even where a treaty provides certain benefits for nationals of a particular state ... individual rights are only derivative through the states.' *United States v. Valot*, 625 F.2d 308, 310 (9<sup>th</sup> Cir. 1980) (quoting *United States ex rel. Lujan v Gengler*, 510 F.2d 62, 67 (2d Cir. 1975) (internal quotation omitted)). Minute 242 provides that parties must resolve disputes under the 1944 Water Treaty through diplomatic means:

With the objective of avoiding future problems, the United States and Mexico shall consult with each other prior to undertaking any new development of either the surface or the groundwater resources, or undertaking substantial modifications of present developments, in its own territory in the border area that might adversely affect the other country.

Minute 242, Resolution 6, T.I.A.S. No. 7708, 24 U.S.T. 1968 (Aug. 30, 1973)

Plaintiff CDEM's Counts 1 through 4 are based on its alleged rights to seepage water derived from the Colorado River. (Am. Compl. ¶¶ 50-54, 57-58, 60, 65 & 68.) Allocation of seepage water from the Colorado River is governed by the 1944 Water Treaty. Because the Water Treaty provides no individual rights and does not contain provisions which would allow individuals to sue under the Treaty, CDEM cannot assert rights under the Treaty. Accordingly, Plaintiff CDEM has failed to assert an injury in fact that this Court may redress and lacks standing under the 1944 Water Treaty.

Order Re Motion to Dismiss, *Consejo de Desarrollo Económico de Mexicali, A.C. et. Al. v. United States et. Al.* (Caso CV-S-05-0870-KJD-GWF) (June 23, 2006) p. 7. (Exhibit R-28, page 532). The plaintiffs in this proceeding apparently are pursuing an appeal.

<sup>15</sup> Memorial, ¶ 136, footnote 102; see also paragraphs 144 and 145.

the opportunity to make a submission in response, and will ask the Tribunal to consider in its decision the resulting costs.

9. On the other hand, proof of the citizenship of the individual claimants was offered in an untimely manner (only after Mexico filed its Memorial). However, it has never been demonstrated that the lawyers who appear in these proceedings are authorized to represent the corporate claimants. Even more, the economic interests in the dispute of the irrigation districts, which only distribute water but do not use it, have not been identified.

10. Mexico will address these topics in more detail in the following sections.

## **II. THERE IS NO DISPUTE REGARDING THE KEY FACTS**

11. In section III of its Memorial, Mexico presented a description of the facts concerning the claim. After presenting a historic view of the relationship between both countries with regard to the waters of the Rio Bravo in the first part of that section, Mexico dealt in detail in the following paragraphs with the Bilateral Water Treaty, the distribution of water between both countries under the Treaty, the water deficit which Mexico incurred as a consequence of the long period of drought that the northern part of the country encountered, and the actions that both countries carried out in a spirit of cooperation to resolve the difference caused over the correct interpretation of the treaty. Mexico also explained the legal regime for waters in Mexico and the legal nature of the Claimants' rights to use water under Texas law. Mexico's arguments are supported by documentary evidence.

12. The Claimants do not dispute, but in fact agree with Mexico, that their water rights are based on the ruling of the *Hidalgo* case<sup>16</sup>. They admit that the *Hidalgo* case applied Texas law to distribute the rights of use of water allocated to the United States<sup>17</sup>. They do not dispute Mexico's explanation of the way water is allocated in Texas to individuals and to irrigation districts (in fact, the Counter-Memorial does not even refer to it), including the fact that the certificates of adjudication allocate to the users a proportional share of available water in Texas and do not guarantee an absolute fixed share of water.<sup>18</sup>

13. The Claimants do not dispute that the United States did not bring a complaint against Mexico via the institutional channels contemplated by the 1944 Water Treaty. They also do not contest Mexico's description of the negotiations that the countries carried out on the allocation between them of the waters of the Rio Bravo and the agreement at which they arrived on the manner of covering the water deficit, and in particular they do not contest that it is consistent with

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<sup>16</sup> See Counter-Memorial, ¶¶ 12, 77; see also Memorial, ¶¶ 53-59.

<sup>17</sup> Counter-Memorial, ¶ 77.

