COURT FILE NO.: 07-CV-340139-PD2
DATE: 20080505

ONTARIO

SUPERIOR COURT OF JUSTICE

2008 CanLII 22120 (ON SC)

B E T W E E N:	)	
	)	
Bayview Irrigation District #11, Brownsville Irrigation District, Cameron County Irrigation District #2, Cameron County Irrigation District #6, Delta Lake Irrigation District, Donna Irrigation District Hidalgo County #1, Engleman Irrigation District, Hidalgo County Irrigation District #1, Hidalgo County District Irrigation #2, Hidalgo County Irrigation District #5, Hidalgo County Irrigation District #6, Hidalgo County Irrigation District #16, Hidalgo & Cameron County Irrigation District #9, La Feria Irrigation District Cameron County #3, Santa Maria Irrigation District Cameron County #4, United Irrigation District, Valley Acres Irrigation District, Arthur E. Beckwith, W.G. Bell Jr. Trust, Luther Bradford, Capote Farms, Ltd., Estate of E. F. Davis, Jr. Richard Drawe, Electric Gin Company of San Benito, Odus D. Emery, Jr., Willard Fike, Fike Farms, Fuller Farms , Krenmueller Farms, Moore & Sons Farms Inc., North Alamo Water Supply Corporation, Donald Phillipp, Francis Phillipp, Pine Tree Conservation Society, Juan F. Ruiz, James D. Russell, Sam Sparks L.P., Gregory Schreiber, Rita Schreiber, Charles Shofner, Theimer Trust, Julie G. Uhlhorn Applicants	)	*John Terry and Ian Laird,* for the Applicant
- and -	)	
	)	
The United Mexican States Respondent	)	*Patrick G. Foy, Q.C. and J.C. Thomas, Q.C.,* for the Respondent
	)	
	)	**HEARD:** March 25, 2008
	)	

Allen J.

REASONS FOR JUDGMENT

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BACKGROUND

[1] Seventeen Texas irrigation districts, 24 individual water users, and a corporate investor ("the Applicants")[1] bring this Application under Article 34 of the *UNCITRAL Model Law on International Commercial Arbitration* (the "Model Law"), attached to the *International Commercial Arbitration Act*, R.S.O 1998, c. I.9 as amended, for judicial review of an Award made by a tribunal constituted under Chapter 11 of the North American Treaty Agreement ("NAFTA"). The Respondent, The United Mexican States ("Mexico") oppose the Application.

[2] NAFTA was finalized among the governments of Canada, Mexico and the United States of America and came into force on January 1, 1994. Under Chapter 11, the United States, Canada and Mexico have an arbitral remedy if an investor makes an investment in another NAFTA state and suffers damages as a result of measures undertaken by that state. The Applicants applied for arbitration under Chapter 11.

[3] The procedural rules that govern arbitration are set under the Additional Facility Rules of the International Centre for Settlement of Investment Disputes ("the ICSID Additional Facility Rules"). ICSID Additional Facility Rules, Article 20 provides the arbitral panel shall select the location for the arbitration proceedings in consultation with the parties. Articles 9 and 10 set the procedure for the selection of the arbitral panel. The Applicants selected The Honourable Edwin Meese III (an American national) and Mexico selected Mr. Ignacio Gómez-Palacio (a Mexican national). Both Parties agreed on the appointment of Professor Vaughan Lowe (a British national) as President of the arbitral tribunal ("the Tribunal"). The Tribunal was constituted to sit in Toronto, Ontario.

[4] The Applicants claim ownership in 1,291,521 acre-feet of water allocated to the United States under a treaty signed in 1944 between the United States of America and Mexico ("the 1944 Treaty")[2]. The provisions of the 1944 Treaty regulate the joint management by the U.S. and Mexico and regulate the allocation between the U.S. and Mexico of the waters of the lower Rio Grande River (referred to in Mexico as the Rio Bravo) and six of its tributaries. The water rights allocated to the U.S. were transferred to the State of Texas and subsequently granted by the State of Texas to the Applicants. Some of the Applicants own irrigation, pump and canal facilities in Texas. The Applicants own no such facilities in Mexico.

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[1] A party or parties, the Texas farmers and irrigation districts in this case, that make a claim pursuant to the arbitration provisions under Chapter 11 of NAFTA, are designated as "Claimants". For simplicity, in view of the Application before this Court, I refer throughout my decision to the "Claimants" as "Applicants".

[2] *Treaty Between the United States of America and Mexico Respecting Utilization of Waters of the Colorado and Tijuana Rivers and the Rio Grande*, February 3, 1944, U.S.-Mex., 59 Stat. 1219 (effective November 8, 1945).

[5] An international reservoir that straddles the U.S./Mexico border was constructed jointly through funding from the two countries and jointly operated by both countries through an international organization, the International Boundary Water Commission ("the IBWC") which measures, tracks and releases water as requested by those with water rights in the two countries. The Applicants dispute the manner in which, for the period 199 – 2002, Mexico treated the allocation of water between the farmers and irrigation districts in Texas and Mexico.

[6] The Applicants bring the Application before this Court under Rule 14.05 of the Ontario *Rules of Civil Procedure*, R.R.O. 1990, Reg. 94 as amended to set aside the jurisdictional decision made by the Tribunal on June 19, 2007. Articles 18 and 34 of the Model Law set out the grounds on which a court can set aside an arbitral decision by an international commercial tribunal.

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GOVERNING LAW

NAFTA, Chapter 11

[7] The threshold provision under NAFTA relevant to this Application is Article 1101(1)(b) under Chapter 11, Part Five, "Investment, Services and Related Matters", Section A, "Investment". Article 1101 provides in its relevant part:

Article 1101

1. This Chapter applies to measures adopted or maintained by a Party relating to:

    a. investors of another party

    b. investments of investors of another Party in the territory of the Party;

…

Article 1116

[8] Article 1116, entitled "Claim by an Investor on its Own Behalf" establishes the grounds on which an application for arbitration may be brought and provides a party may apply if another party has breached an obligation under Section A and the aggrieved party has incurred a loss or damage as a result of that breach.

