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Grasp on Water: A Natural Resource That Eludes NAFTA's Notion of Investment

Paul Stanton Kibel

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INTRODUCTION

In formulating this Article’s title, the concept of grasping seemed particularly on point for several reasons. First, many international trade lawyers have conceptual difficulty grasping the nature and scope of private legal interests in the use of water. Second, many water lawyers have conceptual difficulty grasping the nature and scope of investor protections under international trade agreements such as the North American Free Trade Agreement (NAFTA). Then there are recent efforts of private water users to secure recognition of entitlements to water under international trade agreements. These efforts represent a type of grasping as well.

Although the focus of this Article is on water entitlement claims brought under NAFTA, the uncertain junction of water law and international trade law is a question now being debated in many other

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Paul Stanton Kibel is Director of Policy West, of counsel to the firm of Fitzgerald Abbott & Beardsley, an adjunct professor at Golden Gate University School of Law and visiting lecturer in water policy at Berkeley’s Goldman School of Public Policy. He is the author of The Earth on Trial: Environmental Law on the International Stage (1999) and edited Rivertown: Rethinking Urban Rivers (2007). He holds an LL.M from Berkeley’s Boalt Hall School of Law and a B.A. from Colgate University. This Article covers developments through December 2006.
international forums such as the World Trade Organization (WTO), the European Union, and the South African Development Community. The question is also now an important focal point for academic work in the field of international law, as evidenced by Oxford University Press' 2005 book *Freshwater and International Economic Law*, a collection of essays by leading international law scholars from around the world. The debate over the scope of private interests in water under international law is therefore global in nature and not limited to North America.

This Article begins by outlining the hydrologic and legal restraints to private ownership of water resources. It then details the provisions of NAFTA that pertain to private rights in water, and reports on two high-profile water entitlement cases that have arisen under NAFTA's foreign investor protection regime. The piece concludes by observing that the experience of United States of America (U.S.) federal courts with state water law may provide a jurisprudential template to bring NAFTA into alignment with existing domestic water law and international water treaties.

I. PRIVATE RIGHTS TO WATER: ELUSIVE BY NATURE AND LAW

NAFTA was approved by Canada, the United States, and Mexico in 1993 and went into effect on January 1, 1994. The bulk of NAFTA's provisions focus on the transnational trade in goods and products. Early on, however, the NAFTA parties recognized that water did not fit neatly within accepted notions of what constituted a good or product under traditional trade law terminology. This recognition led the parties to issue a joint statement in 1993 concerning NAFTA's application to water resources (1993 NAFTA Statement).

The 1993 NAFTA Statement provides:

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 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 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.\(^7\)

Following up on the reference to the 1909 Boundary Waters Treaty between Canada and the United States in the 1993 NAFTA Statement, the International Joint Commission (IJC) issued its own statement in 2000 (2000 IJC Statement) which considered water rights not only under NAFTA, but also under WTO agreements.\(^8\) The IJC is the binational institution with primary responsibility for resolving disputes under the 1909 Boundary Waters Treaty.

The 2000 IJC Statement provides:

The Commission believes it is unlikely that water in its natural state (e.g., in a lake, river, or aquifer) is included within the scope of any of these trade agreements since it is not a product or good. . . .

. . . NAFTA and the World Trade Organization agreements do not constrain or affect the sovereign right of a government to decide whether or not it will allow natural resources within its jurisdiction to be exploited and, if a natural resource is allowed to be exploited, the pace and manner of such exploitation.\(^9\)

Within the NAFTA regime, we can therefore see that Canada, Mexico, and the United States have long agreed that there is something fundamentally different about water compared to other items that may cross national boundaries—something that eludes and often precludes traditional notions of private ownership. Although the 1993 NAFTA Statement and the 2000 IJC Statement do not spell out exactly what it is about water that warrants this special treatment, it may have to do with certain characteristics that are somewhat unique to water.

\(^7\) Id.


\(^9\) Id.
First, there are peculiar hydrologic uncertainties and fluctuations inherent with water resources. Precipitation and temperature levels during any given period will affect how much water is stored as snowpack, the amount of precipitation that remains as snowpack versus the amount of precipitation that melts to become runoff that makes its way into creeks, streams, rivers, and underground aquifers, when such runoff occurs, and how much surface water is lost due to evaporation.

