IN THE ARBITRATION UNDER CHAPTER ELEVEN
OF THE NORTH AMERICAN FREE TRADE AGREEMENT
AND THE UNCITRAL ARBITRATION RULES
BETWEEN

METHANEX CORPORATION,

Claimant/Investor,

-and-

UNITED STATES OF AMERICA,

Respondent/Party.

AMENDED STATEMENT OF DEFENSE OF RESPONDENT UNITED STATES OF AMERICA

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In accordance with the Tribunal's order of June 2, 2003 and Articles 19 and 22 of the UNCITRAL Arbitration Rules, respondent United States of America respectfully submits this amended statement of defense to the claims of Methanex Corporation ("Methanex") under Chapter Eleven of the North American Free Trade Agreement (the "NAFTA").

PRELIMINARY STATEMENT

1. The claims asserted by Methanex in this arbitration have no basis in either law or fact.

2. *First*, the claims do not fall within the scope of the NAFTA's investment chapter. The measures at issue do not relate to Methanex or its investments in the United States, as required by NAFTA Article 1101(1). The measures ban the use of the additive

MTBE in California gasoline. Methanex does not produce or market MTBE. It produces methanol, an ingredient used to manufacture MTBE and many other products as well. As the Tribunal found in its First Partial Award, the connection between the ban of MTBE and Methanex is, on its face, not legally sufficient to bring this dispute within the jurisdiction of a tribunal established under the NAFTA's investment chapter.

3. Methanex's attempt to stretch the facts to fit within the investment chapter is not supported by the record. The evidence does not sustain Methanex's farfetched theory that the ban of MTBE was really intended to address methanol producers. Instead, it shows that the purpose of the ban was precisely what the measures said it was: to protect California's drinking water supplies from a contaminant that makes water taste like turpentine. Nor does the record support Methanex's contention that the science supporting the ban was so faulty that it could only be viewed as a pretext. To the contrary, the record shows that California decision-makers had before them the best available scientific information at the time of their decision – and had no reason to question the good faith of the scientists who provided that information. Moreover, time has shown only that the extent of MTBE contamination is even greater than initially predicted. Methanex's allegation that California acted for reasons other than those stated in the measures themselves would require the existence of a vast conspiracy among scores of scientists, legislators and regulators. The record admits no such thing.

4. Methanex's latest theory – that the measures relate to it because methanol and ethanol compete with each other in the market for oxygenates in California gasoline – has been invented from whole cloth. Methanol cannot legally be used as an oxygenate in the United States – a fact that Methanex has repeatedly disclosed to its own shareholders.

Methanol cannot practically be used as an oxygenate either, because it corrodes engine parts in ordinary automobiles. Methanol has never commercially been used as an oxygenate in gasoline, and has no apparent prospects of being so used. It in no sense competes with ethanol in the oxygenate market.

5. At the March 31, 2003 procedural hearing, Methanex urged the Tribunal to consider its contentions on "relating to" in light of all of the evidence of record. So considered, it is plain that Methanex's contentions lack any substance. The record establishes that the ban of MTBE does not "relate to" Methanex.

6. *Second*, for similar reasons, Methanex's claims necessarily fail to meet the test of proximate cause required by the NAFTA. Methanex's claimed loss is, at best, based on the effect of the MTBE ban on blenders and refiners of California gasoline, who will buy less MTBE from manufacturers of that gasoline additive, who will in turn buy less methanol from methanol producers and marketers like Methanex. Under well-established principles of international law, such an indirect causal chain is far too attenuated to give rise to an admissible claim. Methanex's claims fail, as a matter of law, for this reason alone.

7. The claims also fail as a matter of fact. Methanex has not proven any loss as a result of the ban. Indeed, according to Methanex's chief executive officer, the state of the current methanol market is such that the California MTBE ban is "unlikely to have any significant impact" on Methanex. To the contrary, he advised Methanex's investors that the ban will provide Methanex "welcome relief" in the form of "a bit of breathing room and opportunity to replenish our inventories."

8. Moreover, Methanex's Fortier, Louisiana plant never served the California

market. It was shuttered before the 1999 Executive Order for reasons that had nothing to do with the California ban. No evidence suggests any impact of the ban on Methanex US, a small marketing and trading unit that has apparently never been a profit center for Methanex. And Methanex itself has seen a steady, unmistakable *increase* in its fortunes since the announcement of the Executive Order in 1999. Methanex's overseas factories are now working at record levels and methanol prices are significantly higher than in past years. And indeed, even if Methanex could show an impact on its overseas plants (which it has not), such an impact would not be cognizable under the NAFTA's investment chapter, which is limited to treatment with respect to investments in the territory of the United States.

9. Whether considered individually or as a whole, each of the heads of loss claimed by Methanex fail for lack of proof or because international law does not admit recovery of indirect or speculative damages. Methanex has shown no loss proximately caused by the measures at issue.

10. *Third*, Methanex's claim that it has been denied national treatment is baseless. The record establishes that, at the time of the measures in question, there was (and is today) a large U.S. methanol industry, including U.S.-owned producers and marketers of that chemical in precisely the same circumstances as Methanex's investments. Indeed, Methanex does not dispute this fact. What Methanex seeks here is not treatment equivalent to its U.S. counterparts, but *better* treatment – for Methanex asks to be compared not to methanol producers and marketers, but to those of a product it does not manufacture and does not market – ethanol. This is not a national treatment claim.

11. Methanex's reliance on a national treatment provision of the General

Agreement on Trade and Tariffs – which addresses "like products," not investors and investments "in like circumstances" – is both legally and factually insupportable. The GATT is a different treaty, with a different object and purpose. Its jurisprudence on "like products" does not translate to the NAFTA investment chapter's national treatment provision. Methanex's analysis, moreover, fails on its own terms. Ethanol, methanol and MTBE are different products that would not fit the GATT's "like products" provision for purposes of these measures in any event.

12. *Fourth*, the latest iteration of Methanex's ever-changing claim under Article 1105(1) is no more meritorious than the previous ones.

13. To the extent that Methanex's claim of discrimination in violation of Article 1105(1) is based on a supposed breach of the national treatment provision, it fails for two reasons. First, as just noted, there is and can be no predicate national treatment breach here. Second, it fails because, as the NAFTA Free Trade Commission has made clear, Article 1105(1) does not provide any claim for breach of other articles of the NAFTA or any other international agreement.

14. To the extent that Methanex's claim is based on supposed principles of non-discrimination under customary international law, it also fails. First, the NAFTA's investment chapter addresses non-discrimination so comprehensively that Article 1105(1) cannot be construed to incorporate any general principle of non-discrimination. Second, Methanex has made no effort to demonstrate the existence of such a general principle under customary international law. In fact, while customary international law requires non-discrimination in certain discrete contexts, there is no principle that requires non-discrimination in the context alleged by Methanex – that of supposed differential

treatment of domestically-produced and foreign-produced goods. And, in any event, there has been no differential treatment here.

15. *Fifth*, Methanex makes no attempt to support its claim of expropriation. Its failure to do so is to be expected, for no such claim can be sustained on these facts. Despite the United States' repeated challenges to prior iterations of this claim on this ground – and the Tribunal's express recognition of the relevance of this ground to the merits phase of this case – Methanex has made no effort to identify what, precisely, the United States has supposedly taken from it. Nor has Methanex offered any evidence that suggests any taking of anything. Moreover, in general, measures such as the MTBE ban – adopted to protect public health by safeguarding drinking water supplies – by their nature are not expropriatory under recognized principles of customary international law.

16. In sum, Methanex's claims are without basis in law, without substance in fact and without support in the evidence before this Tribunal. They should be dismissed in their entirety, with prejudice and with a full award of costs to the United States.

17. In the pages that follow and as contemplated by Article 19(2) of the UNCITRAL Arbitration Rules, we address the facts of the case, the points of law in issue and the appropriate remedy. We include footnotes referencing the evidence and authorities we rely upon for each proposition stated in the text. For the convenience of the Tribunal, we restate in this pleading the objections to admissibility previously stated in the memorials of the jurisdictional phase, thus providing in a single document every argument the Tribunal need consider in this phase. We have, as appropriate, adapted those objections to the claims as stated in Methanex's fresh pleading and to the evidentiary materials offered by Methanex. This pleading represents the definitive

statement of the defenses of the United States, except to the extent it expressly incorporates by reference earlier arguments and authorities.

FACTS[1]

MTBE

18. MTBE is a hazardous chemical compound produced from methanol and isobutylene.[2] MTBE is used as a fuel additive for two reasons, both born of regulation.[3] First, it is a source of octane, which improves a fuel's resistance to uncontrolled combustion (engine knock).[4] Second, MTBE is an oxygenate: it increases the oxygen content of gasoline.[5]

19. MTBE's use as a source of octane in the United States resulted from federal environmental and public health regulations requiring a substantial reduction of the use of lead in gasoline.[6] MTBE has been used in the United States since the 1970s as an octane-enhancing replacement for lead, primarily in mid- and high-grade gasoline.[7]

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[1] The Joint Submission of Evidence is cited as "[volume number] JS tab [number] at [page number]."