Article 1139

[9] Article 1139 under Part A, Section C contains definitions including a definition for "investment". That term is defined, in the part relevant to this Application as:

"investment" means

…

1(g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purpose

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The Model Law

[10] The following provisions of the Model Law govern the procedure before the Tribunal and the recourse parties have against the Tribunal's decision. Cited below are the pertinent parts of the Articles relevant to this Application:

> **Article 18**
>
> The parties shall be treated with equality and each party shall be given a full opportunity of presenting his case.
>
> **Article 19**
>
> (1) Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings.
>
> (2) Failing such agreement, the arbitral tribunal may, subject to the provisions of this Law, conduct the arbitration in such manner as it considers appropriate. The power conferred upon the arbitral tribunal includes the power to determine the admissibility, relevance and weight of any evidence.
>
> **Article 34**
>
> (1) Recourse to a court against an arbitral award may be made only by an application for setting aside in accordance with paragraphs (2) and (3) of this article.
>
> (2) An arbitral award may be set aside by the court specified in article 6 if:
>
> (a) The party to the arbitration furnishes proof that:
>
> …
>
> (ii) the party making the application was not given proper notice of the appointment of an arbitrator of the arbitral proceedings or was otherwise unable to present his case, or
>
> (iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside, or

…

(b) the court finds that

(i) the subject- matter of the dispute is not capable of settlement by arbitration under the law of this State, or

(ii) the award is in conflict with the public policy of this State

STANDARD OF REVIEW

[11] Article 5 of the Model Law sets the basis for the intervention of the court:

Article 5

5. In matters governed by this Law, no court shall intervene except where so provided in this Law.

Article 34 sets out the grounds upon which a court can set aside an arbitration award. The court's role in reviewing an award is restricted to those grounds. Article 34(2)(a) establishes a claimant has the onus to prove one or more of the grounds under Article 34 is present. The Court is not permitted to engage in a hearing *de novo* on the merits of the Tribunal's decision or to undertake a review such as that conducted by a court in relation to a decision of a domestic tribunal. A high degree of deference is accorded on review by a court. [*United Mexican States v. Marvin Feldman Karpa* (2005), 74 O.R. (3d) 180 at para. 41 ("*Karpa*")]. Authorities have construed the court's authority to refuse enforcement narrowly. Lax, J. of this Court considered the authority of a domestic court in reviewing the award of a tribunal established under the Model Law. Lax, J. held at p. 191, citing excerpts from the Alberta and British Columbia Courts of Appeal:

> The purpose of the United Nations Conventions and the legislation adopting them is to ensure that the method of resolving disputes in the forum and according to the rules chosen by the parties is respected. Canadian Courts have recognized that predictability in the enforcement of dispute resolution provisions is an indispensable precondition to any international business transaction and facilitates and encourages the pursuit of freer trade on an international scale. [Re *Corporacion Transnacional de Inversiones, S.A. de C.V. et al. and STET International, S.p.A. et al* (1999), (2000), 45 O.R. (3d) 183 (Ont. S.C.J.); aff'd by the Court of Appeal (2000), 49 O.R. (3d) 414 (C.A.); leave to appeal to the Supreme Court refused, S.C.C.A. [2000] No. 581. ("*Corporacion Transnacional*"), citing *Kaverit Steel & Crane Ltd. v. Kane Corp.* (1992), 87 D.L.R. (4th) 129 at p. 139, 85 Alta L.R. (2d) 287 (C. A.)].

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[12] The British Columbia Court of Appeal, following an examination of court decisions on the standard of review of international commercial arbitral awards, refused to set aside an arbitral award and said the following on the standard of review:

> The reasons advanced in the cases discussed above for restraint in the exercise of judicial review are highly persuasive. The "concerns of international comity, respect for the capacities of foreign and transnational tribunals and sensitivity to the need of the international commercial system for the predictability in the resolution of disputes" spoken of by Blackmun, J.[3] are as compelling in this jurisdiction as they are in the United States or elsewhere. It is meet, therefore, as a matter of policy, to adopt a standard which seeks to preserve the autonomy of the forum selected by the parties and to minimize judicial intervention when reviewing international commercial arbitral awards in British Columbia.

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[13] The standard of review of a domestic court of a decision of an international commercial arbitral award is high. In the interest of comity among nations, predictability in decisions and respect for autonomy of the parties' chosen panel, it is only in exceptional circumstances that an arbitral decision will be set aside. The grounds for refusing enforcement of an arbitral award under Article 5 are to be construed narrowly such that the award is not rendered invalid even where the tribunal wrongly decided a point of fact or law. [*Corporacion Transnacional*, *supra*, p. 192].

[14] While there is great deference shown to arbitral tribunals, the Tribunal has the obligation, pursuant to Articles 18 and 34 of the Model Law, to ensure equal treatment of the parties, that minimum procedural standards are observed and that their decision does not offend public policy. Academic commentators have addressed the issue of due process and the minimum procedural standards that should be fulfilled by an arbitral tribunal. If an arbitral tribunal falls short of those standards a court can set its decision aside. Redfern and Hunter made the following comments:

> Certain minimum procedural standards must be observed if international commercial arbitrations are to be conducted fairly and properly. These procedural standards are designed to ensure that the arbitral tribunal is properly constituted; that the arbitral procedure is in accordance with the agreement of the parties… and that the parties are given proper notice of proceedings, hearings and so forth. In short, the aim is to ensure that the parties are treated with equality and are given a fair hearing, with full and proper opportunity to present their respective cases.
>
> [Redfern and Hunter, *Law and Practice of International Commercial Arbitration*, 4th ed. (London: Sweet and Maxwell, 2004) p. 413].