Second, the availability of a water resource for a particular party is often contingent on how other parties divert the resource. If two parties are withdrawing groundwater from the same underground aquifer, the withdrawals of one party may affect the groundwater available to the other party. The same is true for surface water diversions by multiple parties—reduction in instream flow caused by one diverter reduces the remaining flow for other diverters and for instream uses and users (i.e., fisheries and fishermen).

Finally, water has long been considered by most domestic legal systems to be a resource that is public, or at least quasi-public. As Professor Michael Hanemann of the University of California, Berkeley recently observed:

The public good nature of water . . . has had a decisive influence on the legal status of water. In Roman Law, and, subsequently, in English and American common law, and to an extent in Civil Law systems, flowing waters are treated as common to everyone (res communis omnium), and are not capable of being owned.

A few local examples from California and the American West illustrate the public or quasi-public domestic legal status of water resources.

The California Supreme Court's 1983 decision in National Audubon Society v. Superior Court confirmed that all surface waters in the state...
are subject to the public trust doctrine. The public trust doctrine restricts the ability of the state of California—acting through its state water board—to grant private entitlements to divert waters that significantly impair the public’s interest in maintaining adequate instream flows. In setting aside a series of state agency permits allowing the city of Los Angeles to divert waters away from Mono Lake, the court clarified that “before state courts or state agencies approve water diversions they should consider the effect of such diversions upon interests protected by the public trust, and attempt, so far as feasible, to avoid or minimize any harm to those interests.”

In June 2006, in the case of Allegretti & Co. v. Imperial County, the California Court of Appeal rejected the argument that a county’s application of groundwater anti-overdraft pumping restrictions constituted a physical taking of a landowner’s water under the Fifth Amendment of the U.S. Constitution. A “physical taking” covered by the Fifth Amendment entitles a property owner to “just compensation” for the property taken. The court in Allegretti held:

[The] County’s action with respect to Allegretti in the present case—imposition of a permit condition limiting the total quantity of groundwater available for Allegretti’s use—cannot be characterized as or analogized to the kinds of permanent physical occupancies or invasions sufficient to constitute a categorical physical taking. [The] County did not physically encroach on Allegretti’s property or aquifer and did not require or authorize any encroachment; it did not appropriate, impound or divert any water.

In 2005, in the case of Klamath Irrigation District v. United States, the U.S. Court of Claims rejected a Fifth Amendment takings claim, finding that the plaintiff’s entitlement to divert water from the Klamath River (located in California and Oregon) under contracts with the U.S. Bureau of Reclamation was subject to compliance with the habitat protection provisions of the Federal Endangered Species Act. The Court of Claims held:

[T]he court is mindful that... this ruling may disappoint a number of individuals who have long invested effort and expense in developing their lands based upon the expectation that the waters of the Klamath Basin would continue to flow, uninterrupted, for irrigation. But, those expectations, no matter how understandable, do not give those landowners any more property rights as against the United States,

15. Id. at 712.
16. 42 Cal. Rptr. 3d 122 (Ct. App. 2006).
17. Id. at 130–31 (internal citations omitted).
and the application of the Endangered Species Act, than they actually obtained and possess.19

In three recent California Court of Appeal decisions—Planning & Conservation League v. California Department of Water Resources20 in 2000, Santa Clarita Organization for Planning & the Environment v. County of Los Angeles21 in 2003, and Vineyard Area Citizens for Responsible Growth, Inc. v. City of Rancho Cordova22 in 2005—the court recognized a distinction between “wet water” and “paper water.” These three cases clarified that “wet water” is water supply that is actually and physically available for diversion and use, while “paper water” are water supply entitlements that are referenced in documents (such as delivery contracts with California’s State Water Project) but that do not in fact exist due to hydrological realities, environmental restraints, or uncompleted infrastructure. As the court in the Planning and Conservation League case explained, State Water Project entitlements represent nothing more than hopes, expectations, water futures or, as the parties refer to them, “paper water.” “Paper water always was an illusion. ‘Entitlements’ is a misnomer, for contractors surely cannot be entitled to water nature refuses to provide or the body politic refuses to harvest, store and deliver.”23

These domestic law conceptions of water provide the backdrop for understanding the 1993 NAFTA Statement and the 2000 IJC Statement. They explain the difficulty in applying standard notions of property, ownership, and entitlement to alleged private claims to a specific quantity of water.