<sup>18</sup> Memorial, ¶¶ 52-66. The Claimants acknowledge that, pursuant to *Hidalgo*, the waters subject to that decision are allotted by the Water Master. Counter-Memorial, ¶ 77.

the rights and obligations of Mexico in accordance with that treaty.<sup>19</sup> They merely state that these facts do not relate to their claim.<sup>20</sup>

### **III. THE CLAIMANTS DO NOT HAVE PROPERTY RIGHTS OVER THE WATER IN MEXICO OR UNDER INTERNATIONAL LAW AND THEREFORE DO NOT HAVE AN INVESTMENT IN MEXICO WITHIN THE MEANING OF NAFTA CHAPTER XI**

14. One of the central arguments of the Memorial was that the Claimants do not have an investment in Mexico. NAFTA is based on the principle of territorial jurisdiction<sup>21</sup>. In accordance with Article 1101, NAFTA Chapter XI applies to “investments of investors of another Party in the territory of the Party,” that is to say, in the context of this dispute, to the investments of U.S. investors carried out in Mexico’s territory. The water usage rights granted by the state of Texas to the Claimants – which are valid only in U.S. territory – do not establish property rights for the Claimants over waters located in Mexico and do not constitute an investment under Chapter XI of the NAFTA in terms of the specific definition contained in Article 1139.

15. The Memorial explains in detail the legal system for waters in Mexico.<sup>22</sup> In spite of the fact that the Claimants argue – incorrectly – that Mexican law allows private ownership of river waters<sup>23</sup>, they seem to recognize that, in fact, they lack property rights in waters located in Mexican territory. Thus, they argue that articles 1102 and 1105 “apply to all measures taken by Mexico relating either to investors of another party or their investments, whether those investments are in Mexican territory or not.”<sup>24</sup> They add that “[t]he ‘national treatment’ analysis under Article 1102 does not include a determination of the territory in which the investment is carried out” and “[s]imilarly, Article 1105 provides a remedy for denial of ‘fair and equitable treatment’ regardless of the location of the investor or investment”.<sup>25</sup> This position is clearly incorrect.

16. Article 1101 establishes with precision: “This Chapter,” including Articles 1102 and 1105, “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” (emphasis added). As Mexico explained in its prior submission, “investor of another Party” means, among other things, “a national or company of that Party that expects to carry out, carries out, or has carried out

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<sup>19</sup> Memorial, ¶¶ 35-44.

<sup>20</sup> Counter-Memorial, ¶ 84, footnote 31: “Nor is it relevant whether the United States and Mexico settled their recent differences under the 1944 Treaty.”

<sup>21</sup> Memorial, ¶¶ 78-81.

<sup>22</sup> See section III.E in Memorial.

<sup>23</sup> Counter-Memorial, ¶ 79. The Claimants cite to that effect a sentence of the Mexican constitution, but omit the specific text that expressly states: “They are property of the Nation ... the waters ... of the rivers and their direct and indirect tributaries.” The Constitution adds that in the case of such river waters, among others, “the dominion of the Nation is inalienable and imprescriptible.” See Memorial, ¶ 46. Also, they ignore the laws of the specific legislation on the matter.

<sup>24</sup> Counter-Memorial, ¶ 49.

<sup>25</sup> Memorial, ¶¶ 50-51.

an investment.<sup>26</sup> Chapter XI does not apply to investors of another Party in abstract terms, as the Claimants suggest<sup>27</sup>, because, by definition, all investors of one party should have an investment (or expect to have one), and because of Article 1101, all investments should be in the territory of one Party different from that of which the investor is a national. All of Chapter XI is based on the principle of territoriality.

17. Mexico emphasized that, just as in the *Methanex* case, there is no legally significant link between Mexico's actions to regulate the river flow in its territory and the Claimants or their economic activities in the United States. Furthermore, there is no link whatsoever since none of the Claimants has an investment in Mexico for purposes of Chapter XI.<sup>28</sup>

18. The Claimants rely on the case *S.D. Myers, Inc. v. Canada* to support their argument that it is not necessary that they have an investment in Mexico. However, the case *S.D. Myers* does not assist them. In the *S.D. Myers* case, the Tribunal determined that the investment in Canada was a Canadian company, Myers Canada. The particular controversy was whether Myers Canada could itself be considered an investment of S.D. Myers when Myers Canada was not owned by S.D. Myers, but rather by members of the same family that also controlled S.D. Myers<sup>29</sup>. The *S.D. Myers* award does not support the argument that Chapter XI grants nationals of one Party the right to file a claim against another Party when they have no investment in the other Party's territory.

19. In their Counter-Memorial, the Claimants propose the theory that the Bilateral Water Treaty in some way incorporates the property rights of Texas law,<sup>30</sup> through which they are applicable in Mexico. The Claimants criticize Mexico's position on its sovereignty over the waters that are located in its territory, and they instead propose a theory that is based on the sovereignty of Texas law in Mexico. With all due respect, the argument is absurd.

20. The ownership of the waters of the national rivers (including the tributaries of the Rio Bravo) are governed in the first instance by Mexican law (specifically the laws alluded to in section III.E of the Memorial) and by the Bilateral Water Treaty, whose goal is to divide the waters between both countries. The ownership of the waters in rivers and international dams (to which articles 8 and 9 of the Bilateral Water Treaty refer) are governed by international law, and in particular, by the oft-cited 1944 Water Treaty. Under the former regime, the dominion of the waters corresponds to the Mexican nation—even if in accordance with Bilateral Water Treaty Mexico should drain a fixed share allocated to the United States—and private property does not exist. Under the latter, the property corresponds to Mexico and the United States, according to the terms of the cited treaty. Neither Mexican law nor international law—including the Bilateral Water Treaty and the NAFTA—establish property rights in Mexico for U.S. nationals or, much less, derived from an extraterritorial application of U.S. law.