[3] The British Columbia Court of Appeal refers to a United States Supreme Court decision by Blackmun, J., *Mitsubishi Motor v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614.

[15] C.L. Campbell, J. for this Court, interpreting the provisions of the Model Law in relation to an award by an arbitral panel, accepted the proposition advanced by the applicant that once a breach of principles of fundamental justice is established, the entire resulting decision is invalid. [*Xerox Canada v. M.P.S. Technologies*, unreported decision of C.L. Campbell, J., November 30, 2006, para. 110].

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THE ARBITRAL HEARING ON JURISDICTION

Mexico's Objection to Jurisdiction

[16] The Applicants launched a Request for Arbitration on January 19, 2005 ("the Request") under Chapter 11 of NAFTA. The claims asserted in the Applicants' Request can be summarized as follows:

a) that the Applicants are entitled to damages because Mexico violated their rights under Chapter 11 between 1992 and 2002 by capturing and diverting water, over which the Applicants have rights, to Mexican farmers and municipalities;

b) that the Applicants have sustained substantial damage; and

c) that Mexico violated NAFTA by denying the Applicants fair and equitable treatment in violation of the 1944 Treaty and Article 1110 by expropriating the Applicants' water without fair compensation, contrary to Articles 1102, 1195 and 1110 of NAFTA.

[17] The Applicants asks the Tribunal to determine whether Mexico's seizure of the Applicants' investments or its water rights which are located in Mexico, fall within the scope of Chapter 11 of NAFTA. Mexico refused to consent to the Tribunal hearing the Applicants' claims on the basis that the claims are beyond the scope of the Tribunal's jurisdiction to decide.

Arbitral Hearing Procedure

[18] The Tribunal derives its authority to rule on its jurisdiction from Article 45 of the ICSID Additional Facility Rules and Chapter 11 of NAFTA. The Tribunal suspended the hearing of the merits of the Request pending a preliminary determination on the jurisdictional question. The jurisdictional hearing took place on November 14 and 15, 2006.

[19] At the Tribunal's First Session on procedure on February 14, 2006, the Tribunal requested:

> The Parties will present their cases concerning the competence of the Tribunal in their entirety with the written claim and written response, respectively, which must include all relevant documentary evidence, testimony, and expert opinions. The Parties will submit these pleadings in the formats stipulated in paragraph 9.

[20] The Tribunal also advised that in addition to the requirements under Article 38 of the Additional Facility Rules, the Parties can agree to and the Tribunal can request the filing of post-hearing briefs.

[21] At the First Session, the Parties agreed that the ICSID Additional Facility Rules would govern the written procedure. In accordance with Article 38, the Parties agreed on a schedule to file pleadings. Mexico filed a Memorial on Jurisdiction ("the Memorial"), the Applicants, a Counter-Memorial on Jurisdiction ("the Counter-Memorial"). Mexico then filed a Reply on Jurisdiction ("the Reply") and the Applicants, a Rejoinder to the Reply ("the Rejoinder").

[22] The Tribunal also gave direction on the use and availability requirements for fact and expert witnesses. The Parties were directed to supplement their pleadings with written declarations or affidavits of their witnesses and experts as a substitute for direct examination and make the witnesses available for cross-examination and re-direct examination.

Mexico's Pleadings before the Arbitral Tribunal

[23] In its Memorial, Mexico asserts a number of jurisdictional deficiencies that in its view are not capable of being remedied:

a) that water rights do not constitute investments under NAFTA;

b) that the Applicants did not make a monetary investment in Mexico;

c) that the remedy for water rights holders arises under another statute;

d) that the claims were brought too late; and

e) that there are fatal deficiencies in some individual claims

The first three alleged deficiencies were the focus of the Parties' arguments and the arbitral Award.

[24] Mexico argues none of the Applicants have an investment in Mexico as required under Chapter 11 of NAFTA and as such the Applicants' claim is beyond the scope of the Tribunal. According to that view, the Applicants' claim is not in keeping with the object and purpose of NAFTA and the rules of customary international law. Territoriality is a central principle. None of the Parties to NAFTA can assume obligations or property rights in each other's territories and each Party has sovereignty over its own resources. If any right by a Party in another party's territory is to exist, that right must be established by the laws of the territory in which the right is

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sought. Chapter 11 only applies to investments by investors of one Party in the territory of another Party. U.S. investors would have to have an investment in Mexico for Chapter 11 to apply, and that is not the case with the Applicants.

[25] Mexico argues the Applicants' allegation that Mexico violated their water rights by breaching its obligations under the 1944 Treaty is outside the scope of NAFTA. Mexico submits any allegation of a violation of the 1944 Treaty can be brought by the U.S. or Mexico under the dispute resolution process provided under that Treaty. Neither the U.S nor Mexico has raised such a dispute. Mexico submits NAFTA has no jurisdiction to determine whether Mexico has breached its obligations under the 1944 Treaty.

[26] Mexico further submits even if the claim were within the Tribunal's jurisdiction, the right of action expired under the time limit set by Part B of Chapter 1. The actions forming the subject matter of the complaint all occurred over three years before the Request for Arbitration.

[27] Mexico pointed a number of procedural deficiencies in the individual claims consolidated into this proceeding such as the identity of the water users the irrigation districts purport to represent; evidence of the nationality of claimants who are natural persons; and evidence that the corporate claimants have authorized the firm retained by the Applicants as their representative in the proceeding.

[28] In their Reply, Mexico essentially repeated the position set out in their Memorial.

The Applicants' Pleadings Before the Arbitral Tribunal

[29] In their Counter-Memorial, the Applicants assert the following claims:

a) that the Applicants own the water allotted to them under the 1944 Treaty;

b) that although Mexico possessed no right to the water allotted to the Applicants under the 1944 Treaty, they diverted the Applicants' water for use in Mexico;

c) that the Applicants have suffered unredressed economic injuries as a result of Mexico's failure to provide water to the Applicants;

d) that their claim is not out of time; and

e) they have complied with mandatory procedural requirements.