II. WATER AND INVESTMENT UNDER NAFTA CHAPTER 11

Chapter 11 of NAFTA is designed to protect foreign investors from appropriation of their property by host nations. More specifically, Chapter 11 prohibits a host nation from taking measures that are “tantamount to nationalization or expropriation” of an “investment” except on “payment of compensation” based on “fair market value.”24 Foreign investors who believe that a host nation has taken such measures may initiate binding arbitration proceedings that can result in an enforceable damages award.25 There is no requirement that a foreign

19. Id. at 540.
20. 100 Cal. Rptr. 2d 173 (2000).
22. 25 Cal. Rptr. 3d 596 (2005), rev’d on other grounds, 150 P.3d 709 (Cal. 2007).
24. NAFTA, supra note 5, art. 1110.
25. Id. art. 1120.
investor first exhaust domestic legal remedies available in the host nation before initiating a Chapter 11 claim.

Chapter 11’s use of the term “investment,” instead of the terms “goods” or “products,” makes for a confusing application to water resources. Although the 1993 NAFTA Statement provides that water generally should not be considered a good or product for NAFTA purposes, it does not directly address the question of how this characterization might affect claims regarding an investment in water brought pursuant to Chapter 11. More specifically, the 1993 NAFTA Statement on water leaves open the possibility of claims regarding investments in water that might exist independent of claims that water itself is a good or product subject to private ownership.

Article 1139 of NAFTA attempts to offer some guidance on what might be considered an investment for Chapter 11 purposes. Article 1139(g) provides that the term “investment” may include “real estate or other property acquired in the expectation or used for the purpose of economic benefit.” Yet given the body of domestic law establishing that any private right “acquired” to use water is subject to significant limitations, the definition provided in Article 1139(g) is not particularly helpful when applied to water resources. It merely begs the underlying question of whether, and if so to what extent, a private party can acquire water as property.

Article 1139(h) of NAFTA similarly attempts to offer guidance by providing that an investment may include “interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory.” As with the use of the term “acquired” in Article 1139(g), the use of the term “interests” in this context raises more questions than it answers when applied to water resources. Once again, given the body of domestic law establishing that any private interest to use water is subject to significant limitations, what type of interest in water can a private party be said to possess?

Chapter 11’s definition of “investor” in Article 1139 also provides little help. This definition provides that an “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.” As to

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26. Id. art. 1139.
27. Nathalie Bernasconi-Osterwalder & Edith Brown Weiss, International Investment Rules and Water: Learning from the NAFTA Experience, in FRESH WATER AND INTERNATIONAL ECONOMIC LAW, supra note 1, at 267 (“Although the [1993 NAFTA] Statement considers the link between water and free trade in goods, it neglects the question of how the investment rules in Chapter 11 might affect the ability of a State to protect its water resources.”).
28. NAFTA, supra note 5, art. 1139(g).
29. Id. art. 1139(h).
30. Id. art. 1139.
what constitutes an investment for purposes of determining who constitutes an investor in the context of Chapter 11 claims involving water resources, we are left again with the ambiguities of Article 1139's definition of investment.

In light of the uncertain relationship between the 1993 NAFTA Statement and Chapter 11, and the less-than-helpful water-related definitions of “investment” provided in Article 1139 of NAFTA, it is not surprising that disputes have arisen over Chapter 11’s application to foreign investment appropriation claims involving water resources.

To date, there have been two NAFTA Chapter 11 cases where claims regarding water resources have been front and center.

A. Claim by California’s Sun Belt against Canada

Sun Belt Water Inc. (Sun Belt) is a California corporation created to provide additional water supply to real estate developments in California.31 In 1990, Sun Belt entered into a joint venture with Snowcap Waters Limited (Snowcap), a company based in British Columbia, Canada.32 The joint venture called for the diversion of water from the Fraser River in British Columbia. The bulk water exports would be transported by retrofitted oil supertankers down the Pacific Coast to California where Sun Belt would market the water.33

In 1991 the government of British Columbia—concerned about the impacts of these diversions and exports on instream flow, fishery resources, and water quality—passed a temporary ban on bulk water exports and refused to award Snowcap its requested permit.34 This ban rendered the Snowcap–Sun Belt endeavor unviable.