[2] *See* Expert Report of Bruce Burke ("Burke Report") ¶¶ 23, 40 (13 JS tab B). *See generally* U.S. Environmental Protection Agency, *Advance Notice of Proposed Rulemaking under Section 6 of the Toxic Substances Control Act to Eliminate or Limit the Use of MTBE as a Fuel Additive in Gasoline* ("EPA ANPRM"), 65 Fed. Reg. 16094 (Mar. 24, 2000) (18 JS tab 146).

[3] *See Health & Environmental Assessment of MTBE: Report to the Governor and Legislature of the State of California as Sponsored by SB 521* ("UC Report"), Vol. V, *Cost and Performance Evaluation of Treatment Technologies for MTBE-Contaminated Water* at 2 (5 JS tab 40); *see also* 65 Fed. Reg. 16094, 16096-97 (Mar. 24, 2000) (18 JS tab 146 at 2716-17).

[4] *See* UC Report, Vol. V, *Cost and Performance Evaluation of Treatment Technologies for MTBE-Contaminated Water* at 2 (5 JS tab 40); *see also* 65 Fed. Reg. 16094, 16096 (Mar. 24, 2000) (18 JS tab 146 at 2716).

[5] *See* UC Report, Vol. I at 15 (4 JS tab 36); *see also* 65 Fed. Reg. 16094, 16096 (Mar. 24, 2000) (18 JS tab 146 at 2716); Witness Statement of James W. Caldwell ("Caldwell Statement") ¶¶ 28-29 (13 JS tab C).

[6] *See* UC Report, Vol. II at 2 (4 JS tab 37); *see also* 65 Fed. Reg. 16094, 16096 (Mar. 24, 2000) (18 JS tab 146 at 2716).

[7] *See* UC Report, Vol. I at 15 (4 JS tab 36); *see also* 65 Fed. Reg. 16094, 16096 (Mar. 24, 2000) (18 JS tab 146 at 2716).

20. MTBE's use as an oxygenate in the United States also resulted from federal environmental and public health standards.[8] In 1990, the United States enacted amendments to the federal Clean Air Act that required increased oxygen content in gasoline under two programs for certain areas of the United States, including California.[9] The programs require that oxygenates be added to gasoline as a means of reducing harmful emissions in automobile exhaust.[10]

21. Among other things, the federal programs conditionally require a minimum oxygen content in gasoline of between 2.0 and 2.7 percent by weight, depending on the season.[11] Two percent oxygen by weight is equivalent to approximately 11 percent MTBE by volume.[12]

22. The programs apply to a discrete number of metropolitan areas in the United States with the most severe ozone or carbon monoxide levels.[13] These metropolitan areas include Los Angeles, Sacramento and San Diego.[14] Certain other areas with high ozone levels can opt into one of the programs.[15]

23. Federal regulations do not mandate the use of any specific oxygenate. Of the thousands of oxygen-containing chemical compounds that satisfy the technical

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[8] *See generally* Caldwell Statement (reviewing EPA regulatory framework governing use of oxygenates) (13 JS tab C).

[9] *See* UC Report, Vol. II at 2 (4 JS tab 37); *see also* Caldwell Statement ¶¶ 11-14 (13 JS tab C).

[10] *See* UC Report, Vol. I at 15 (4 JS tab 36); *see also* Caldwell Statement ¶ 10 (13 JS tab C).

[11] UC Report, Vol. II at 2 (4 JS tab 37); *see also* Caldwell Statement ¶¶ 11-14 (13 JS tab C).

[12] UC Report, Vol. II at 2 (4 JS tab 37); *see also* Caldwell Statement ¶ 29 (13 JS tab C).

[13] UC Report, Vol. I at 15 (4 JS tab 36); *see also* Caldwell Statement ¶¶ 12, 14 (13 JS tab C).

[14] *See* Caldwell Statement n.5 and accompanying text (13 JS tab C). *See also* Witness Statement of Dean C. Simeroth ("Simeroth Statement") ¶ 12 (13A JS tab H) (greater Los Angeles is the only area of California that continues to be designated by U.S. EPA as not attaining the NAAQS for CO, and therefore the only area in California in which the wintertime oxygenate requirement continues to apply).

definition of "oxygenate,"[16] only those oxygenates that meet U.S. Environmental Protection Agency ("U.S. EPA" or "EPA") requirements for fuel additives can be used in gasoline.[17] First, to avoid contributing to vehicle emissions control system failures that could result in increased emissions of pollutants, since at least 1981 manufacturers have been required to demonstrate that any new fuel additive is "substantially similar" to a fuel additive that was used in vehicle certification.[18] Second, since 1994 all fuels or fuel additives that do not meet certain U.S. EPA specifications must undergo health-effects testing before they can be used commercially.[19]

24. Ethanol is the principal oxygenate used under the Winter Oxyfuel Program, with the exception of greater Los Angeles, whose refiners chose to use MTBE.[20] MTBE is the principal oxygenate used in the federal Year-Round Reformulated Gasoline Program (RFG Program).[21] Tertiary amyl methyl ether ("TAME") is also used, although infrequently, as an oxygenate.[22] Other oxygenates – including ethyl tertiary butyl ether (ETBE), diisopropyl ether (DIPE) and tertiary butyl alcohol (TBA) – are available, but have been used little, if at all.[23]

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[15] *See* Caldwell Statement ¶ 14 (13 JS tab C).

[16] *See* Burke Report ¶ 20 (13 JS tab B).

[17] *See* Caldwell Statement ¶ 28 (13 JS tab C).

[18] *See id.* ¶¶ 17-22 (13 JS tab C).

[19] *See id.* ¶¶ 23-26 (13 JS tab C).

[20] *See id* ¶ 13 (13 JS tab C); *see also* 65 Fed. Reg. 16094, 16097 (Mar. 24, 2000) (18 JS tab 146 at 2717).

[21] *See* Caldwell Statement ¶ 14 (13 JS tab C); *see also* 65 Fed. Reg. 16094, 16097 (Mar. 24, 2000) (18 JS tab 146 at 2717).

[22] *See* Burke Report ¶ 21 (13 JS tab B); *see also* 65 Fed. Reg. 16094, 16097 (Mar. 24, 2000) (18 JS tab 146 at 2717).

[23] *See* Burke Report ¶ 21 (13 JS tab B).

25. For years, California has regulated the content of gasoline sold in the state in order to combat air pollution – a particularly difficult problem for California because of its large population centers and its unique topographic and climatic conditions.[24] California's regulations are almost always more stringent than the federal regulations, which also apply in the state.[25]

26. Beginning in March 1996, California began to require the use of California Phase 2 Reformulated Gasoline ("CaRFG2"), which typically has an oxygen content of 1.8 to 2.2 percent.[26] Thus, beginning in 1996, MTBE constituted about 11 percent by volume of the California gasoline containing it.[27]

The California Market For MTBE

27. There are two categories of MTBE producers in the United States: gasoline refiners that produce and mix MTBE into gasoline at their refineries; and merchant MTBE producers that produce MTBE for sale to gasoline refiners.[28]

28. Merchant MTBE producers in the United States are, with one exception (in Wyoming), located on the United States Gulf Coast.[29] Most of the MTBE produced

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[24] *See* Simeroth Statement ¶ 6 (13A JS tab H).

[25] *See* U.S. International Trade Commission, *Methyl Tertiary-Butyl Ether (MTBE): Conditions Affecting the Domestic Industry* ("USITC MTBE Report") at 3-27, n.104 and accompanying text (Sept. 1999) (5 JS tab 42).

[26] CAL. CODE REGS. tit. 13, § 2262.5 (1997) (14 JS tab 10 at 89); *see also* UC Report, Vol. II at 2 (4 JS tab 37); Simeroth Statement ¶¶ 8-9 (13A JS tab H).

[27] *See* UC Report, Vol. II at 2 (4 JS tab 37); *see also* Caldwell Statement ¶ 29 (13 JS tab C).

[28] *See* Burke Report ¶ 30 (13 JS tab B).

[29] *See* Burke Report Exhibit 4 & n.12 (13 JS tab B). "Gulf Coast" for these purposes, refers essentially to the parts of Texas and Louisiana on the coast of the Gulf of Mexico, where much of the United States petrochemical industry is located.

or consumed in the United States is transported by ship to coastal facilities, with some moved inland by barge, rail or truck.[30]

29. The cost of transporting MTBE produced in the United States from one United States location to another is substantial.[31] For example, in 1998 the average total cost per ton of MTBE shipped from the Gulf of Mexico to the Atlantic coast of the United States was $9.73, compared with $21.92 for MTBE shipped from the Gulf of Mexico to the Pacific coast.[32] Depending on market conditions, it may be difficult for merchant MTBE producers located in the Gulf of Mexico competitively to ship their product to the Pacific coast.[33]

30. The California market for MTBE therefore was served principally by foreign MTBE producers and, to a lesser extent, by U.S.-based merchant MTBE producers and California refiners that purchase methanol and produce MTBE for their own use.[34] Historically, 85 percent of the MTBE used by California refiners was supplied by merchant MTBE producers in the United States and other countries.[35] The remaining 15 percent of MTBE was produced by certain California refiners at their refineries for their own use.[36]

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[30] *See id. See also* USITC MTBE Report at 3-20 (5 JS tab 42).

[31] *See* USITC MTBE Report at 3-20, 3-21 (5 JS tab 42).

[32] *See id.* at 3-21, tbl. 3-13 (5 JS tab 42).