[30] The Applicants argue the history of their ownership of the Treaty waters dates back to 1969 when the waters allotted to the State of Texas in 1944 were transferred to the towns, irrigation districts and individual farmers by judicial decree in *State of Texas et al v. Hidalgo County Water Control & Improvement Dist. 18 et al*, 443 S.W. 2d 728 (Tex. Civ. App. 1969). The reservoirs built and jointly financed by U.S. and Mexican sources store and comingle water belonging to the Applicants and Mexico. The IBWC maintains records of the water owned by each party, and authorizes the withdrawal of water from

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the reservoir. The Applicants argue their part of the water stored in those reservoirs, together with their water conveyance and distribution facilities, irrigation works, farms, equipment and irrigation farming businesses, all constitute an integrated investment.

[31] The Applicants point to the fact that under the 1944 Treaty, the U.S. was allotted one-third of the water flow from the six Mexican tributaries, not to be less than an average amount of 350,000 acre-feet annually during a cycle of five years. The Applicants' claim is based on their allegation that during the five year cycles 1992 – 1997 and 1997 – 2002, Mexico wrongfully diverted Treaty waters the Applicants owned, in violation of the 1944 Treaty.

[32] The Applicants claim 1,212,521 acre-feet of irrigation water have been wrongfully withheld by Mexico and diverted from the Lower Rio Grande Valley region in Texas. Due to Mexico's failure to supply the Applicants' water to that region in Texas, Texas has suffered irrigation water shortages since the mid-1990s. The Applicants estimate that due to decreased irrigation in the area as a result of Mexico's actions, there has been $1 billion in lost business and 30,000 lost jobs.

[33] In their Rejoinder, the Applicants argued Mexico has the burden to prove the Tribunal lacks jurisdiction. The Tribunal must assume the facts alleged by the Applicants are true in interpreting Article 1101(1) and must determine whether the Applicants' claim falls within the scope of Chapter 11. The Applicant further submitted Mexico in its pleadings raised irrelevant issues that went to the merits of the case and that the Tribunal should not at the preliminary jurisdictional stage consider Mexico's argument on the merits. The Applicants expressed the view that at the preliminary stage the sole question before the Tribunal is whether, accepting the Applicants' allegations against Mexico as true, Mexico's activities in capturing and diverting the Applicants' water fall within the scope of Chapter 11.

[34] Further in their Rejoinder, the Applicants opposed Mexico's view that the claim falls under the dispute resolution provisions under the 1944 Treaty and not NAFTA. The Applicants contended the dispute resolution provisions under the 1944 Treaty apply to state-to-state disputes and not to the circumstances where both Parties are not states.

The Arbitral Award

[35] At the jurisdictional proceeding, the Tribunal adopted an approach contrary to the position the Applicants assert in their pleadings. To determine its competence, the Tribunal decided it was necessary to first determine whether the Applicants met the requirement of having an 'investment' as defined under Chapter 11 of NAFTA. The Tribunal dealt with the question of where an 'investment' must be situated in order to fall under the scope of Chapter 11.

> There is no doubt that the Claimants include persons who have invested in farms and irrigation facilities within the State of Texas. There is no doubt that the Claimants include persons who own or control directly or indirectly those farms and facilities in Texas. The initial question is whether those farms and facilities in Texas qualify not simply as an

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> 'investment' in general terms but as an 'investment' which entitles the owner to initiate under NAFTA the specific claims against Mexico in this case. We come thus to the question whether there is indeed, for the specific purposes of a claim under NAFTA Chapter 11, an 'investment' in this case. [Tribunal Award, para. 91]

[36] In deciding the initial question, the Tribunal relied on the decision of another arbitral panel constituted under NAFTA that was faced with a similar jurisdictional question:

> Adopting the terminology of the Methanex v. United States Tribunal*, it is necessary that the measures of which the complaint is made should affect an investment that has a "legally significant connection" with the State creating and applying those measures. The simple fact that an enterprise in one NAFTA State is affected by measures taken in another NAFTA State is not sufficient to establish the right of that enterprise to protection under NAFTA Chapter 11: it is the relationship, the legally significant connection, with the State taking those measures that establishes the right to protection, not the bare fact that the enterprise is affected by those measures [**United States v. Methanex*, First Partial Award, 7 August 2002, para. 147] [Tribunal Award, para.101].

[37] Article 1101(1)(b) of Chapter 11 provides that provision applies to "investments of investors of another Party in the territory of the Party". The Tribunal acknowledged that the above interpretation of Article 1101(1)(b) had ultimately been adopted by the Parties and it concluded the Applicants' farms and facilities in Texas constitute domestic investments in Texas. [Tribunal Award, paras. 104 and 105].

[38] The Tribunal then went on to address the more contentious position of the Applicants – their assertion they have an investment in Mexico in the form of their rights to water located in Mexico. The Tribunal was willing to go as far as to find the water rights constitute "property" as the term is used in the definition of "investment" in Article 1139 (g) of Chapter 11, and that water rights acquired for agricultural purposes are "acquired in the expectation or used for the purpose of economic benefit". However, the Tribunal refused to accept the Applicants' contention they own water in Mexico "in the sense of ownership of personal property rights in the physical water of rivers flowing in Mexican territory." [Tribunal Award, para. 114]. The Tribunal expressed conceptual difficulty with the notion there could be ownership in water in Mexico under an arrangement where water is apportioned between the Party States and measured over a period of time as it flows through tributaries to the Rio Grande in Mexico. The Tribunal held:

> There is an evident and inescapable conceptual difficulty in positing the existence of property rights in water up-river in Mexico in a context where the entitlement of each Claimant depends upon the apportionment of a certain volume of water, measured over a five-year period (or possibly longer, if the possibility of repayment of water debts in subsequent cycles

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> is taken into account), which can be determined only by reference to the volume of water that actually reached the main channel of the Rio Bravo/Rio Grande River.
>
> One owns a bottle of water, as one owns a can of paint. If another person takes it without permission, that is theft of one's property. But a holder of a right granted by the State of Texas to take a certain amount of water from the Rio Bravo/Rio Grande does not 'own', does not 'possess property rights in', a particular volume of water as it descends through Mexican streams and rivers through the Rio Bravo/Rio Grande and finds its way into the rights-holders' irrigation pipes [Tribunal Award, paras. 115 and 116].