Because Snowcap was a Canadian company and not a foreign investor, it could not use Chapter 11 against Canada. Over many years, Sun Belt attempted unsuccessfully to reach a settlement with the government of British Columbia, and then had its claim for damages rejected by the Canadian courts. In 1998 Sun Belt filed a Chapter 11 claim against Canada alleging $10.5 billion in damages resulting from lost profits, lost market access, and lost access to water resources.35 The Sun

32. Id. at 6.
33. Id. at 7.
34. Id. at 8.
Belt NAFTA claim has not yet proceeded to arbitration, and as of this writing no final settlement has been reached.36

A November 2000 report commissioned by the North American Commission for Environmental Cooperation in Montreal explained the broader context for the dispute:

The Canadian government considers water in its natural state not a good and therefore not subject to Canada's trade obligations. Accordingly, it has proposed a limited form of ban on the export of water from Canada's main watersheds.

... Ambiguities about water in trade agreements have concerned citizens and nongovernmental organizations in the Great Lakes and St. Lawrence River basins because they have struggled since the early 1980s to prevent large alterations to basin water systems, such as dams, large takings, erosion control projects, flow control structures, and diversions of water from the basin. Ambiguities about water in trade agreements threatened to make diversions, in the form of tanker, pipeline, bulk export, and multiple scale removals and consumptive uses impossible to prevent... Given recent tribunal decisions under NAFTA Chapter 11's investor-state dispute mechanism, even non-discriminatory measures are open to challenge.37

Sun Belt's Chapter 11 claim, although unresolved, raises a fundamental question. If the Canadian courts have already reviewed its claim and determined that Sun Belt has no property interest entitling it to compensation under Canadian law, should a NAFTA Chapter 11 tribunal defer to this domestic judicial determination? Chapter 11 does not require that a foreign investor first exhaust domestic judicial remedies before bringing a Chapter 11 claim.38 Nevertheless, the lack of a domestic exhaustion requirement does not establish that a Chapter 11 tribunal can or should disregard a previous domestic judicial ruling in the host county that directly addressed the question of whether regulation of a specified natural resource in a particular manner gave rise to a governmental duty to compensate a particular party. The issue here is not so much whether a previous domestic court ruling acts to deprive a NAFTA panel of jurisdiction to consider a Chapter 11 claim. Rather, the issue is what degree of deference a NAFTA panel owes a domestic court in the event

38. See discussion supra first paragraph of Section II.
that a Chapter 11 claimant's alleged property interest has already been examined and ruled upon.

B. Claim by Texas Farmers against Mexico

The 1993 NAFTA Statement on water provides, "International rights and obligations respecting water in its natural state are contained in separate treaties and agreement negotiated for that purpose. Examples are the United States–Canada 1909 Boundary Waters Treaty and the 1944 Boundary Waters Treaty between Mexico and the United States."

To understand the Texans' Chapter 11 Rio Grande claim against Mexico, a brief review of the 1944 Waters Treaty is required.

The 1944 Waters Treaty between Mexico and the United States established separate allocation regimes for the Colorado River and the Rio Grande. In the case of the Rio Grande, the two largest tributaries to the river—the Rio Conchos and the Rio Bravo—have their headwaters in northern Mexico. Therefore, the Rio Grande allocation regime set forth in the 1944 Waters Treaty obligates Mexico to allow certain flows to reach the United States. A converse regime was established under the 1944 Waters Treaty for the Colorado, which flows from the United States to Mexico, which calls upon the United States to release certain flows.

The 1944 Waters Treaty allocated to the United States one-third of the flow of the tributaries in Mexico that reach the Rio Grande. Except in times of "extraordinary drought," this one-third allocation is not to be less than 350,000 acre feet (AF) annually, averaged over a five-year period. If the five-year period averages less than 350,000 AF due to drought conditions, then Mexico is left with a "water debt." Under the terms of the treaty, Mexico must pay back an accumulated "water debt" in the next five-year period through increased releases. The 1944 Waters Treaty is silent as to the specific timeframe or schedule for making these increased releases, and the agreement is also silent about what happens if extraordinary drought conditions occur in back-to-back five-year periods.