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<sup>26</sup> Memorial, ¶ 91.

<sup>27</sup> See paragraph 48 of Counter-Memorial.

<sup>28</sup> Memorial, ¶¶ 84-85.

<sup>29</sup> See *S.D. Myers v. Canada* award, ¶¶ 222-232.

<sup>30</sup> See, for example, paragraph 81 of Counter-Memorial.

21. In paragraph 78 of the Counter-Memorial, the Claimants argue that the NAFTA obliges Mexico to respect “water rights, validly created under United States law” and gives examples of other types of property created and registered abroad: used cars, intellectual property rights, Treasury Bonds, and stock certificates. The argument, however, has numerous flaws.

22. It is true that all legal systems recognize property rights created abroad and that they can be moved across borders. Thus, the Federal Civil Code of Mexico, for example, states in Article 13: “Legal situations validly created ... in a foreign State under its law, shall be recognized...”<sup>31</sup> (emphasis added). Mexico recognizes property rights created in the United States under U.S. law. Nonetheless, the Claimants confuse rights created in a foreign State under its law with a new category they propose: rights created by foreign law in Mexico. In addition to the legal provisions referred to in Section III.E of the Memorial, under Mexican law, the flowing waters are real property as provided by the Civil Code<sup>32</sup> itself, and the constitution and the system of ownership rights (as well as movable property) are governed by their location<sup>33</sup>. For what is referred to as the acquisition of property on real estate in particular, the same provision states: “Foreigners ... in order to acquire real property, shall observe what is stated in Article 27 of the Mexican Constitution and its statutory laws”<sup>34</sup> (including the Law of National Waters, both already referred to in the Memorial). The Civil Code adds: “The use of the waters of public dominion shall be governed by the respective special law,” that is to say, the Law of National Waters.<sup>35</sup>

23. As has been stated, Mexico recognizes rights validly created abroad by foreign law, but when those laws (or goods) are located in Mexico, they are subject to Mexican regulation. As was indicated, Article 13 of the Federal Civil Code states that movable property (including used vehicles<sup>36</sup>, stock certificates<sup>37</sup>, copyrights<sup>38</sup>, and other types of analogous rights like patents or debt instruments, for example U.S. Treasury Bonds<sup>39</sup>) is governed by its location and, as the sovereignty of U.S. law does not exist in Mexico, though Mexico can regulate such rights and goods when they are located in its territory, for the same reasons it lacks the authority to regulate them when they are located abroad, such that it cannot, for example, revoke a patent registered in

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<sup>31</sup> Federal Civil Code, available at <http://www.diputados.gob.mx/LeyesBiblio/index.htm>.

<sup>32</sup> Id., Article 750, Section IX.

<sup>33</sup> Id., Article 13, Section III.

<sup>34</sup> Id., Article 773. Article 2274 essentially contains the same rules referred to specifically in the sale of real estate: “Foreigners and individuals cannot buy real estate, but rather are subject to that Article 27 of the Mexican Constitution and its statutory laws.”

<sup>35</sup> Id., Article 936.

<sup>36</sup> Id., Article 753: “They are movable property by their nature, bodies that can move themselves from one place to another, they can move by themselves, by the effect of an external force.”

<sup>37</sup> Id., Article 755: “In associations or societies, each member’s shares will be known as movable property, even when some real estate belongs to them.”

<sup>38</sup> Id., Article 758: “Copyrights are considered movable property.”

<sup>39</sup> Id., Article 754: “They are movable property by determination of the law, the obligations and the laws or actions that they have movable things or necessary candidates by virtue of personal action”; and 759: “In general, they are movable goods, all other things not considered by the law as real estate.”

the United States or Canada, or cancel stock certificates or Treasury Bonds issued in the U.S. However, in terms of the applicable Mexican law, Mexico can refuse to recognize within Mexico a patent granted abroad, or restrict and even prevent the circulation of stock or foreign debt certificates, in the same way it can impound or insure foreign vehicles.<sup>40</sup>

24. The Claimants' arguments that Mexico "confiscated" water rights created by U.S. law in Mexico is incorrect from both the factual and legal point of view. The rights that they argue have been affected by Mexico are only valid in U.S. territory, once the waters leave Mexican territory, and, in fact, the international channels, and are distributed under applicable U.S. law. They are not an investment according to the terms of Article 1139, in relation to Article 1101. Therefore, as the claim is outside the scope of application of Chapter XI, the Tribunal lacks jurisdiction over the claim and should dismiss it. Mexico refers the Tribunal to sections IV.B and IV.C of the Memorial.