[33] *See id.* at 3-20, 3-21 (5 JS tab 42).

[34] *See* Burke Report ¶ 38 (13 JS tab B); *see also* USITC MTBE Report at 3-21 (5 JS tab 42); California Air Resources Board ("CARB"), *An Overview of the Use of Oxygenates in Gasoline* (Sept. 1998) at 22 (2 JS tab 3).

[35] *See* California Energy Commission, *Quarterly Report Concerning MTBE Use In California Gasoline, January 1 through March 31, 2000* at 2 (May 2000) (14 JS tab 13 at 168).

[36] *See id. See also generally* California Energy Commission, Quarterly Reports Concerning MTBE Use In California Gasoline, *available at* http://www.energy.ca.gov/mtbe/documents/index.html; Burke Report Exh. 4 (U.S. MTBE Production Facilities) (13 JS tab B).

31. Demand for MTBE in California and elsewhere in the United States remained strong from 1999 through 2002.[37]

MTBE's Effects On Public Health And The Environment

32. Because of its unique chemical properties, MTBE contamination of groundwater presents a significant risk to drinking water supplies in California.[38]

33. Gasoline is one of the most ubiquitous toxic substances in the United States. Because of the vast number of places where it is stored and people who handle it on a daily basis, a significant number of gasoline spills and leaks into the environment are inevitable. Indeed, according to some estimates, the equivalent of a full supertanker of gasoline (about nine million gallons) is released into the environment in the United States every year from leaks and spills.[39]

34. Gasoline can be released into the environment wherever it is stored, transported, transferred or disposed. Specifically, sources of gasoline releases include underground storage tanks ("USTs"), above-ground storage tanks, pipelines, spills (*e.g.*, during fueling operations and from tank trucks, automobile accidents and consumer disposal) and storm water runoff.[40] In addition, certain types of watercraft, particularly

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[37] *See* Burke Report ¶¶ 37-38 (13 JS tab B).

[38] *See* UC Report, Vol. V, *Cost and Performance Evaluation of Treatment Technologies for MTBE Contaminated Water* at 3-4 (5 JS tab 40); Executive Order D-5-99 by the Governor of the State of California ("1999 EXECUTIVE ORDER") pmbl. (1 JS tab 1(c)); CARB Resolution 99-39 at 6 (Dec. 9, 1999) (16 JS tab 24 at 1215) ("Along with toxicological concerns, low levels of MTBE in drinking water can be tasted and smelled by susceptible individuals with the taste characterized as solvent-like, bitter, and objectionable; the people of California will not accept drinking water in which they can taste MTBE."). *See generally* Expert Report of Dr. Graham E. Fogg ("Fogg Report") (13 JS tab D); Expert Report of Dr. Anne M. Happel ("Happel Report") (13 JS tab E).

[39] *See* 65 Fed. Reg. 16094, 16098 (Mar. 24, 2000) (18 JS tab 146 at 2718).

[40] *See* UC Report, Vol. IV, *Impact of MTBE on California Groundwater* at 6 (4 JS tab 39); *see also* 65 Fed. Reg. 16094, 16100-02 (Mar. 24, 2000) (18 JS tab 146 at 2720-22).

watercraft with two-stroke engines, introduce gasoline into surface waters as part of their normal operation, without any accidental leaks or spills.[41]

35. Both the federal government and California have implemented a number of programs to minimize the potential for leaks and spills of gasoline; both enforce laws and regulations intended to prevent and clean up gasoline releases.[42] Despite the existence and implementation of these federal and state programs, a substantial number of releases of gasoline into the environment are inevitable because of the omnipresence of the fuel.[43]

36. Leaks and spills of conventional gasoline generally pose no widespread threat to drinking water supplies because the components of conventional gasoline biodegrade relatively quickly and are not highly soluble in water.[44] Many spills of conventional gasoline may effectively be left to undergo bioremediation, or natural attenuation.[45] In those cases where active intervention is required, conventional gasoline releases can often be cleaned up relatively quickly and inexpensively.[46]

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[41] *See* UC Report, Vol. I at 11-12 (4 JS tab 36); *see also* 65 Fed. Reg. 16094, 16100-02 (Mar. 24, 2000) (18 JS tab 146 at 2721-22).

[42] *See* UC Report, Vol. V, *Cost and Performance Evaluation of Treatment Technologies for MTBE Contaminated Water* at 2 (5 JS tab 40); *see also* 65 Fed. Reg. 16094, 16100 (Mar. 24, 2000) (18 JS tab 146 at 2720); Happel Report at 9-13 (13 JS tab E).

[43] *See* UC Report, Vol. V, *Cost and Performance Evaluation of Treatment Technologies for MTBE Contaminated Water* at 2 (5 JS tab 40); *see also* 65 Fed. Reg. 16094, 16100 (Mar. 24, 2000) (18 JS tab 146 at 2720); Happel Report at 1, 10-39 (13 JS tab E).

[44] *See* UC Report, Vol. I at 49 (4 JS tab 36); *see also* 65 Fed. Reg. 16094, 16100, 16102 (Mar. 24, 2000) (18 JS tab 146 at 2720, 2722).

[45] *See* UC Report, Vol. I at 49 (4 JS tab 36); *see also* 65 Fed. Reg. 16094, 16100, 16102 (Mar. 24, 2000) (18 JS tab 146 at 2720, 2722); *see also* Fogg Report ¶¶ 26, 55 (13 JS tab D) ("[N]atural attenuation is the term used to describe contaminant removal from the environment (typically the subsurface) through natural processes, without engineered intervention.").

[46] *See* UC Report Vol. I at 48-49 (4 JS tab 36); *see also* 65 Fed. Reg. 16094, 16102 (Mar. 24, 2000) (18 JS tab 146 at 2722).

37. Leaks and spills of gasoline containing MTBE, however, do pose a substantial threat to drinking water supplies.[47] MTBE is highly soluble in water.[48] MTBE is more soluble in water than other components in gasoline, including benzene, toluene, ethylbenzene and xylene (collectively referred to as "BTEX").[49] MTBE also travels through soil rapidly.[50] In groundwater, MTBE moves at nearly the same velocity as the groundwater and, therefore, often migrates further than BTEX.[51]

38. MTBE is also highly resistant to biodegradation. It biodegrades much more slowly than BTEX or ethanol, the second most common oxygenate in U.S. gasoline.[52]

39. MTBE has a foul, turpentine-like taste and odor.[53] Even at extremely low concentrations, MTBE can render water unpotable.[54] In controlled studies, MTBE's taste has been detected at concentrations as low as 2.0 parts per billion ("ppb"), and MTBE's

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[47] *See* UC Report, Vol. I at 37-38 (4 JS tab 36); *see also* UC Report, Vol. IV, *Impact of MTBE on California Groundwater* at 25 (4 JS tab 39); 65 Fed. Reg. 16094, 16102 (Mar. 24, 2000) (18 JS tab 146 at 2722); Fogg Report ¶¶ 14, 55-66, 100-09 (13 JS tab D).

[48] *See* UC Report, Vol. II at 4 (4 JS tab 37); *see also* Fogg Report ¶ 39 (13 JS tab D); 65 Fed. Reg. 16094, 16097 (Mar. 24, 2000) (18 JS tab 146 at 2722).

[49] *See* Fogg Report ¶ 42 (13 JS tab D).

[50] *See* UC Report, Vol. I at 37 (4 JS tab 36); *see also* Fogg Report ¶ 44 (13 JS tab D); 65 Fed. Reg. 16094, 16097 (Mar. 24, 2000) (18 JS tab 146 at 2717).

[51] *See* UC Report, Vol. V, *Cost and Performance Evaluation of Treatment Technologies for MTBE Contaminated Water* at 3-4 (5 JS tab 40); *see also* Fogg Report ¶¶ 39, 44 (13 JS tab D); Happel Report at 45 (13 JS tab E); 65 Fed. Reg. 16094, 16097 (Mar. 24, 2000) (18 JS tab 146 at 2717).

[52] *See* UC Report, Vol. I at 37, 52 (4 JS tab 36); *see also* Fogg Report ¶ 60 (13 JS tab D); Happel Report at 8, 63 (13 JS tab E); 65 Fed. Reg. 16094, 16097 (Mar. 24, 2000) (18 JS tab 146 at 2717).

[53] *See* UC Report, Vol. II at 177 (4 JS tab 37); *see also* 65 Fed. Reg. 16094, 16096, 16098 (Mar. 24, 2000) (18 JS tab 146 at 2716, 2718); Burke Report ¶ 39 (13 JS tab B). Furthermore, the U.S. EPA has classified MTBE, a toxic chemical that is a known animal carcinogen, as a possible human carcinogen on the basis of inhalation tests. *See* UC Report, Vol. II at xviii. (4 JS tab 37).