42. Id. at 1226–27.
43. Id.
44. Id. at 1224–28.
45. Id.
46. Id.
Under the 1944 Waters Treaty, the bilateral institution entrusted with overseeing the allocation regime for both the Colorado River and the Rio Grande is the International Boundary and Waters Commission (IBWC).\(^\text{47}\) In the 1992–1997 five-year period, and then again in the 1997–2002 period, Mexico did not provide an annual average of 350,000 AF.\(^\text{48}\) Mexico maintained that drought conditions prevented it from making these deliveries. At the end of the 1997–2002 five-year cycle, Mexico had accumulated a 1.3 million AF water debt.\(^\text{49}\) With assistance from the IBWC, in March 2005 the United States and Mexico agreed on a schedule for Mexico to discharge its Rio Grande water debt through additional releases.\(^\text{50}\)

Although the United States government was satisfied with this resolution, a collection of farming irrigation districts in Texas (Texas farmers) were not. These Texas farmers initiated a NAFTA Chapter 11 claim against Mexico in late 2004, seeking close to $700 million in damages.\(^\text{51}\) The thrust of the Texas farmers’ Chapter 11 claim is that they had and continue to have a legal entitlement to the minimum 350,000 AF, and that Mexico appropriated this entitlement by failing to provide this quantity. The Texas farmers argued that Mexico improperly relied on the treaty’s drought conditions exception.\(^\text{52}\)

The Rio Grande NAFTA Chapter 11 dispute involves more than conflicting views of the scope and nature of the Texas farmers’ property interest in water. The dispute also raises the preliminary question of whether the IBWC dispute resolution process provided for in the 1944 Waters Treaty deprives a NAFTA Chapter 11 panel of jurisdiction over the Texas farmers’ claim. Article 30 of the Vienna Convention on the Law of Treaties, entitled “Application of successive treaties to the same
suggests that NAFTA's dispute resolution procedures should govern. Article 30(3) provides in pertinent part, "When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not suspended or terminated . . . the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty." Application of this provision suggests that since Mexico and the United States are both parties to the earlier 1944 Waters Treaty and to the later NAFTA, the provisions of NAFTA should govern in the event of a conflict between the two treaties.

However, other considerations of international law point to an alternative conclusion. First, the primary focus of the 1944 Water Treaty is on the allocation of river resources, whereas the primary focus of NAFTA Chapter 11 is on private investment. Therefore, it could be argued that the two treaties do not in fact relate to the "same subject matter" and that Article 30(3) of the Vienna Convention is therefore inapplicable.

Second, Article 31(a) of the Vienna Convention provides that "[t]he context for the purpose of the interpretation of a treaty shall comprise, in addition to the text . . . any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty." The 1993 NAFTA Statement, approved by both Mexico and the United States, declared, "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 Waters Treaty between Mexico and the United States." To the extent the 1993 NAFTA Statement falls within the scope of Article 31(a) of the Vienna Convention, it suggests that NAFTA was not intended to displace or replace the terms—including the dispute resolution terms—of the 1944 Waters Treaty.

Finally, another rule of treaty interpretation under customary international law, lex specialis, holds that a more specific treaty or treaty provision should prevail over a more general treaty or treaty provision. Given that the 1944 Waters Treaty relates specifically to the question of Rio Grande allocations between Mexico and the United States, and given

54. Id.
57. 1993 NAFTA Statement, supra note 6.
that NAFTA Chapter 11 relates to the more general question of appropriation of foreign investments, *lex specialis* would dictate that the dispute resolution provisions of the 1944 Waters Treaty should prevail over the dispute resolution provisions of NAFTA when allocation of the Rio Grande is at issue.

To provide a sense of the opposing positions in this case on both the jurisdictional and property interest questions, below are excerpts from the opening briefs submitted to the NAFTA Rio Grande tribunal in the summer of 2006.

1. *Briefing Submitted by Government of Mexico*

On the question of the NAFTA tribunal's jurisdiction over the dispute, the government of Mexico stated:

The claim is outside the scope of NAFTA by reason of the nature of the treaty: The breaches of NAFTA alleged by the claimants are based exclusively on the argument that Mexico breached obligations established in the Treaty Between the United States of America and Mexico Respecting Utilization of Waters of the Colorado and Tijuana Rivers and of the Rio Grande entered into by Mexico and the United States in 1944.

... The Bilateral Water Treaty has its own dispute settlement mechanism, which can only be invoked by Mexico and the United States. 59

... [T]he Water Treaty of 1944 ... grants the [IBWC] exclusive jurisdiction.60

On the question of the issue of "ownership" of the alleged investment, the Government of Mexico maintained:

[N]one of the claimants even argue that they have a property right in Mexico, whether in land, water or any other assets. [Mexico's] Secretariat of Economy requested that they present a copy of the property title or other documents that proves that each one has a direct or indirect ownership or control of the investment allegedly affect. None of the claimants did so.61

...