#### **IV. THE 1993 JOINT STATEMENT ACTUALLY SUPPORTS MEXICO'S POSITION**

25. In their attempt to strengthen an unsupportable position, the Claimants add another obviously incorrect argument that shows even more clearly their case's weakness. They suggest that the Rio Bravo and its tributaries' water "enters into commerce [and] falls under NAFTA's provisions."<sup>41</sup> The Claimants cite the Joint Statement of the Parties of the NAFTA issued in 1993:

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 the 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 the 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

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<sup>40</sup> In the case of intellectual property rights, the claimants make an additional mistake. Industrial property rights (patents and brands, among others) registered abroad do not receive recognition as such in Mexico, nor do registered Mexican products receive such abroad. In matters of industrial property, the registry of the country in question normally is constituent to the law in that country, such that, in order to obtain the protection of Mexican law, registration is required in Mexico and, to that extent, what is protected is a right created in Mexico by Mexican law, not foreign law. See, for example, Articles 4 and 6 of the Paris Convention for the Protection of Industrial Property, whose provisions are applicable in the framework of NAFTA and the Agreement on the Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) of the WTO, as required by Article 1701(2) of the former and Article 2 of the latter. See also Article 1708 of NAFTA, in particular paragraph 4, in relation to paragraphs 2, 3, 5, 7, 8, and 9 of the same; paragraph 1 of Article 1709 of the treaty itself, in relation to paragraphs 2 and 3 of the same; and Articles 15 to 19 on the matter of trademarks, and 29 on the matter of patents of the TRIPS Agreement. Copyrights follow a slightly different system because normally the registry is not constituent to the registry (see, for example, Article 5(2) of the Berne Convention for the Protection of Literary and Artistic Works, whose provisions also are applicable in the context of NAFTA and the WTO by virtue of Articles 1701(2) of the first and Article 9 of the TRIPS Agreement).

<sup>41</sup> Counter-Memorial, ¶ 53.

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.

International rights and obligations respecting water in its natural state are contained in separate treaties and agreements negotiated for that purpose. Examples are the United States-Canada Boundary Waters Treaty of 1909 and the 1944 Boundary Waters Treaty between Mexico and the United States.<sup>42</sup>

26. The Joint Statement's purpose was to allay the concerns that had arisen, particularly in Canada, that the NAFTA could be used to pressure one of the treaty's Parties into sharing its water resources.<sup>43</sup>

27. First, it should be noted that neither the 1944 Water Treaty nor the NAFTA regulate trade of the waters of the various international rivers and their tributaries. Mexico and the Claimants agree that the purpose of the 1944 Treaty is to divide the waters of the rivers and tributaries mentioned<sup>44</sup>; but it is not a treaty on water commerce. The NAFTA also does not incorporate the waters of such rivers and tributaries into international commerce. In fact, those waters are not in international commerce, precisely because the legal system that applies to them in the international realm is the one established by the Bilateral Water Treaty, and no NAFTA provisions apply to them. For example, Mexico does not "export" nor do the United States or any of the Claimants "import" – the terms understood as operations of foreign trade subject to the corresponding customs regulations – the water that flows from the Mexican tributaries and the Rio Bravo; those waters are not subject to the payment of tariffs covered in Chapter III (cf. Article 302 and Annex 302.2) or to the rules of origin established in Chapter IV (cf. Article 401 and Annex 401); they do not have a "transaction value"<sup>45</sup> for purposes of the same chapter; and also are not subject to the customs procedures contemplated by Chapter V, all of the NAFTA, including the necessity to

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<sup>42</sup> Exhibit R-29. The Claimants incorrectly suggest that this is an interpretation by the Free Trade Commission under Article 1131 of the NAFTA. This is an agreement between the Parties of the treaty for purposes of Article 31 of the Vienna Convention on the Law of Treaties, but it is not an interpretation of the Free Trade Commission. In fact, the declaration is from December 1993, while the Free Trade Commission was established on January 1, 1994, when the NAFTA came into effect (see Article 2001 of the NAFTA).

<sup>43</sup> During the term of the 1988 Canada-United States Free Trade Agreement (a predecessor of the NAFTA), opponents of free trade raised alarms due to feelings that one State could use the treaty to force another State to transfer its natural resources, especially water. This debate continued during the NAFTA negotiations and Canada's government requested the issuance of a joint statement to allay any such fears. See, for example, "Close Call on NAFTA," in the Toronto Star (Dec. 3, 1993), p. A28 ("Chretien also got the Americans and Mexicans to agree to a joint statement that NAFTA cannot be used to force Canada to make large-scale exports of water. This clarification should satisfy those who feared that, under the deal, Canada would lose control over one of its most important resources."). Exhibit R-30.