[54] *See* UC Report, Vol. II at 20 (4 JS tab 37); *see also* Fogg Report ¶ 40 (13 JS tab D); Happel Report at 42 (13 JS tab E); California Environmental Protection Agency, Air Resources Board, *Final Statement of Reasons, Secondary Maximum Contaminant Level for Methyl tert-Butyl Ether and Revisions to the*

odor has been detected at concentrations as low as 2.5 ppb.[55] California law requires public water systems to monitor their sources for MTBE, among other substances, to determine compliance with drinking water standards, also known as maximum contaminate levels.[56] California prohibits state public drinking water agencies from delivering drinking water with an MTBE concentration in excess of 5.0 ppb.[57]

40. MTBE's foul taste and smell is so potent that one tablespoon of the chemical can render 586,000 gallons (2,220,000 liters) of water undrinkable.[58] There is enough MTBE in the fuel tank of a single automobile to contaminate 230 million gallons (870 million liters) of water.[59]

41. Because of its chemical properties, when released into the environment, MTBE contaminates substantially more groundwater than other components of concern in gasoline, including BTEX.[60]

42. Even a small release of gasoline containing MTBE can have significant adverse effects. For example, a December 1997 car accident in Standish, Maine led to

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Unregulated Chemical Monitoring List, Title 22, California Code of Regulations ("Final Reasons for MTBE MCL") at 2-4 (1997) (14 JS tab 20 at 547-49).

[55] *See* UC Report, Vol. II at 21 (4 JS tab 37); *see also* Fogg Report ¶ 40 (13 JS tab D); 65 Fed. Reg. 16094, 16097 (Mar. 24, 2000) (18 JS tab 146 at 2717); Final Reasons for MTBE MCL at 4, 10 (14 JS tab 20 at 549, 555).

[56] *See* CAL. CODE REGS. tit. 22, § 64449 (2003) (14 JS tab 11 at 150); *see also* UC Report, Vol. II at 4 (4 JS tab 37).

[57] *See* UC Report, Vol. II at 21 (4 JS tab 37); *see also* CAL. CODE REGS. tit. 22, § 64449(a) (2003) (14 JS tab 11 at 150) ("The secondary MCLs . . . shall not be exceeded in the water supplied to the public, because these constituents may adversely affect the taste, odor or appearance of drinking water.").

[58] *See* Fogg Report ¶ 40 (13 JS tab D)

[59] *See id.*

[60] *See* UC Report, Vol. I at 48 (4 JS tab 36) (finding that MTBE plumes "are typically 50 to 100% more expensive to characterize than comparable plumes from conventional gasoline with no MTBE"); *see also* Fogg Report tbl. 2 & ¶ 117 (13 JS tab D); Happel Report at 45 (13 JS tab E); 65 Fed. Reg. 16094, 16097 (Mar. 24, 2000) (18 JS tab 146 at 2717).

the release of about ten gallons of gasoline containing MTBE.[61] The release contaminated twenty-four private wells with MTBE.[62] MTBE concentrations at two of the wells exceeded 1,000 ppb – a level hundreds of times greater than that at which people can detect MTBE's unpleasant taste and odor.[63]

43. Approximately 30 percent of the 34 million people who reside in California rely on groundwater as a drinking water source.[64]

44. California has experienced some of the worst and most widespread MTBE contamination of groundwater of any state in the United States.[65] This contamination, which stems from a variety of sources, has affected drinking water wells at dozens of sites in California.[66]

45. For example, MTBE contamination forced the closure of groundwater wells that prior to 1996 supplied approximately half of the drinking water of the City of Santa Monica. Some of the wells recorded contamination at concentrations up to 610 ppb.[67]

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[61] *See* 65 Fed. Reg. 16094, 16099 (Mar. 24, 2000) (18 JS tab 146 at 2719); *see also* Fogg Report ¶ 167 (13 JS tab D).

[62] *See* 65 Fed. Reg. 16094, 16099 (Mar. 24, 2000) (18 JS tab 146 at 2719); *see also* Fogg Report ¶ 167 (13 JS tab D).

[63] *See* 65 Fed. Reg. 16094, 16099 (Mar. 24, 2000) (18 JS tab 146 at 2719); *see also* Fogg Report ¶ 167 (13 JS tab D); *supra* nn.55-57 and accompanying text (discussing California's secondary minimum contaminant levels).

[64] *See* UC Report, Vol. V, *Evaluation of Management Options for Water Supply and Ecosystem Impacts* at 15 (5 JS tab 40); *see also* Fogg Report ¶ 119 (13 JS tab D) (stating California relies on "groundwater basins . . . for nearly half of its drinking water supply").

[65] *See* UC Report, Vol. V, *Evaluation of Management Options for Water Supply and Ecosystem Impacts* at 15-16 (5 JS tab 40); *see also* 65 Fed. Reg. 16094, 16098-99 (Mar. 24, 2000) (18 JS tab 146 at 2718-19).

[66] *See* UC Report, Vol. I at 32 (4 JS tab 36); *see also* 65 Fed. Reg. 16094, 16098-99 (Mar. 24, 2000) (18 JS tab 146 at 2718-19); Fogg Report ¶¶ 75, 88-91, 98 (13 JS tab D); Happel Report at 40, 45 & tbl. 10 (13 JS tab E).

[67] *See* UC Report Vol. V, *Evaluation of Management Options for Water Supply and Ecosystem Impacts* at 29 (5 JS tab 40) (stating that the City of Santa Monica closed several wells after discovering that two of

46. In Glennville, California, residential drinking water wells were contaminated with MTBE at concentrations up to 20,000 ppb. Consequently, as of 1997, the town has relied on alternative sources of drinking water.[68]

47. The South Lake Tahoe Public Utility District shut down 35 percent of its public drinking water wells because of MTBE contamination. The contamination forced the district to develop new production wells at substantial expense.[69]

48. Because of MTBE's affinity for water and resistance to biodegradation, cleanup of MTBE contamination takes longer and is more difficult and costly than cleanup of conventional gasoline.[70]

49. For example, the U.S. EPA estimates that, as of March 2000, over $60 million has been spent to address the MTBE contamination at one of the two MTBE-contaminated well fields that together had supplied approximately half of Santa Monica's drinking water. The final cleanup of that well field is expected to cost more than $160 million.[71]

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three aquifers were contaminated with MTBE); *see also* 65 Fed. Reg. 16094, 16098 (Mar. 24, 2000) (18 JS tab 146 at 2718); Happel Report at tbl. 10 (13 JS tab E).

[68] *See* UC Report, Vol. IV, *Impact of MTBE on California Groundwater* at 45 (4 JS tab 39) (stating that at least fifteen wells were contaminated with MTBE); *see also* 65 Fed. Reg. 16094, 16099 (Mar. 24, 2000) (18 JS tab 146 at 2719); Happel Report at 54 (13 JS tab E).

[69] *See* 65 Fed. Reg. 16094, 16098-99 (Mar. 24, 2000) (18 JS tab 146 at 2719); *see also* UC Report, Vol. V, *Evaluation of Management Options for Water Supply and Ecosystem Impacts* at 16 (5 JS tab 40) (stating that high MTBE contamination caused the closure of wells in South Lake Tahoe); Fogg Report ¶ 85 (13 JS tab D); Happel Report at 52 (13 JS tab E).

[70] *See* UC Report, Vol. I at 47-49, tbl. 3 (4 JS tab 36); *see also* 65 Fed. Reg. 16094, 16097, 16102, 16106 (Mar. 24, 2000) (18 JS tab 146 at 2717, 2122, 2126); Fogg Report ¶¶ 13, 55-73, 100-09 (13 JS tab D); Happel Report at 53-54 (13 JS tab E).

[71] *See* 65 Fed. Reg. 16094, 16098 (Mar. 24, 2000) (18 JS tab 146 at 2718); *see also* Expert Report of Dr. W. Ed Whitelaw ("Whitelaw Report") 48-49 (13A JS tab K).

California's Actions Regarding MTBE

Senate Bill 521

50. On October 8, 1997, California Governor Pete Wilson signed into law Senate Bill 521. The bill had been passed unanimously by the California Legislature, by a vote of 35 to 0 in the Senate and 79 to 0 in the Assembly.[72] That bill, among other things, appropriated $500,000 to the University of California for a study and assessment of the human health and environmental risks and benefits, if any, of MTBE.[73]

51. Senate Bill 521 provided for the commissioned University of California study to be submitted to the Governor by January 1, 1999.[74] The bill further provided that the Governor would then be required to determine whether using MTBE in gasoline posed a risk to human health and the environment and, if so, to take appropriate action to protect human health and the environment from such a risk.[75] The Governor's determination was to be "based solely upon the assessment and report submitted . . . and any testimony presented at the public hearings."[76]

52. The bill's purpose was as follows:

> The Legislature hereby finds and declares that the purpose of this act is to provide the public and the Legislature with a thorough and objective evaluation of the human health and environmental risks and benefits, if any, of the use of methyl tertiary-butyl ether (MTBE), as compared to ethyl teriary-buytl ether (ETBE), tertiary amyl methyl ether (TAME) and

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[72] *See* S.B. 521 Senate Bill – History (18 JS tab 126 at 2479) (vote of Sept. 11 and 12).

[73] S.B. 521, 1997-98 Reg. Sess., § 3(a) (Cal. 1997) (18 JS tab 125 at 2476).

[74] *See id.* § 3(d).

[75] *See id.* § 3(e).