60. *Id.* at 37.

61. *Id.* at 16 (footnotes omitted).
None of the systems, facilities, and infrastructure that they allege to own is located in Mexican territory; all are located in the United States.62

... 

[A]t a more basic level, if the claimants are located in the United States and are subject to U.S. jurisdiction, specifically, to that of the State of Texas, it is perplexing at best to wonder how they can simultaneously be subject to Mexican jurisdiction... or how it is that Mexico could have expropriated a property right created by foreign legal system and existing only in another country.63

2. Briefing Submitted by Texas Farmers

On the question of whether the IBWC has exclusive jurisdiction over the matter, to the exclusion of the NAFTA Chapter 11 tribunal, the Texas farmers argued:

The fact that Mexico may have breached a treaty obligation [under the 1944 Waters Treaty] owed to the United States does not immunize it from the separate consequences of a violation of Chapter 11 of NAFTA. Simply put, this arbitration is about national treatment, the minimum standard of treatment, and expropriation and compensation, resulting from Mexico's seizure of water owned by Claimants. As investors, Claimants have the right to pursue this claim for Respondent's adoption of measures relating to their investment, and this Tribunal has jurisdiction over this claim.64

On the question of ownership of water interests, the Texas farmers contended:

Claimants are the legal owners of 1,219,521 acre-feet of the irrigation water wrongfully withheld and diverted from the Rio Grande by Mexico's manipulation of its dams and reservoirs as of October 2002. These water rights, as well as delivery facilities, irrigation works, farms, equipment, and irrigated farming businesses of which they are an essential element, form an integrated investment, the expropriation and diversion of which has severely damaged the ability of Claimants to produce crops.65

...
Claimants' expectations to the right to the receipt of use of the water at issue in these claims were fixed by the [1944] Treaty Between the United States of America and Mexico... 66

On the question of the applicability of the 1993 NAFTA Statement to water, the Texas farmers maintained:

Since Claimants' water, which flows within courses of the six above-named Mexican tributaries before reaching the Rio Grande, where it is stored in Falcon and Amistad reservoirs, sold on the Water Market, and delivered through a complex of irrigation works, is clearly a good or product in commerce, it necessarily falls within the scope of NAFTA. 67

The reference by the Texas farmers to "reservoirs" in support of their argument that the Rio Grande water should be considered a "good" or "product" under the 1993 NAFTA Statement on water is particularly interesting given that the 1993 NAFTA Statement specifically 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, and therefore is not and never has been subject to the terms of any trade agreement." 68

So far, Mexico has persevered in its opposition to the Texas farmers claim for compensation. However, given the ambiguous status of water under NAFTA Chapter 11, there are risks to Mexico in taking this hard line. As Kyla Tienhaara from the Institute for Environmental Studies at Vrije University in Amsterdam observed in a November 2006 article in Global Environmental Politics:

The uncertainty created by the current framework for investor-state dispute settlement, coupled with the high cost associated with arbitration proceedings, can leave governments in developing countries in a precarious position. When faced with a decision on whether to risk millions of dollars for an unknown outcome, many countries may opt instead to retract, amend or fail to enforce an environmental regulation. 69

66. Id. at 1.
67. Id. at 25.
68. 1993 NAFTA Statement, supra note 6 (emphasis added). The Merriam-Webster Dictionary defines a "reservoir" as "an artificial lake where water is collected and kept in quantity for use." MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (11th ed. 2003) (emphasis added). To the extent the Texas farmers contend that water stored in a "reservoir" is not "water in a natural state," this interpretation would appear to render the inclusion of the word "reservoir" in the 1993 NAFTA Statement nonsensical since a reservoir is by definition an artificial man-made impoundment (as opposed to a naturally occurring aquifer or lake).
These are considerations that may well factor in to Mexico’s future calculations of whether to curtail water deliveries to the United States for domestic Mexican water resource conservation and environmental objectives.

III. REACHING INCOMPETENCE

Stepping back from the particulars of the Rio Grande and Sun Belt NAFTA Chapter 11 claims, what is so intriguing about these disputes is the way claimants are advancing private property notions of water that are contrary to domestic water law.