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[39] The Tribunal also rejected the Applicants' argument that by the 1944 Treaty, Mexico relinquished title to one-third of the water in the six rivers, that Mexico owns one-third of the water and the U.S. two-thirds. The Tribunal saw this as a problematic proposition because due to the nature of the sharing formula, it could not be determined at any given time who owned what water and found that any diversion would not be a breach of the 1944 Treaty. The Tribunal reasoned that the 1944 Treaty is an agreement to apportion water as it arrives in the international river that runs between the two States and was not intended to create property rights amounting to investments.

[40] The Tribunal concluded the Applicants failed to establish they had an investment in Mexico and for that reason the Tribunal lacked jurisdiction over all of the Applicants' claims.

PARTIES' ARGUMENTS ON REVIEW OF THE TRIBUNAL AWARD

The Applicant

[41] The Applicants argue the Tribunal's Award should be set aside on the basis it did not adhere to fundamental legal principles in arriving at its decision. They argue:

a) that contrary to settled arbitral practice on jurisdictional motions, Mexico challenged the facts alleged in Request;

b) that the Tribunal made a finding of fact that the Applicants did not own water in Mexico challenging facts alleged in the Request contrary to settled arbitral practice; and

c) that the Tribunal arrived at determinations of facts without the benefit of a complete evidentiary record.

Factual Allegations and Factual Findings Contrary to Those Alleged in the Request

[42] The Applicants argue their position is supported by a decision of the International Court of Justice ("the I.C.J.") which adopted the principle they advance before this Tribunal. The I.C.J held the claims of the Claimant are to be accepted *pro tem* for jurisdictional purposes. [*Case*

Concerning Oil Platforms (*Islamic Republic of Iran v. United States of America*), I.C.J. Reports 1996, II, p. 856, para. 32]. The Applicants cite decisions of other NAFTA arbitral tribunals, *Methanex, supra*, and *UPS v. Canada*, which have held the appropriate test is to assume the facts alleged in the claim are correct. [*Methanex, supra*, at para. 112 and *UPS Canada, Decision on Jurisdiction*, November 22, 2002]. The tribunal in *Methanex* held:

> …the correct approach is to assume that Methanex's factual contentions are correct (insofar as they are not incredible, frivolous or vexatious) and to apply, under whatever test, the relevant principles to those assumed facts.

[43] It is the Applicants' view that, based on the settled practice, it was inappropriate at the jurisdictional stage for Mexico to challenge the facts alleged in the Request. Mexico made the factual allegation that the Applicants did not own water rights in Mexico. The Applicants referred to transcripts of the jurisdictional proceeding where Mexico indicated early on it did not take issue with that principle. The Applicants say subsequently Mexico advanced arguments in opposition to the Applicants' allegation they owned property rights in water in Mexico. That factual allegation by Mexico was unsubstantiated by evidence, and in the Applicants' view, largely inaccurate. The Applicants asserted the position that any consideration of the merits at the jurisdictional stage, except to determine whether the claims are colourable, would be inappropriate. [Transcript, Day 1, p. 124]. The Applicants stated the sole issue before the Tribunal at the jurisdictional stage was: "Did the Respondent's seizure of the Claimants' investments in their water rights, which are located within Mexico, fall under the ambit of Chapter 11 of NAFTA?" [Transcript Day 1, p. 130].

[44] The Applicants submit the Tribunal strayed in its decision from the settled practice and deferred to Mexico's factual allegations contrary to the allegations in the Applicants' claim. The Applicants take issue with the Tribunal arriving at findings in the following areas:

a) the finding the Applicants did not have an investment in the territory of Mexico because it did not own water in Mexico in the sense of ownership of personal property in the physical water of rivers flowing in the Mexican territory, ownership being a fact to be proved like other facts. [Tribunal Award, paras. 112 -115].

b) the finding that under the Mexican Constitution and Mexican law, the Applicants could have no property rights in water, which pertains to municipal law, a fact to be proved like any other fact. [Tribunal Award, para.118].

c) various findings regarding the operation and effect of the 1944 Treaty in respect of the apportionment and flow of waters from the Rio Grande River between Mexico and the U.S., and the effect of the 1944 Treaty on water rights, which findings were not supported by evidence filed by either party. [Tribunal Award, paras. 119 – 121].

[45] The Tribunal, in the Applicants' opinion, ought to have deferred the finding of those facts to the merits stage as the tribunal did in *UPS* where it deferred certain factual considerations to the merits stage in circumstances where the jurisdictional question pertained to where certain investments were located. [*UPS, supra*, p. 118-122]. The Applicants cite the ICSID Additional

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Facility Rules, Article 45(3) which provides an objection to the tribunal's jurisdiction may be dealt with as a preliminary question or be joined to the merits of the dispute.

Factual Findings Without a Complete Evidentiary Record

[46] The Applicants reason that the Tribunal at the jurisdictional stage is not equipped to decide the merits because a complete factual record is not before a tribunal if the facts pleaded by a claimant are assumed to be true.