[76] *See id.*

> ethanol, in gasoline, and to ensure that the air, water quality, and soil impacts of the use of MTBE are fully mitigated.[77]

The University of California Report

53. As contemplated by the Bill, the University of California issued a competitive, peer-reviewed request for proposals and commissioned a multidisciplinary team of scientists to research a range of complex issues mandated by SB 521. Their research findings and opinions were presented in 17 independently prepared papers. The papers were compiled into the University of California report entitled *Health & Environmental Assessment Of MTBE: Report To The Governor And Legislature Of The State Of California As Sponsored By SB 521* ("UC Report"), which was issued in November 1998.

54. The UC Report organizes the papers in five volumes, each of which addresses a different topic: I – Summary and Recommendations; II – Human Health Effects; III – Air Quality and Ecological Effects; IV – Ground and Surface Water; V – Risk Assessment, Exposure Assessment, Water Treatment and Cost Benefit Analysis. Together, the five volumes span more than 600 pages, and reflect substantial scholarship. The more than sixty authors who are listed in the UC Report are highly-credentialed researchers, including many tenured faculty members at major research universities located in California. For example, Dr. Graham E. Fogg, University of California at Davis professor of hydrogeology and a witness in this case, co-authored the volume IV paper entitled "Impacts of MTBE on California Groundwater."[78]

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[77] *Id.* § 2.

[78] *See* UC Report, Vol. I, Contents (4 JS tab 36).

55. The UC Report concluded that there are significant risks and costs associated with water contamination due to the use of MTBE. [79] Specifically, the authors found that if the use of MTBE were to continue at its then-current level, there would be an increased danger of surface and groundwater contamination.[80] The UC Report concluded that the cost of treatment of MTBE-contaminated drinking water sources in California could be enormous.[81]

56. To remedy the serious problems facing California's water supply, the UC Report recommended consideration of phasing out MTBE in gasoline over an interval of several years.[82] The UC Report reached this conclusion in light of the substantial costs associated with cleaning up MTBE contamination if MTBE were not phased out, and the ability to achieve comparable air quality benefits without relying on MTBE.[83]

57. Public hearings on the UC Report were held on February 19, 1999 in Diamond Bar, California, and on February 23-24, 1999 in Sacramento, California.[84] At the hearings, authors of the UC Report made presentations regarding their findings,[85] and

[79] *See* UC Report, Vol. I at 11-12 (4 JS tab 36).

[80] *See id.* at 12, 32.

[81] *See id.* at 12, 47.

[82] *See id.* at 13.

[83] *See id.* at 11-12.

[84] *See generally* California Environmental Protection Agency, Public Hearings to Accept Public Testimony on the University of California's Report on the Health and Environmental Assessment of Methyl Tertiary-Butyl Ether (MTBE) (Feb. 19, 23-24, 1999) (15 JS tab 22).

[85] Transcript of UC Report Hearing no. 1 at 17-78 (Feb. 19, 1999) (15 JS tab 22 at 580-635); Transcript of UC Report Hearing no. 2 at 10-83 (Feb. 23, 1999) (15 JS tab 22 at 789-855).

government officials[86] and members of the public – including representatives of MTBE and methanol producers – had an opportunity to ask questions.[87]

58. After the question and answer sessions, members of the public gave oral testimony. Those testifying included persons affected by MTBE water contamination and individuals associated with the chemical and oil industries, among others. This testimony indicated broad-based support for the conclusion that MTBE posed a serious threat to California's drinking water and that imposition of a ban on the use of MTBE in California gasoline was warranted.[88]

59. California and federal agencies were given an opportunity to review and comment on the UC Report. On February 22, 1999, CARB provided comments to the California Environmental Protection Agency ("Cal EPA") regarding the UC Report.[89]

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[86] Representatives of the California Air Resources Board (CARB), the California Energy Commission (CEC), the Office of Environmental Health Hazard Assessment, the State Water Resources Control Board, the Department of Health Services and the State Fire Marshal, who served as panel members at the public hearings, posed questions. *See generally id.*

[87] *See, e.g.,*Transcript of UC Report Hearing no. 1 at 93-121 (15 JS tab 22 at 649-74); Transcript of UC Report Hearing no. 2 at 102-147 (15 JS tab 22 at 872-912). Representatives of the Oxygenated Fuels Association, an organization whose members produce MTBE and other oxygenates, were among those who posed questions to the panel of presenters. Transcript of UC Report Hearing no. 1 at 110 (15 JS tab 22 at 664); Transcript of UC Report Hearing no. 2 at 123, 127 (15 JS tab 22 at 890-94). Other questions were presented by methanol producers, such as Neste Oil, and MTBE producers, such as Huntsman Corporation. Transcript of UC Report Hearing no. 1 at 96 (15 JS tab 22 at 580-652); Transcript of UC Report Hearing no. 2 at 207 (15 JS tab 22 at 996-97).

[88] The majority of speakers present at the public hearings on the UC Report testified in favor of a ban on MTBE. *See* Transcript of UC Report Hearing no. 1 at 121-236 (15 JS tab 22 at 674-779); Transcript of UC Report Hearing no. 2 at 148-263 (15 JS tab 22 at 913-1017); Transcript of UC Report Hearing no. 3 at 3-207 (Feb. 24, 1999) (15 JS tab 22 at 1022-1205) (of the 109 persons that testified during the public hearings, 69 speakers testified in favor of banning MTBE, 23 speakers testified against banning MTBE and 17 speakers testified on other issues). Those speakers included public officials, lobbyists and consultants, water district and public utility representatives, political action committee members, scientists, small business owners and local chambers of commerce representatives, and private citizens concerned about the threat of MTBE to their communities. *See id.*

[89] *See, e.g.,* CARB Comments to Cal. EPA Regarding the University of California Health & Environmental Assessment of MTBE, November 1998 (Feb. 22, 1999) (16 JS tab 25 at 1229).

The UC Report was independently reviewed by the U.S. Geological Survey and the U.S. Agency for Toxic Substances and Disease Registry at the Centers for Disease Control.[90]

The 1999 Executive Order

60. On March 25, 1999, Governor Gray Davis issued Executive Order D-5-99 ("1999 Executive Order"). The basis for the order was stated as follows:

> [T]he findings and recommendations of the U.C. report, public testimony, and regulatory agencies are that, while MTBE has provided California with clean air benefits, because of leaking underground fuel storage tanks MTBE poses an environmental threat to groundwater and drinking water.[91]

61. In accordance with those findings and recommendations, Governor Davis certified that, "on balance, there is significant risk to the environment from using MTBE in gasoline in California."[92] The 1999 Executive Order tasked the CEC, in consultation with CARB, with developing "a timetable by July 1, 1999 for the removal of MTBE from gasoline at the earliest possible date, but not later than December 31, 2002."[93]

62. The 1999 Executive Order did not, however, embrace ethanol as a preferred alternative to MTBE. The order directed CARB to request an immediate waiver of the federal reformulated gasoline oxygenate requirement from the Administrator of the U.S. Environmental Protection Agency.[94] Such a waiver, if granted,

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[90] *See, e.g.,* U.S. Geological Survey Comments to Cal. EPA Regarding the University of California Health & Environmental Assessment of MTBE, November 1998 (cover memorandum) (Dec. 23, 1998) (18 JS tab 148 at 2741); U.S. Department of Health and Human Services Comments to Cal. EPA Regarding the University of California Health & Environmental Assessment of MTBE, November 1998 (cover memorandum) (Dec. 24, 1998) (18 JS tab 145 at 2711). Links to all peer review comments regarding the UC Report are available at http://www.calepa.ca.gov/programs/mtbe/default.htm.

[91] 1999 EXECUTIVE ORDER pmbl. (1 JS tab 1(c)).

[92] *Id.*

[93] *Id.* ¶ 4.

[94] *Id.* ¶ 2.

would permit California to use reformulated gasoline that achieved air quality requirements without any oxygenate.[95]

63. The 1999 Executive Order also directed several California agencies to prepare reports on the environmental and health effects of using ethanol as an oxygenate. These reports were to be peer-reviewed and presented to the Environmental Policy Council for its consideration by December 31, 1999.[96] As the Governor noted in a certification made along with the 1999 Executive Order, he ordered this study of ethanol having "learn[ed] a lesson from [California's] experience with MTBE and [recognizing the necessity of] carefully asess[ing] the environmental impacts of other oxygenates such as ethanol *before* committing to its widespread use in California's gasoline supply."[97]

California's Request For A Waiver Of The Federal Oxygenate Requirement

64. As noted above, in the 1999 Executive Order, the Governor directed California officials to seek a waiver of the oxygenate requirement in the federal reformulated gasoline program.[98] That requirement mandates that gasoline contain two percent oxygen by weight.[99] California, however, believed that it could achieve air quality standards without using any oxygenate at all and sought the waiver on this

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[95] *Id.*

[96] *Id.* ¶ 10.

[97] *Certification of Human Health or Environmental Risks of Using Gasoline Containing MTBE in California* at 2 (Mar. 26, 1999) (16 JS tab 35 at 1289) (emphasis added).

[98] *See* 1999 EXECUTIVE ORDER ¶ 2 (1 JS tab 1(c)).

[99] *See* 42 U.S.C. § 7545(k)(2)(B) (2003) (18 JS tab 144 at 2701).

basis.[100] If the waiver were granted, therefore, the result would likely be that oxygenates, like ethanol, would be much less frequently used in California reformulated gasoline.