In domestic water law, the past several decades have seen an increase in the legal recognition of the public interest in water resources. Fishery habitat protection for endangered species, the public trust doctrine, instream flow requirements, and the wet water/paper water distinction are all elements of this domestic water law trajectory.70 Yet within the framework of multilateral investment treaties such as NAFTA’s Chapter 11, we are now confronted with efforts to re-characterize water resources as quantitatively fixed private property. If these efforts are successful, we will be left with a fundamental disconnect and divergence between domestic water law and international trade law. This disconnect and divergence have the potential not only to impact public regulation of water resources but also to erode support for the current trade agenda.

If progress is to be made in bringing NAFTA Chapter 11—and, potentially, other foreign investor protection regimes—into closer alignment with domestic law notions of the private interest in water, an analytic framework for such reconciliation can be found in the domestic litigation leading up to the California Supreme Court’s 1983 decision in National Audubon.71 The court held that California’s public trust doctrine applies to instream waters, and that this doctrine imposes an obligation on California agencies to limit the private interest in diversion of such waters to avoid and minimize adverse public impacts.72 The path by which the underlying litigation in National Audubon made its way into the California courts may provide instructive lessons for NAFTA Chapter 11 tribunals.

72. Id. at 712.
The environmental plaintiffs in *National Audubon* filed their initial lawsuit in May 1979 in Mono County Superior Court against the Department of Water and Power of the City of Los Angeles (DWP).\(^73\) The case was then transferred to Alpine County Superior Court.\(^74\) In January 1980, DWP cross-complained against several other parties, including the United States federal government.\(^75\) Upon being named, the United States removed the case from state court to the federal district court for the Eastern District of California.\(^76\) However, because certain California water law questions were central to the plaintiffs' claims and DWP's defenses, Federal District Court Judge Lawrence Kramer sent these questions back to the California courts for resolution.\(^77\) As the California Supreme Court decision in *National Audubon* explained:

> [T]he district court stayed its proceedings under the federal abstention doctrine to allow resolution by the California courts of [an] important issue[] of California law. . . . What is the interrelationship of the public trust doctrine and the California water rights system, in the context of the right of the Los Angeles Department of Water and Power ("Department") to divert water from Mono Lake pursuant to permits and licenses issues under the California water rights system? In other words, is the public trust doctrine in this context subsumed in the California water rights system, or does it function independently of that system? Stated differently, can the plaintiffs challenge the Department's permits and licenses by arguing that those permits and licenses are limited by the public trust doctrine, or must the plaintiffs challenge the permits and licenses by arguing that the water diversions and uses authorized thereunder are not "reasonable or beneficial" as required under the California water rights system?\(^78\)

In essence, Judge Kramer determined that since the public trust doctrine was a matter of California law, the California courts should first be provided with an opportunity to provide further clarification on the scope of the doctrine before the federal courts took up the issue. The U.S. Court of Claims adopted a similar approach in *Klamath Irrigation District v. United States.*\(^79\) In *Klamath Irrigation*, Judge Allegra concluded that federal courts need to take account of background principles of state water law in reviewing claims alleging a property interest in water, because otherwise the federal court result might be an

\(^73\) *Id.* at 716.  
\(^74\) *Id.*  
\(^75\) *Id.*  
\(^76\) *Id.* at 716–17.  
\(^77\) *Id.* at 717.  
\(^78\) *Id.*  
award of compensation “for the taking of interests that may well not exist under state law.”

In NAFTA Chapter 11 tribunals’ review of alleged private investments in domestic water resources, a level of restraint similar to that exercised by Judge Kramer in the National Audubon litigation and Judge Allegra in the Klamath Irrigation decision is warranted. To the extent the existence and scope of an alleged property interest in water is contingent on domestic water law, a NAFTA Chapter 11 tribunal considering this alleged interest needs to properly identify and reflect such domestic water law. To the extent the existence and scope of an alleged property interest in water is contingent on an international water treaty, such as the 1944 Waters Treaty or the 1909 Boundary Waters Treaty, a NAFTA Chapter 11 tribunal considering this alleged interest needs to properly identify and reflect the treaty.

In short, there are sound reasons for NAFTA Chapter 11 tribunals to abstain from taking upon themselves the task of interpreting water law questions more appropriately answered by domestic courts or by dispute resolution bodies (such as the IBWC) established under international water treaties. To do otherwise will only evidence the potential of NAFTA’s foreign investor regime to reach into areas of domestic and international natural resource law that are outside its competency.

80. Id. at 538.