[47] The Applicants submit they made their position on the deficiency of the evidentiary record clear early in the proceedings. The Applicants say the Parties arrived at an agreement on procedure before the Tribunal, resulting in an expectation that the question of whether water rights constituted an investment would be decided at the merits proceeding. The Applicants argue the Tribunal acted in non-compliance with the Model Law, Article 18 and Article 34(2)(a)(ii) which require parties to be given fair opportunity to present their case. The Tribunal at no time, in the Applicants' view, made known during the proceeding its intention to take evidence on disputed facts or to make findings of fact. The Applicants say they were not alerted by the Tribunal that the rules would change. That approach constitutes, in their view, a breach of Article 34(2)(a)(iii) which provides an Award can be set aside if the Award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or provides decisions on matters beyond the scope of the submission to arbitration.

[48] The Applicants identified areas where the evidentiary record was deficient to support the factual findings made by the Tribunal:

a) the Parties presented only arguments and few exhibits;

b) neither Party filed expert opinions on Mexican or Texan law or on any other fact relevant to the question of whether the Applicants owned water rights;

c) neither Party filed affidavits or an official record of the IBWC, or of any engineers or other professionals charged with the implementation or regulation of the 1944 Treaty

[49] The Applicants argue if they had been given fair opportunity to present their case on the disputed facts they would have filed a considerable quantity of evidence. The Applicant detailed numerous types of expert evidence it would have filed, including evidence on: various aspects of water manage, allotment and storage systems; transfers of water ownership and loans of water between the U.S. and Mexico; the flow of water through reservoirs; the diversion of waters by Mexico; the generation of electricity for Mexico by water owned by the U.S.; establishing the Applicants own most of the water credited to them by the IBWC and located in Mexico; and on the active trade and sale of water located in Mexico and owned by the Applicants.

[50] The Applicants also rely on the public policy ground in Article 34(2)(b)(ii) of the Model Law to have the Tribunal's Award set aside. Although that area of their argument was not developed, the Applicants appear to be saying the conduct of the Tribunal proceedings and the

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resulting Award manifest such a breach of the principles of fundamental justice as to engage Article 34(2)(b)(ii).

[51] In sum, the Applicants' position is the change in the agreed upon rules of procedure, the Tribunal's consideration of and findings on disputed facts contrary to settled arbitral practice, its decision based on an incomplete record, and its denial of a fair opportunity for the Applicants to present the evidence to support its position on ownership of water rights in Mexico constitute incurable breaches of fundamental justice which invalidate the Tribunal's Award.

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Mexico

No Breach of Fundamental Justice

[52] Mexico's position is that this is not one of those rare and exceptional cases where a domestic court should set aside the decision of an international arbitral tribunal. Mexico asks this Court to apply the principles enunciated in such decisions as *Karpa*, *supra*, and *Corporacion Transnacional*, *supra*, and extend deference to the Tribunal's decision. The thrust of provisions and rules enacted under NAFTA require consent and agreement among the Parties. Mexico argues both Parties were fully engaged in the preliminary meetings and negotiations to set an agreed agenda for the procedure before the Tribunal. They agreed on the members of the arbitral panel. Mexico argues this Court should adopt the standard employed by other courts and recognize the autonomy of the forum the Parties chose to determine their dispute. Mexico disputes the Applicants' contention there has been a breach of the principles of fundamental justice and contends there is no reason for judicial intervention.

[53] Mexico challenges the Applicants' position that the Tribunal acted contrary to Articles 18 and Article 34(2)(a)(ii). Mexico cited excerpts from the Minutes of the First Session of the Tribunal and excerpts from the Transcripts of the oral arbitration proceeding to show the Applicants were fully aware of Mexico's argument on jurisdiction, knew the case they had to meet, and had a full and fair opportunity to present their case. Mexico made the following points:

a) the order by the arbitral Panel at the First Session of the Tribunal that the Parties present their "entire cases" on the jurisdictional question with a written claim and response which were "to include all relevant documentary evidence, testimony, and expert opinions. [Minutes of First Session, February 14, 2006, para. 16];

b) that after the first round of pleadings, the Tribunal ordered a second round with exchange of further written material and the Applicants were allowed time to file a Rejoinder in response to Mexico's Reply. [Tribunal Transcript, February 14, 2006, p. 53-54];

c) that at the First Session, the Tribunal gave detailed directions on the exchange and presentation of documentary evidence, the presentation of fact and expert witnesses and set a schedule for written and oral hearings. [Minutes of First Session, February 14, 2006, paras, 18 and 19];

d) that the Applicants made argument and submitted exhibits in support of their position that the Tribunal had jurisdiction over their claim, evidence on: the history and the text of the 1944 Treaty; the history of the construction of the reservoirs by the U.S. and Mexico; the Hidalgo adjudication; the operation of the IBWC and commentary regarding the interpretation of the 1944 Treaty. [Applicants' Counter-Memorial, paras. 8-14 and 56-82]; and

e) regarding the Applicants' objection to the Tribunal's findings on the effect of the 1944 Treaty on water rights, the Applicants stated during the proceeding they did not claim a violation of the 1944 Treaty. [Tribunal Transcript, February 14, 2006, p. 30].

No Violation of Settled Arbitral Practice

[54] Mexico spoke to the practice advanced by the Applicants that the facts alleged in the claim should be presumed to be true. Mexico argues that its position as stated in its written submissions and at the oral hearing was that it did not dispute the underlying facts but did dispute the legal characterization of the facts, whether ownership rights in water in Texas give rise to an investment in Mexico. Mexico pointed out while it accepted *Methanex* could be relied upon for the narrow proposition that the facts be presumed to be correct, it maintained at the hearing that the question of ownership in water in Mexico is a question of law. Mexico submitted that the Parties diverged on that point and stated at the hearing:

> Where the Claimants go wrong is making the jump from alleged allegations of fact that they owned farms or ranches and associated infrastructure in Texas that rely on irrigation of water from the Rio Bravo [Rio Grande] to the conclusion that this amounts to an investment in water flowing in streams located wholly within Mexico. It is not an allegation of fact, but a conclusion of law, and a palpably incorrect conclusion of law, as my colleague will explain to you in the course of the morning's submissions [Tribunal Transcript, November 14, 2006, p.17].