65. On April 12, 1999, Governor Davis wrote a letter to U.S. EPA Administrator Carol Browner formally requesting the waiver.[101] Following this, Governor Davis pressed California's case for a waiver with a second letter to Administrator Browner[102] and a letter to President George W. Bush.[103]

66. The U.S. EPA denied California's request for a waiver of the federal oxygenate requirement on June 12, 2001. In response, the Governor challenged the denial in federal court.[104] On July 17, 2003, the United States Federal Court of Appeals for the Ninth Circuit issued a decision holding that the U.S. EPA had abused its discretion by denying California's waiver request without having evaluated the effect of an oxygenate on California's efforts to comply with particulate-matter standards.[105]

67. In response to the Ninth Circuit's decision, Governor Davis stated his hope that "the EPA will take a hard look at this court decision, realize they were wrong and

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[100] *See* Letter from Gray Davis, Governor of California, to Carol M. Browner, Administrator, U.S. EPA at 1 (Apr. 12, 1999) (16 JS tab 65 at 1568) ("Many California refineries have the capability to produce significant amounts of gasoline that provides all of the required emission reductions without using MTBE or any other oxygenate."); *id.* at 2 ("[California's] regulations accomplish the needed emissions reductions without requiring a minimum level of oxygen.").

[101] *Id*. Thereafter, CARB corresponded with U.S. EPA on a number of occasions, providing scientific and economic information in support of the waiver. *See* California's Request for a Waiver From the Federal Year-Round Oxygen Mandate (16 JS tab 23 at 1208) (providing links to documents submitted by CARB to U.S. EPA in support of the oxygenate waiver).

[102] Letter from Gray Davis, Governor of California, to Carol M. Browner, Administrator, U.S. EPA (Dec. 15, 1999) (16 JS tab 66 at 1581).

[103] *See* Letter from Gray Davis, Governor of California, to George W. Bush, President of the United States (May 22, 2001) (16 JS tab 67 at 1583).

[104] *See* Press Release, Office of the Governor of California, Governor Davis Sues U.S. EPA Over Gasoline Additive (Aug. 13, 2001) (17 JS tab 117 at 2280).

[105] *Davis v. U.S. EPA*, 336 F.3d 965 (9th Cir. 2003) (16 JS tab 41 at 1331).

give California what it needs: the ability to make gasoline with or without oxygenates as conditions warrant."[106] Governor Davis also sent a letter to acting EPA Administrator Marianne Horinko, reiterating California's request for a waiver in light of the court's decision.[107]

Senate Bill 989

68. On October 8, 1999, Governor Davis signed into law Senate Bill 989. The bill had passed in the California Senate by a vote of 25 to 10, and in the California Assembly by a vote of 73 to 6.[108] That bill had been proposed by the Association of California Water Agencies,[109] an association of 400-plus public agencies and mutual water companies responsible for most of the water delivered to California's farmers, businesses and cities.[110] Senate Bill 989 imposed stringent, new requirements on underground storage tanks to prevent leaks.[111] These new requirements were in many respects significantly more stringent than federal regulations applicable to underground storage tanks.[112]

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[106] Press Release, Office of the Governor of California, Governor Davis Statement Regarding Federal Court's MTBE Ruling (July 17, 2003) (17 JS tab 116 at 2278).

[107] Letter from Gray Davis, Governor of California, to Marianne Lamont Horinko, Acting Administrator, U.S. EPA (Aug. 6, 2003) (16 JS tab 68 at 1585).

[108] *See* S.B. 989 Senate Bill – History (18 JS tab 128 at 2512).

[109] *See* S. Comm. on Envtl. Quality, Analysis of S.B. 989, 1999-2000 Reg. Sess. (Apr. 12, 1999) (18 JS tab 129 at 2517).

[110] *See* More About A.C.W.A. (17 JS tab 93 at 2248).

[111] *See* S.B. 989, 1999-00 Reg. Sess., § 13 (Cal. 1999) (18 JS tab 127 at 2481).

[112] *See* Happel Report at 12-13 (13 JS tab E).

69. The bill also required the CEC and the State Water Resources Control Board to "develop a timetable for the removal of MTBE from gasoline at the earliest possible date."[113]

70. "According to the author and supporters of the bill, this [bill was] intended to place into statute Executive Order D-5-99 issued by Governor Davis on March 26, 1999, and to enact several other provisions of law designed to protect groundwater and drinking water from MTBE contamination."[114]

The CaRFG3 Regulations

71. Following a December 9, 1999 hearing,[115] on June 16, 2000, CARB adopted the California Reformulated Gasoline Phase 3 ("CaRFG3") standards, which included a prohibition on the use of MTBE in gasoline beginning December 31, 2002.[116] CARB also required sulfur and benzene levels in California gasoline to be reduced.[117] These regulations became effective on September 2, 2000.[118]

72. In granting its approval to adopt the regulations, CARB found that

> MTBE is highly soluble in water and will transfer to groundwater faster, farther, and more easily than other gasoline constituents such as benzene when gasoline leaks from underground storage tanks and pipelines; even upgraded storage tanks are not leak-proof and future leaks from a small

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[113] S.B. 989, 1999-00 Reg. Sess., § 26 (Cal. 1999) (18 JS tab 127 at 2483).

[114] *Supra* n.108 at (Comments: (1) Purpose of Bill) (18 JS tab 129 at 2516).

[115] *See* California EPA, Air Resources Board, *Resolution 99-39 Hearing* (Dec. 9, 1999) (5 JS tab 45) (summary of Dec. 9, 1999 hearing).

[116] *See* California Environmental Protection Agency, Air Resources Board, *Final Regulation Order, The California Reformulated Gasoline Phase 3 Amendments, Title 13, California Code of Regulations*, § 2262.6(a) (adopted June 16, 2000) (codified at CAL. CODE REGS. tit. 13, § 2262.6(a) (2000)) (14 JS tab 18 at 497).

[117] *See id.* §§ 2261, 2262.2, 2262.3 (14 JS tab 18 at 482, 485, 487).

[118] *See generally* CAL. CODE REGS. tit. 13, §§ 2260-2276 (2003) (including most recent amendments) (14 JS tab 10). A link to the CaRFG3 Regulations as of May 1, 2003 is available at http://www.arb.ca.gov-/fuels/gasoline/050103carfg3reg.pdf.

> percentage of the thousands of gasoline storage tanks in the state will continue in the future; MTBE has been detected in the public drinking water supplies in South Lake Tahoe, Santa Monica, Los Angeles, San Francisco, Santa Clara, and other locations;
>
> Along with toxicological concerns, low levels of MTBE in drinking water can be tasted and smelled by susceptible individuals with the taste characterized as solvent-like, bitter, and objectionable; the people of California will not accept drinking water in which they can taste MTBE;
>
> Accordingly, the threat posed by MTBE to California's potential drinking water supplies, and the high estimated costs for the continuing costs of cleaning up MTBE groundwater contamination, make it necessary to prohibit the use of MTBE in California gasoline being supplied from production and import facilities on or after December 31, 2002 – the appropriate deadline identified by the CEC; . . . .[119]

The 2002 Executive Order And The Amended CaRFG3 Regulations

73. On March 14, 2002, Governor Davis issued Executive Order D-52-02 (the "2002 Executive Order") which directed CARB to take action to postpone the ban on the use of MTBE in gasoline by one year.[120] As the Order notes, this action was taken by the Governor in response to the U.S. federal government's denial of California's request for a waiver of the federal oxygenate requirement.[121] The Order noted that "the current production, transportation and distribution of ethanol is insufficient to allow California to meet federal requirements and eliminate use of MTBE on January 1, 2003[. . . .]"[122] The Governor concluded that "[a]s a result [of the denial of California's waiver request], if

[119] CARB Resolution 99-39 at 6-7 (Dec. 9, 1999) (16 JS tab 24 at 1215).

[120] Executive Order D-52-02 by the Governor of the State of California ("2002 EXECUTIVE ORDER") pmbl., 16 JS tab 46 at 1415).

[121] *Id.*

[122] *Id.*

use of MTBE is prohibited January 1, 2003, California's motorists will face severe shortages of gasoline, resulting in substantial price increases[. . . .]"[123]

74. In a public statement released on the day he issued the 2002 Executive Order, the Governor expressed his unwillingness to maintain the original effective date of the ban when doing so would harm California's economy and motorists and would benefit the ethanol industry: "I am not going to allow Californians to be held hostage by another out-of-state energy cartel[. . . .]"[124]

75. On November 8, 2002, CARB adopted amendments to the CaRFG3 regulations postponing imposition of the CaRFG3 standards and the prohibition of MTBE in California gasoline from December 31, 2002 until December 31, 2003.[125]

Methanex's Business

Methanex And Its U.S. Investments

76. Methanex is the world's largest producer and marketer of methanol. Methanex is incorporated under the laws of Canada with its primary place of business in Vancouver, British Columbia.

77. Methanex owns methanol production facilities around the world, including in Chile, Trinidad and New Zealand. Methanex also owns several older plants in North America, including three plants in Medicine Hat, Alberta, a plant in Kitimat, British Columbia, and a plant in Fortier, Louisiana. Methanex has closed all of its North

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[123] *Id.*

[124] Press Release, Office of the Governor of California, Governor Davis Allows More Time for Ethanol Solution (Mar. 15, 2002) (17 JS tab 115 at 2276).