<sup>44</sup> "The purpose of the 1944 Treaty was thus to partition not only the waters in the main channel of the Rio Grande, but also the waters of the numerous other international tributaries to it...". Counter-Memorial, ¶ 70. Mexico does not agree with the characterization of the tributaries as international rivers, but agrees that the purpose of the treaty was to divide up the waters between both countries.

<sup>45</sup> Article 415 of the NAFTA defines: "**transaction value** means the price actually paid or payable for a good or material with respect to a transaction of, except for the application of Article 403(1) or 403(2)(a), the producer of the good, adjusted in accordance with the principles of paragraphs 1, 3 and 4 of Article 8 of the Customs Valuation Code [currently the Customs Valuation Agreement of the WTO (see the respective definition of Article 201 of the NAFTA)], regardless of whether the good or material is sold for export."

present a certificate of origin for “commercial importation”<sup>46</sup> of goods whose value exceeds one thousand U.S. dollars (cf. Article 503).

28. In fact, the joint statement of the NAFTA Parties supports Mexico’s position and not the Claimants’. It specifies that the NAFTA does not create rights with respect to the natural water resources of any of the three Parties of the treaty. It clarifies that the water in its natural state in rivers, reservoirs and basins, among others, “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” and, specifically, that it “is not covered by the provisions of ... the NAFTA” (emphasis added). The reference to the NAFTA includes, of course, Chapter XI.

29. Contrary to the Claimants’ argument that the “water, which flows within courses of the six above-named Mexican tributaries before reaching the Rio Grande, where it is stored in the Falcon and Amistad reservoirs ... is clearly a good or product in commerce” over which they have property rights, and “necessarily falls within the scope of NAFTA,”<sup>47</sup> the Joint Statement confirms that they are not a good or product, and, therefore, are not covered by the NAFTA or any other trade treaty because the waters of the rivers indicated are found in their natural state, precisely as covered by the Joint Statement. The fact that the waters of the Rio Bravo and its tributaries do not constitute commercial imports in the United States and lack a transaction value for purposes of the NAFTA confirms that they are not the object of commerce.<sup>48</sup> Water that can be marketed (and, therefore, considered a good or product) is that which has been taken out of its natural source, for example to be bottled or stored in bulk in other types of containers.<sup>49</sup>

30. The Claimants confuse the water that flows in the rivers with “water rights” that may or may not be marketable<sup>50</sup>. As Mexico explained in detail, under Mexican law the waters of the

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<sup>46</sup> Article 514 defines: “**commercial importation** means the importation of a good into the territory of any Party for the purpose of sale, or any commercial, industrial or other like use.”

<sup>47</sup> Counter-Memorial, ¶ 55.

<sup>48</sup> Under Mexican law, the water of the mentioned rivers is also not in commerce. Article 747 of the Federal Civil Code establishes: “They can be an object of appropriation all the things that are not excluded from commerce.” Article 740 adds: “They are outside of commerce by their nature those things that cannot be possessed by one individual exclusively, and order of the law, those things that it declares irreducible to private property.” In the case of Mexico, Constitution Article 27 declares irreducible the private property of the water of the rivers, as has already been explained in detail.

<sup>49</sup> See section 7 of the Implementation Act of the NAFTA of Canada:

7. (1) For greater certainty, nothing in this Act or the Agreement, except Article 302 of the Agreement, applies to water.

(2) In this section, “water” means natural surface and ground water in liquid, gaseous or solid state, but does not include water packaged as a beverage or in tanks.

[Emphasis added].

Furthermore, as was already explained, even when the waters of the Rio Bravo and its tributaries can be used for commercial, industrial, or similar purposes (e.g. agricultural), under the joint statement, while the waters are in their natural state in the rivers and even in the international dams, they are not a good or product, and in no case can it be considered that the United States or the Claimants are carrying out a commercial importation (see footnote 46 of this submission).

<sup>50</sup> Counter-Memorial, ¶ 55.

rivers and its tributaries are property of the Nation, and this dominion is inalienable. Their exploitation or use by individuals can only be done by means of concessions<sup>51</sup>. However, the rights conferred by the concessions (exploitation or use of national waters, but not the right of ownership) can be transmitted totally or partially<sup>52</sup>.

31. Finally, in paragraph 54 of the Counter-Memorial, the Claimants alluded to the case *Sun Belt Water, Inc. v. Canada* to support their arguments regarding the Joint Statement, as evidence that their claims involving water rights have already been the object of investment arbitration under the NAFTA. This is also not correct. The case never went beyond the serving of the notice of intent to submit a claim to arbitration, more than eight years ago<sup>53</sup>. It is not possible to draw conclusions or even make inferences to the position maintained by a potential claimant whose claim was never put to the test before a tribunal.