[55] Mexico pointed to references in the Transcripts where the Applicants conceded questions of law were before the Tribunal. The Applicant changed its position before the Tribunal from stating that ownership in property rights in Mexico is a question of fact to such ownership being a question of mixed fact and law [Tribunal Transcript, November 15, 2006, p. 19]. Further, the Applicants conceded interpreting the Treaty of 1944, being the legislation that gave rise to the alleged property rights, is a matter of international law and did not dispute the Tribunal's jurisdiction to interpret the 1944 Treaty. [Tribunal Transcript, November 14, 2006].

[56] Mexico's position is that the Tribunal was within its authority to decide the legal issues respecting ownership of water rights in Mexico and, as a matter of international law, to interpret the 1944 Treaty and in doing so the Tribunal did not stray from settled arbitral practice.

No Violation of Public Policy

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[57] Mexico asserts the bases on which to engage the public policy provision in Article 34(2)(b)(ii) are limited. Mexico cited authorities to support that view. Authorities looking at the grounds to set aside an arbitral award express the view that the "public policy" ground is directed at such egregious circumstances as those involving corruption, bribery or fraud in the arbitral process. In their 1985 discussions on the interpretation of provisions of the Model Law and NAFTA, the United Nations Commission on International Trade Law stated:

> It was understood that the term "public policy", which was used in the 1958 New York Convention and many other treaties, covered principles of fundamental law and justice in substantive and procedural respects. Thus, instances such as corruption, bribery or fraud and similar serious cases would constitute a ground for setting aside.
>
> [*Report of the United Nations Commission on International Trade Law,* on the Work of the Eighteenth Session (June 3 – 21, 1985), para. 297].

[58] Courts have held caution must be exercised when considering public policy reasons for setting aside an arbitral award. *Corporacion Transnacional* citing U.S. jurisprudence and the Ontario Court General Division in *Schreter v. Gasmac Inc*. (1992), 7 O.R. (3d) 608 (Gen. Div.) at p.623 held:

> Accordingly, to succeed on this ground the awards must fundamentally offend the most basic and explicit principles of justice and fairness in Ontario, or evidence intolerable ignorance or corruption on the part of the Arbitral Tribunal. The applicants must establish that the awards are contrary to the essential morality. [*Corporacion Transnacional*, at p. 183].

Mexico argues Article 34(2)(b)(ii) of the Model Law clearly does not contemplate the types of challenges the Applicants have advanced in respect of the Award and the proceedings before the Tribunal.

COURT'S ANALYSIS

[59] I have carefully considered the Parties' arguments and reviewed the materials filed and I am persuaded for the following reasons to accept Mexico's position.

[60] I first consider the standard of review. My role on judicial review is not to conduct a hearing *de novo* of the merits of the Tribunal's decision on jurisdiction. The standard of review is narrower in scope than that governing the review by a domestic court of the decision of a domestic administrative tribunal. The Supreme Court of Canada in a recent judgment held there are only two standards – correctness and reasonableness *simpliciter*. [*Dunsmuir v New Brunswick*, [2008] S.C.C. 9, at para. 34].

[61] I agree with Mexico this is not one of those extraordinary cases where a domestic court should intervene.

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[62] The spirit guiding the handling of disputes under Chapter 11 of NAFTA, as expressed through the provisions of the Model Law and the rules set by the ICSID Additional Facility, is based on open participation and agreement among the parties. Courts have been reluctant to interfere with a decision of an arbitral panel where the panel is chosen by the parties and the rules governing the process are arrived at through agreement. Court decisions speak of the vital need for predictability in the enforcement of dispute resolution provisions as a precondition for free trade and international business transactions. The requirement for restraint in the exercise of judicial review is founded on respect for the experience and expertise of international tribunals. [*Corporacion Transnacional*, at 101]. Article 8 of the ICSID Additional Facility Rules addresses the qualifications and expertise of arbitrators.

Article 8

> Arbitrators shall be persons of high moral character and recognized competence in the fields of law, commerce, industry, or finance, who may be relied upon to exercise independent judgment.

[63] While the decisions of international arbitral tribunals are not immune from challenge, any challenge advanced is confronted with the "powerful presumption" that the tribunal acted within its authority. An arbitral decision is not invalid because it wrongly decided a point of fact or law. [*Corporacion Transnacional*, at p. 192]. The grounds cited by the Applicants under Article 18 and Article 34(2)(a)(ii), 34(2)(a)(iii) and 34(2)(b)(ii) of the Model Law must therefore be construed narrowly and the Applicants must satisfy a high threshold to succeed in having the Award set aside.

[64] I start with consideration of the Applicants' least persuasive ground for review. The Applicants made a rather bare submission that the Tribunal acted in violation of public policy in violation of Article 34(2)(b)(ii) of the Model Law. I find it is apparent from the United Nations Commission on International Trade Law's interpretation of "public policy", and the court decisions that have considered that interpretation, that the Tribunal's conduct was not marked by corruption, bribery or fraud or contrary to the essential morality. Nor did the Applicants allege that to be the case.

[65] The Award cannot be set aside pursuant to Article 34(2)(b)(ii).

[66] I turn now to the Applicants' argument under Article 18 and Article 34(2)(a)(ii) and Article 34(2)(a)(iii) of the Model Law that the Tribunal changed the agreed on rules of procedure and did not allow the Applicants a fair opportunity to present their case.

[67] I conclude from a review of the record of the arbitral proceedings that there was no breach of the principles of fundamental justice in the conduct of the Tribunal. I find the Applicants were provided a full opportunity to know the case they had to meet and fair opportunity to present their case.