[125] *See* California Environmental Protection Agency, Air Resources Board, *Final Regulation Order, Amendments to the California Reformulated Gasoline Regulations to Postpone Imposition of the CaRFG3 Standards and the Prohibition of MTBE and Oxygenates Other Than Ethanol in California Gasoline From*

American plants with the exception of Kitimat, which it has temporarily reopened to meet a shortfall in supply. In early 2003, Methanex lost most of its production capacity at its New Zealand plants when the natural gas supply for those plants became unavailable.[126]

78. Methanex allegedly indirectly owns two investments in the United States: Methanex Fortier, Inc. ("Methanex Fortier") and Methanex Methanol Company ("Methanex US").

79. Methanex Fortier is incorporated under the laws of the State of Delaware. Methanex allegedly indirectly owns all of the shares of Methanex Fortier, although no evidence of record so establishes.

80. Methanex Fortier's primary asset is the methanol production plant in Fortier, Louisiana. Methanex closed that plant in March 1999.[127] In March 2000, Methanex bought out a minority shareholder's interest in the plant, assuming full ownership and control of the facility.[128] In November 2002, Methanex wrote the plant off.[129] Methanex Fortier appears to have no other valuable assets.

81. The Fortier plant served customers in the southeastern United States and along the Mississippi River. Its customers predominantly used methanol to produce chemical derivatives, not MTBE. The overwhelming majority of MTBE production in

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December 31, 2002 to December 31, 2003, § 2261(b)(1) (adopted Nov. 8, 2002) (codified at CAL. CODE REGS. tit. 13, § 2261(b)(3) (2002)) (14 JS tab 17 at 445).

[126] *See* Methanex Corp. 2003 First Quarterly Report at 3 (17 JS tab 83 at 2193) (describing Methanex's loss of all entitlements to the natural gas field serving the New Zealand plants); *see also* Methanex Corp. 2002 Annual Report at 44 (17 JS tab 81 at 2136) (showing 2.4 million tons of capacity at the New Zealand plants out of 6.4 million tons of overall capacity).

[127] *See, e.g.*, Methanex Corp. 1999 Annual Report at 45 (17 JS tab 78 at 1907).

[128] *See* Claimant's Reply to the Statement of Defense ¶ 4 (Aug. 28, 2000).

[129] *See* Press Release, Methanex Corp., Methanex Announces Write-off of Fortier Methanol Facility (Nov. 25, 2002) (17 JS tab 107 at 2267).

the U.S. Gulf was produced in the Texas Gulf, not the Louisiana Gulf where Methanex's Fortier plant was operating. No evidence of record suggests that Fortier supplied any methanol used to produce MTBE for California gasoline.

82. During the five-year period it was in operation, the Fortier plant was run significantly below its full capacity.[130] In 1998, the year before the Fortier plant was closed, it ran at barely 50 percent of its capacity.[131] As Methanex's senior officer, Michael Macdonald, explained at the time of the closure, "[w]e are not making money there. In fact, we are hurting. . . . If it were in our control, we would have had the plant down earlier."[132]

83. Methanex US is allegedly a Texas general partnership of two companies, Methanex Inc. and Methanex Gulf Coast Inc., both incorporated under the laws of the State of Delaware.[133] Methanex allegedly indirectly owns all of the shares of both partners, although no evidence of record so establishes.[134]

84. Methanex US is the marketing and sales office for Methanex's sales in the United States and certain other regions. Methanex US also purchases methanol on the spot market and sells it to Methanex customers in the United States. Methanex US's trades on the spot market are not generally profitable. All shipments by Methanex and its

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[130] *See, e.g.*, Methanex Corp. 2002 Annual Report, Fact Book at iv (17 JS tab 82 at 2172) (showing capacity utilization rates for the Fortier plant of 78.5 percent, 62 percent and 79 percent for 1995, 1996 and 1997, respectively).

[131] *See id.*

[132] *Poor Economics Shuts Down Methanex/Cytec JV Methanol Plant*, 11:10 OXY-FUEL NEWS (Mar. 15, 1999) (17 JS tab 101 at 2258).

[133] *See* Second Affidavit of Michael Macdonald ¶ 4 (attached to Second Amended Statement of Claim at Tab A ("Second Macdonald Affidavit")).

[134] *See id.*

subsidiaries in or to the United States are allegedly booked through Methanex US for legal reasons.[135]

85. Methanex US is a small operation, consisting of about 30 employees in rented office space in Dallas, Texas. It appears to have no significant assets.[136] Methanex appears to structure its transactions with Methanex US such that Methanex US earns no profits that could be subject to taxation in the United States.

The Global Methanol Market

86. Methanol is produced principally through the synthesis of natural gas.[137] Natural gas accounts for the major portion of the cash operating cost of methanol production.[138] The cost competitiveness of any methanol plant thus depends largely upon the cost of its natural gas supply relative to methanol prices.

87. From the mid-1990s, natural gas was expensive in North America, particularly in the U.S. Gulf where Methanex's Fortier plant was located.[139] By contrast, natural gas prices in regions such as South America and the Caribbean were a fraction of those prices.[140] In North America, natural gas is traded through short-term contracts and

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[135] *See id.* ¶ 5.

[136] *See* Methanex Corp. 2002 Annual Report at 72 (17 JS tab 82 at 2164) (listing value of Methanex's property, plant and equipment in the United States after the Fortier write-off as zero).

[137] *See* Methanex Corp.: What is Methanol? (17 JS tab 87 at 2216).

[138] Methanex Corp. 2000 Annual Report at 7 (17 JS tab 79 at 1965) (natural gas constitutes up to 90% of the cost of producing natural gas in North America).

[139] The average natural gas spot price in the U.S. Gulf (where the Fortier plant is located) for 1996 was $2.47 per million BTUs, versus $1.28 in British Columbia (where the Kitimat plant is located) and $0.97 in Alberta (where the Medicine Hat plants are located). *See* Methanex Corp. 1997 Annual Report at 39 (17 JS tab 76 at 1694). For 1997, the prices were $2.45, $1.62 and $1.28 respectively. *See id.* In 1998, the prices were $2.14, $1.75 and $1.52, respectively. *See* Methanex Corp. 1998 Annual Report at 53 (17 JS tab 77 at 1803). In 1999, the prices were $2.26, $2.04 and $1.89, respectively. *See* Methanex Corp. 1999 Annual Report at 46 (17 JS tab 78 at 1908).

[140] For example, in 1999, while the average spot price for natural gas in the U.S. Gulf was $2.26 per million BTUs, in Chile the cost was approximately 50 cents per million BTUs. *See* Karl Greenberg, *New Capacity*

on the spot market, and prices are highly volatile.[141] As a result, since at least the early 1990s, overseas methanol plants have enjoyed a considerable competitive advantage over North American plants, and many plants in North America have been closed.[142]

88. As a globally traded commodity chemical, methanol is characterized by supply-driven price cycles: increasing demand and rising prices lead to new plant investment; new plant investment increases capacity relative to demand, putting downward pressure on prices; lower prices lead to plant shutdowns – generally starting with higher-cost facilities; and plant shutdowns lower capacity relative to demand, again putting upward pressure on prices.[143]

89. Between 1994 and 1996, Methanex brought on line a significant amount of new methanol production capacity.[144] Methanex opened several world-scale plants overseas, including two 700,000 metric ton-capacity methanol plants in New Zealand and an approximately one million-ton plant in Chile.[145] Despite the industry trend to open methanol plants in lower-cost overseas locations, Methanex also acquired several plants in the high-cost North American market, in anticipation of a significant surge in demand there. For example, in January 1994, as part of its purchase of a competitor's assets,

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Hits Outlook for Methanol and Methyl Tertiary Butyl Ether, CHEMICAL MARKET REPORTER at 56 (Mar. 27, 2000) (16 JS tab 51 at 1450-51); *see also* Methanex Corp. 2000 Annual Report at 19 (17 JS tab 79 at 1976) (chart showing the natural gas price at the Henry Hub where the Fortier plant obtained its supply increasing significantly relative to Methanex's average natural gas costs).

[141] *See, e.g.*, Methanex Corp. 1999 Annual Report at 46 (17 JS tab 78 at 1908) ("[Methanol prices] are set in an intensely competitive market and can fluctuate wildly.").

[142] *See, e.g., id*. ("There can be no doubt that the methanol market is facing significant change. Low-cost [overseas] facilities have come on stream and high-cost facilities [in North American] have started to shut down.").

[143] Securities & Exchange Commission Form 40-F of Methanex Corporation, FY ended Dec. 31, 1997 at 65 (18 JS tab 134 at 2538).

[144] *See id.* at 68 (18 JS tab 134 at 2541).

Methanex acquired three methanol plants in Medicine Hat, Alberta with a combined production capacity of 1.1 million metric tons per year.[146] And in September 1994, Methanex completed the conversion of an idled ammonia plant in Fortier, Louisiana into a 570,000-ton per year methanol plant.[147]

90. The amount of new capacity brought on line by methanol producers was a major factor in driving the global methanol price down in the mid-1990s. The average monthly spot price for methanol in the U.S. Gulf fell from a high of over $500 per ton in January 1995 to $130 per ton by the fall of 1995.[148] In the first half of 1999, methanol prices hit a historical low at under $100 per metric ton.[149]

91. Despite this overcapacity and low methanol prices, Methanex continued to build overseas production facilities. In 1999, Methanex brought on line a second one-million-metric-ton-per-year plant in Chile, representing more than one third of the significant methanol capacity additions that year.[150] As Methanex recognized at the end of 1999, "[t]his new supply is the primary factor responsible for the current low [methanol] price environment."[151]

92. Methanol prices began to recover in mid-2000, rising from $125 to $195 per metric ton between the first and second half of the year.[152] North American natural

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[145] *See id.* at 64, 69 (18 JS tab 134 at 2537, 2542).