## V. THE CLAIM IS BASED ON THE WATER TREATY, WHICH IS BEYOND THE TRIBUNAL'S JURISDICTION

32. The Claimants' Counter-Memorial expressly states that the claims are based on the Bilateral Water Treaty:

- “Claimant’s expectations to the right to the receipt of use of the water at issue in these claims were fixed by the [Water Treaty].... Claimants are the owners of 1,219,521 acre-feet of the water allotted to the United States under the 1944 Treaty...”<sup>54</sup>
- “For two consecutive five-year periods, Mexico diverted for its own use water allotted to the United States (and owned by the Claimants) under the 1944 Treaty.”<sup>55</sup>
- “Claimants are the owners of water rights allotted by Treaty to the United States by Mexico in 1944, including water located in the six above-named Mexican tributaries which empty into the Rio Grande.... Respondent’s assertion of defense that Mexico owns all of the waters within its boundaries, including those allotted to

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<sup>51</sup> Memorial, ¶ 46.

<sup>52</sup> National Water Law, Article 33: “The titles of concession for the exploitation or use of national waters, legally valid and established in the Public Register of Water Rights, just as the Unloading Permits can definitively be transmitted completely or partially with a basis in the laws of the present Chapter and those additions that the Law and its regulations foresee” (emphasis added). The Claimants refer to an article of Mr. Mark W. Rosengrant, an American specialist in public policy, and Mr. Renato Gazmurri, ex-official of the Chilean government and currently a consultant in that country, (neither of them is a Mexican lawyer) in which they refer to this transfer of rights and do not suggest that the property regime of national waters in Mexico is different from that which the Respondent already explained in detail with reference to the specific legal laws.

<sup>53</sup> See <http://www.international.gc.ca/tna-nac/sunbelt-en.asp>. The Canadian government explains:

Sun Belt Water, Inc., a United States company, served the Government of Canada with a ‘Notice of Intent to Submit a Claim to Arbitration’ in November 1998. No valid claim has been filed. There is no Chapter XI arbitration on this matter.

<sup>54</sup> Counter-Memorial, ¶ 2.

<sup>55</sup> Id., ¶ 16.

the United States (and thence to Claimants) by treaty in 1944 – ignores both the plain language of the 1944 Treaty and the established rule of equitable distribution of international rivers which it implements.”<sup>56</sup>

- “That investment [irrigation water] is owned by Claimants, as Mexico has relinquished ownership of it under the 1944 Treaty, and the water was physically located in Mexico at the time it was seized and diverted for use by Mexican farmers.”<sup>57</sup>
- “Since Claimant’s water rights, transferred from Mexico to the United States in 1944, and from the United States to Claimants under the national law of the United States, constitute an investment..., this Tribunal has jurisdiction.”<sup>58</sup>
- “The 1944 Treaty between Mexico and the United States, under which the waters of the Rio Grande basin were equitably apportioned between the two nations is such a treaty, negating any claim Respondent may now assert to the one-third share of the waters of the six previously named Mexican tributaries which Mexico ceded to the United States in that Treaty.”<sup>59</sup>
- “In the case of the 1944 Treaty, the State of Texas thus possessed the legal authority to apportion the American share of the Rio Grande waters allotted to the United States by the Treaty.”<sup>60</sup>
- “Following adoption of the 1944 Treaty, Texas commenced a water adjudication process in its state courts to allocate the American share of the waters belonging to the United States under the Treaty. This adjudication culminated in the 1969 decree to which Claimants trace their rights.”<sup>61</sup>
- “Moreover, even if Mexico did not recognize private water rights, its national law would give way before a Treaty – such as the 1944 Treaty or the NAFTA.”<sup>62</sup>
- “Accordingly, Mexico is not free to disregard Claimants’ water rights in the American portion of the Rio Grande’s waters (including the six above-named tributaries) allotted to the United States under the 1944 Treaty.”<sup>63</sup>

33. As Mexico noted in the introduction of this submission, the basis of the claim is that “Respondent’s improper diversion of water”<sup>64</sup> has led to “Respondent’s liability for the water debt under the 1944 Treaty”<sup>65</sup>, which has been settled.<sup>66</sup>

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<sup>56</sup> Id., ¶ 16.

<sup>57</sup> Id., ¶ 52.

<sup>58</sup> Id., ¶ 57.

<sup>59</sup> Id., ¶ 65.

<sup>60</sup> Id., ¶ 76.

<sup>61</sup> Id., ¶ 77.

<sup>62</sup> Id., ¶ 80.

<sup>63</sup> Id., ¶ 81.

<sup>64</sup> Counter-Memorial at ¶ 29.