[68] The Minutes of the First Session of the Tribunal held on February 14, 2006 reveal the Applicants were fully engaged in discussions regarding the establishment of the arbitration

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process. The Tribunal made its expectation clear that the Parties should present their entire cases on jurisdiction. The Tribunal invited the Parties to file their written claim and response including all documentary and testimonial evidence and expert opinions. The Applicants were clearly in a position to know the substance of Mexico's challenge to the Tribunal's jurisdiction. Mexico set out its position in its Memorial and Reply. There were two rounds of written pleadings and the Applicants were allowed extra time to file a Rejoinder to Mexico's Reply.

[69] Both Mexico and the Applicants took up a further opportunity offered by the Tribunal at the First Session to file post-hearing briefs. Mexico filed a Post-Hearing Submission on Jurisdiction and the Applicants filed a Supplemental Memorial in Support of Jurisdiction.

[70] It is apparent from the Transcripts of the proceeding that during the two days of oral proceedings, the Applicants had an opportunity to and did argue their position on the Tribunal's jurisdiction. The Applicants also presented documentary evidence pertaining to the history and the text of the Treaty of 1944, commentary on its interpretation and evidence on the construction of reservoirs by the U.S. and Mexico.

[71] I see no indication on the record that the Applicants objected or asked for an adjournment to allow them to present further evidence. I have to assume the Applicants' counsel were skilled and had expertise in presenting cases before an international arbitral tribunal such that they would be fully capable of raising an objection to the process or asking for an adjournment in order to bring additional argument and evidence before the Award was released.

[72] I see no indication the Applicants requested the Tribunal to excercise its authority under Article 44 of the ICSID Additional Facility Rules to have the proceedings re-opened before the release of the Award on the grounds they required an opportunity to make further submissions and file further evidence in support of their position.

[73] If the Applicants feel in retrospect they did not file sufficient documentary evidence or affidavits and did not call fact and expert witnesses, I find this would not be the result of a lack of opportunity to do so.

[74] I find the Applicants were unable to establish a basis under Article 18 or Article 34(2)(a)(ii) of the Model Law to set aside the Tribunal's Award. I found no violations of the principles of fundamental justice and certainly not amounting to such a mishandling of the arbitration as to likely amount to some substantial miscarriage of justice. [*Corporacion Transnacional*, citing Mustill and Boyd, *The Law and Practice of Commercial Arbitration in England*, 2nd ed. (London: Butterworths, 1989) at p. 550].

[75] Regarding the claim the Tribunal acted contrary to the settled international arbitral practice of presuming the facts claimed are correct, both the Applicants and Mexico were given an opportunity to speak to that issue. Both Parties put their positions squarely before the Tribunal. The Applicants' position that their ownership of water rights in Mexico was a question of fact evolved to a view that the issue is of mixed fact and law. Mexico maintained the position the issue was a question of law. Both parties were in accord that the interpretation of the Treaty of 1944 is a matter of international law and properly before the Tribunal.

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[76] In the Award, the Tribunal considered the Applicants' position on that issue. The Tribunal decided its jurisdiction to hear the merits depended on a determination of whether the Applicants' claim met the threshold requirement under Chapter 11, Article 1101(1)(b) – whether the Applicants' alleged ownership in water rights in Mexico constituted "an investment". The tribunal in *Methanex*, *supra*, similarly grappled with the problem of having to decide its jurisdiction under Article 1101(1) before deciding the merits in circumstances where jurisdictional issues were intertwined with the merits. The tribunal in *Methanex* concluded:

> On the other hand, in order to establish its jurisdiction, a tribunal must be satisfied that Chapter 11 does apply and that a claim has been brought within its procedural provisions. This means it must interpret, definitively, Article 1101(1) and decide whether on the facts alleged by the claimant, Chapter 11 applies. [*Methanex*, *supra*, para. 121].

[77] The Tribunal employed the approach suggested above and arrived at the conclusion it lacked jurisdiction to hear the Applicants' claims. It held the Applicants' ownership of water rights in Mexico did not amount to an investment in Mexico. I defer to the Tribunal's expertise in deciding the substantive and procedural issues before it. I see no reason for the Court to intervene and set aside the Tribunal's decision.

[78] For all the above reasons, the Application is dismissed.

ORDER

[79] **THIS COURT ORDERS** the Application dismissed with costs.

COSTS

[80] If the parties do not settle the amount of costs, they shall provide brief written submissions with a Cost Outline within 30 days of this Judgment. The parties shall advise the Court promptly if they settle costs.

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Allen J.

DATE: May 5, 2008

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COURT FILE NO.: 07-CV-340139-PD2
DATE: 20080505

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ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

Bayview Irrigation District #11, Brownsville Irrigation District, Cameron County Irrigation District #2, Cameron County Irrigation District #6, Delta Lake Irrigation District, Donna Irrigation District Hidalgo County #1, Engleman Irrigation District, Hidalgo County Irrigation District #1, Hidalgo County District Irrigation #2, Hidalgo County Irrigation District #5, Hidalgo County Irrigation District #6, Hidalgo County Irrigation District #16, Hidalgo & Cameron County Irrigation District #9, La Feria Irrigation District Cameron County #3, Santa Maria Irrigation District Cameron County #4, United Irrigation District, Valley Acres Irrigation District, Arthur E. Beckwith, W.G. Bell Jr. Trust, Luther Bradford, Capote Farms, Ltd., Estate of E. F. Davis, Jr. Richard Drawe, Electric Gin Company of San Benito, Odus D. Emery, Jr., Willard Fike, Fike Farms, Fuller Farms , Krenmueller Farms, Moore & Sons Farms Inc., North Alamo Water Supply Corporation, Donald Phillipp, Francis Phillipp, Pine Tree Conservation Society, Juan F. Ruiz, James D. Russell, Sam Sparks L.P., Gregory Schreiber, Rita Schreiber, Charles Shofner, Theimer Trust, Julie G. Uhlhorn

Applicants

- and -

The United Mexican States

Respondent

REASONS FOR JUDGMENT

Allen J.

Released: May 5, 2008