34. Mexico had pointed out in its Memorial that the acts complained of occurred over three years prior to the submission of the claim to arbitration, which is the time period provided in Article 1116<sup>67</sup>, and many occurred even prior to the implementation of the NAFTA. Mexico reiterates the arguments contained in Section IV.E of its Memorial. In its response, the Claimants respond as follows<sup>68</sup>:

The period 1992-1997 is ... 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 [the] NAFTA ....

Respondent invoked its right to roll over this obligation into Cycle 26 due to extreme drought...

Thus, although at first blush, it might seem that Claimants' Cycle 25 claims accrued in 1997 and are therefore barred, this was not the case because as noted above, another qualification to the [Water] treaty allocation scheme is that Respondent may, in the case of "extraordinary drought," elect to postpone its obligations under one cycle until the end of the subsequent cycle. Respondent's election thus rolled over its Cycle 25 delivery obligation to the end of Cycle 26...<sup>69</sup>

35. Thus, the claim is based on whether Mexico delivered the water that corresponded to the United States under the 1944 Water Treaty. Mexico recognizes that it had a water debt which stemmed from a prolonged drought. This situation was contemplated in the Water Treaty, and the Treaty provides a way to resolve it. The Claimants propose an interpretation of the relevant provisions of the Treaty. The Tribunal will note that Mexico and the United States held different interpretations in this respect.<sup>70</sup> However, both countries agreed on the manner in which the debt should be paid, in accordance with the rights and obligations of both countries pursuant to the Treaty without resort to the establishment of a formal legal dispute through the institutional channels provided for in the Treaty.

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<sup>65</sup> Id., ¶ 27

<sup>66</sup> See paragraph 4 of this submission.

<sup>67</sup> Memorial at ¶ 119.

<sup>68</sup> In order to contend timely presentation of their claim, the Claimants argue that the time period for the claim began running on October 1, 2002, one day after the date on which in their view Mexico should have completed delivery of the water for cycles 25 (1992-1997) and 26 (1998-2002). In paragraph 27 of the Counter-Memorial the Claimants note, "[t]he period of limitations starts to run when the claimant has actual or imputed 'knowledge of the [ ] breach and knowledge that it has incurred loss or damage [thereby]'. However, the Claimants seem to forget that throughout the Request for Arbitration they have argued that Mexico's alleged breach began in 1992, for example, they state, "from 1992-2002, Mexico has captured, seized, and diverted to the use of Mexican farmers, the foundation of the investment...owned by Claimants". Request for Arbitration, ¶ 61. See in general the section entitled "Factual Background" of the Request for Arbitration.

<sup>69</sup> Counter-Memorial, ¶¶ 29-31.

<sup>70</sup> See paragraphs 38 and 39 of the Memorial.

36. Therefore, before the Tribunal can consider whether the provisions of the NAFTA are at all applicable – Mexico maintains that they are not – the Tribunal would have to determine the rights and obligations of Mexico and the United States under the Bilateral Water Treaty and whether Mexico acted in agreement with the Treaty, having generated and paid the water debt accordingly. For the claims of a breach of Articles 1102, 1105 and 1110 to be sustained, it would require the Tribunal to decide on such claims. However, it lacks the competence to do so.

**VI. THE CLAIMANTS HAVE CONFIRMED THAT THE IRRIGATION DISTRICTS HAVE NOT SUFFERED REAL DAMAGES AND THEREFORE THEIR CLAIMS SHOULD BE DISMISSED ACCORDINGLY**

37. In both their Notice of Intent and Request for Arbitration, the Claimants explained that each irrigation district brought its claim on its own behalf, as well as on behalf of the water users in its district.<sup>71</sup> In the Memorial, Mexico pointed out that (i) the NAFTA does not allow class actions and (ii) under Texas law, irrigation districts lack the authority to initiate legal claims on behalf of anyone other than themselves.<sup>72</sup> In the Counter-Memorial, the Claimants stated that, in fact, “[t]his 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.”<sup>73</sup> However, this change of position only underscores another flaw in the Claimants’ claim: although the Claimants argue that Mexico’s alleged diversion of water has injured their crops, irrigation districts do not themselves engage in farming or “agricultural businesses.”<sup>74</sup>

38. According to the Texas Commission on Environmental Quality (TCEQ), “[a] water district is a local, governmental entity that provides limited services to its customers and residents, depending on the district’s type.”<sup>75</sup> Specifically, the TCEQ has outlined the authority and functions of water districts as follows:

Most districts have the following powers:

- to incur debt
- to levy taxes

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<sup>71</sup> Notice of Intent at 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 at p. 2 (stating, e.g., “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.”).

<sup>72</sup> Memorial at ¶ 136, fn. 102, quoting Texas Water Code, § 58.181.

<sup>73</sup> Counter-Memorial, fn. 23.

<sup>74</sup> Counter-Memorial at ¶ 6.

<sup>75</sup> Texas Water Districts: A General Guide, Texas Commission on Environmental Quality, December 2004 revision, p. 1, available at [www.tceq.state.tx.us/comm\\_exec/form\\_pubs/pubs/gi/gi-043\\_379907.pdf](http://www.tceq.state.tx.us/comm_exec/form_pubs/pubs/gi/gi-043_379907.pdf) (“Texas Guide”). Note that all of the water districts that are claimants are irrigation districts, which are one of the types of water districts. Letter from Nancie Marzulla to Gabriela Alvarez, 7 March 2005 at p. 3 (stating that, under Texas law, irrigation districts “are political subdivisions of the State.”).

- to charge for services and adopt rules for those services
- to enter contracts
- to obtain easements
- to condemn property.<sup>76</sup>

39. In the Counter-Memorial, the Claimants stated that irrigation districts are engaged in supplying water. Claimants previously informed the ICSID that “[t]he primary purpose of irrigation districts is to deliver untreated water for irrigation, and to provide for drainage.”<sup>77</sup> In fact, the Claimants themselves noted that “their delivery of water to end users is similar to a supplier of goods who sells those goods to retailers.”<sup>78</sup> Thus, the role of the irrigation districts is that of a middleman, transferring water from the State to those who use it for municipal purposes and irrigation.

40. Accordingly, the Claimants’ statement in paragraph 53 of the Request for Arbitration that each claimant is an “investor and owner” of an investment that includes “irrigated fields and farms; farm buildings and machinery; and ongoing irrigated agricultural businesses” is unsupported. In the context of this case, there is no relationship whatsoever between the irrigation districts’ function as municipal water utility companies and the purported loss of the “economic value” of water to the farming businesses that they serve.

41. The fact that the irrigation districts have not suffered any cognizable loss provides another basis for dismissing their claims.

## **VII. THERE ARE STILL MANDATORY PROCEDURAL REQUIREMENTS THAT HAVE NOT BEEN FULFILLED**

42. Mexico has made repeated attempts since the notice of arbitration was filed to have the individual claimants verify their nationality. It was not until May 2, 2006 (more than 10 days after Mexico submitted its Memorial) that Messrs. Marzulla submitted proof of nationality of some of the individuals listed in footnote 109 of the Memorial.<sup>79</sup> It was not until the Claimants filed their Counter-Memorial that they submitted documents evidencing nationality of all the Claimants referenced in the Memorial.

43. Notwithstanding Mexico’s evidence that the irrigation districts are governed by boards of directors, the Claimants assert that officers of the districts can self-certify that they have the

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<sup>76</sup> Texas Guide, p. 2.

<sup>77</sup> Counter-Memorial, ¶ 1; letter from Nancie Marzulla to Gabriela Alvarez, 7 March 2005 at p. 3 (citing Tex. Water Code Ann. § 58.121). In fact, under Texas law, these irrigation districts are known as “limited purpose districts.” Texas Water Code § 58.121.

<sup>78</sup> Letter from Nancie Marzulla to Gabriela Alvarez, 7 March 2005, p. 4.

<sup>79</sup> Copies of documents (passports or birth certificate) evidencing the nationality of the eight Claimants mentioned in footnote no. 109: Odus D. Emery Jr., Juan Francisco Ruiz, Rita Schreiber, Gregory Schreiber, Francis Ludwick Phillip, Richard Berndt Drawe, Donald Francis Phillip and Samuel Robert Sparks.

appropriate authority to initiate this arbitration and bind their corporations as required by Chapter XI (such as the waiver of the right to initiate or continue lawsuits under domestic law arising out of the same measures that are the subject of the claims). Mexico has serious concerns that the irrigation districts will later disclaim responsibility for initiating this arbitration.<sup>80</sup> For that reason, Mexico asks the Tribunal to ensure that the award of costs requested by Mexico is assessed on the Claimants on the basis of joint and several liability, so that each individual Claimant will be liable for the full amount of the award. Mexico should not be burdened with the task of pursuing collection of the award from the 43 claimants, regardless of whether they are corporations or individuals.

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<sup>80</sup> The same situation arises in the case of claimants who are juridical persons. The claimants annexed a Certification of Representation to their Counter-Memorial. These documents already had been provided to the Government of Mexico; however, a second page is enclosed with the certificates, signed by the Secretary or Chairman of the Board, stating that the signor of the Certification of Representation in fact holds the position in question. Notwithstanding, this new document does not suffice to prove that the official has the power to bind the juridical person in the present arbitration and to authorize Messrs. Marzulla to represent it.

**VIII. RELIEF REQUESTED**

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

All of which is respectfully submitted for your consideration;

(Signed in the original)

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Hugo Perezcano Díaz  
Legal Counsel and Representative of  
the United Mexican States  
26 July 2006