[146] *See id.*

[147] *See id.*

[148] *See id.* at 68 (chart and text) (18 JS tab 134 at 2541).

[149] *See* Methanex Corp. 1999 Annual Report at 6 (17 JS tab 78 at 1868).

[150] *See id.* at 50 (showing 2.7 million tons of significant capacity built that year).

[151] *See id*.

[152] *See* Methanex Corp. 2000 Annual Report at 42-43 (17 JS tab 79 at 1999-2000).

gas prices, however, rose to an even greater extent, more than doubling during the same period from $2.50 to $6.00 per million BTUs.[153] The result was that the competitive advantage of overseas methanol plants over North American plants increased even further. Many North American plants were closed, particularly in the U.S. Gulf where natural gas prices were the highest.

93. For example, Georgia Gulf closed its 480,000-ton capacity methanol plant in Plaquemine, Louisiana in December 1998.[154] Three months later, in June 1999, Ashland Chemical closed its 450,000-ton capacity plant in Plaquemine, Louisiana.[155] And in December 2000, Borden Chemicals and Plastics closed its 990,000-ton capacity plant in Geismar, Louisiana.[156]

94. Since the new management team took over at Methanex in the mid 1990s, one of Methanex's primary corporate strategies has been to lower the company's cost structure by producing methanol at overseas plants near cheap sources of natural gas.[157] When economic conditions for methanol production deteriorated in North America in the late 1990s due to the rising cost of natural gas, Methanex accelerated those plans by closing almost all of its plants in that market.

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[153] *See id.*

[154] *See id.*

[155] *See id.*

[156] *See id.*; *see also* Methanex Corp. 1999 Annual Report at 7 (17 JS tab 78 at 1869); Methanex Corp. 2000 Annual Report at 43 (17 JS tab 79 at 2000).

[157] Methanex Corp. 2000 Annual Report at 5 (17 JS tab 79 at 1963) ("Five years ago we implemented a strategy to significantly reduce our costs of doing business."); Pierre Choquette, Speech, Scotia Capital Conference, Toronto, Canada ("Scotia Capital Speech") at 17:54 (June 5, 2003) (reproduced on accompanying CD; click on link corresponding to 16 JS tab 38) (audio recording) ("[t]he best way for us to get to low cost was to get away from plants that were primarily North American-based where the input costs were largely unpredictable and move to a region that has larger plants and almost fixed input costs. *And that's driven almost everything we do*.") (emphasis added).

95. In 1997, Methanex closed one of its three Medicine Hat plants.[158] In 1999, it closed the Fortier plant and a second Medicine Hat plant, attributing the two closures to its strategy of "restructur[ing] . . . assets and reduc[ing] costs."[159] In July, 2000, Methanex shut down the Kitimat plant because it had been "losing a substantial sum of money."[160] In 2001, Methanex closed the third Medicine Hat plant, citing its "noncompetitive cost structure."[161] And in November 2002, Methanex announced that it was taking a write-off on the Fortier plant, attributing the decision to its "low-cost strategy of reducing [its] reliance on North American production by expanding methanol production capacity in Trinidad and Chile."[162]

96. Methanex also sought to address the global oversupply situation by reducing overall production capacity.[163] To that end, Methanex shut down not only its own high-cost plants, it also acquired and shut down many of its competitors' high-cost plants. For example, in 2000, Methanex acquired rights from Sterling Chemical to the output from its Texas City methanol plant and immediately idled that plant.[164] And in

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[158] Securities & Exchange Commission Form 40-F of Methanex Corporation, FY ended Dec. 31, 1997 at 64 (18 JS tab 134 at 2538).

[159] Methanex Corp. 1999 Annual Report at 14 (17 JS tab 78 at 1876).

[160] *See* Press Release, Methanex, Statement to Local Media Regarding Kitimat Methanol Plant (May 24, 2000) (17 JS tab 113 at 2273).

[161] *See* Press Release, Methanex Corp., Methanex Continues Asset Restructuring (Aug. 28, 2001) (17 JS tab 110 at 2270).

[162] *See* Press Release, Methanex Corp., Methanex Announces Write-off of Fortier Methanol Facility (Nov. 25, 2002) (17 JS tab 107 at 2267).

[163] *See* Methanex Corp. 1999 Annual Report at 7 (17 JS tab 78 at 1869) (stating that Methanex was "playing a major role in the necessary restructuring of [the global methanol] industry"); *Experts Say Methanol Prices to Start Retreat in Early 2001*, GAS-TO-LIQUIDS NEWS (Nov. 10, 2000) (16 JS tab 47 at 1418) ("Methanex has been on a crusade in recent years to cut its own high cost plant output and buy up rival methanol makers to soak up the capacity of others.").

[164] *See* Press Release, Methanex Corp., Methanex Takes Further Action in Methanol Industry Restructuring (June 29, 2000) (17 JS tab 112 at 2272).

December 2002, Methanex announced that it had entered into an agreement with Lyondell Chemical pursuant to which Methanex gained the right to shut down production to its Texas-based methanol plant.[165] By its own estimate, Methanex participated in over 60 percent of all methanol plant shutdowns between 1997 and 2000.[166]

Methanex's Participation In The California Market

97. Despite Methanex's large damages claim in this arbitration, its financial interest in the California market at issue is actually quite limited. MTBE consumption represents a minority segment of the U.S. methanol market. As noted, approximately 85 percent of the MTBE used by California refiners is imported into California from merchant MTBE producers.[167] Methanex, however, participates in the far smaller market arising from California gasoline refiners that import methanol and produce MTBE captively.[168] In 2001 (well before the ban was to go into effect), Methanex exported a mere 50,000 metric tons of methanol to California.[169] This represents less than 0.7% of the company's overall sales – or barely enough to fill *half* of Methanex's flagship tanker.[170]

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[165] *See* Press Release, Methanex Corp., Methanex and Lyondell Reach Agreement on Long-Term Methanol Supply (Dec. 16, 2002) (17 JS tab 106 at 2266); Peck Hwee Sim, *Lyondell and Methanex Sign Supply Deal*, CHEMICAL WEEK at 10 (Jan. 1, 2003) (18 JS tab 136 at 2621) (quoting Methanex spokesperson as stating that under the arrangements, "we have the right to operate [the Lyondell plant] or shut it down.").

[166] Methanex Corp. 2000 Annual Report at 15 (17 JS tab 79 at 1972).

[167] *See* Burke Report ¶ 38 (13 JS tab B).

[168] *See* Second Macdonald Affidavit ¶ 23 ("Methanol sales to integrated refiners accounted for 85 percent of Methanex's business in California in 1998.").

[169] *Id*. ¶ 5.

[170] *See id*. (Methanex exported 50,895 metric tons of methanol to California in 2001); *see also* Methanex Corp. 2001 Annual Report at 2 (17 JS tab 80 at 2033) (Methanex sold 7.39 million tons of methanol in 2001); *id*. at 52 (Methanex's largest ocean tanker has a capacity of 100,000 metric tons). Even in its peak year of 1998, Methanex exported a mere 132,000 tons of methanol to California refiners for MTBE production, or barely 2% of Methanex's global methanol sales of approximately 6 million metric tons that

98. Methanex's participation in the California market at issue also appears not to have been lucrative for Methanex. In mid-2000, a year after the ban was announced, MTBE use in California was at record levels.[171] And from 1998 through 2001, demand for methanol by California refiners to produce MTBE increased.[172] During that same period, however, Methanex significantly *decreased* its methanol exports to California because the Kitimat plant serving that market was unprofitable. As Methanex stated when it closed the plant in 2000, the plant had been "losing a substantial sum of money for some time due primarily to the very high natural gas costs."[173] Even after Methanex negotiated a more favorable natural gas supply contract and temporarily reopened the plant in 2001, the plant was, according to Methanex, "at best . . . a break-even operation."[174]

Methanex's Recent Economic Performance

99. Largely as a result of the recovery in methanol pricing, Methanex has generated significant profits in recent years. Methanex reported net profits for 2000 of approximately $145 million, compared to a net loss of $150 million the prior year.[175] By 2002, Methanex had generated a profit over the three-year period of $340 million.[176] And

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year. *See* Second Macdonald Affidavit ¶ 5; Methanex Corp. 1998 Annual Report at 51 (17 JS tab 77 at 1801).

[171] Methanex Corp. 2000 Annual Report at 18 (17 JS tab 79 at 1975).

[172] *See* Expert Report of Kenneth Dexter Miller, Jr. ("Miller Report") ¶ 5 (13A JS tab G).

[173] Press Release, Methanex, Statement to Local Media Regarding Kitimat Methanol Plant (May 24, 2000) (17 JS tab 113 at 2273).

[174] Brian Lewis, *Outlook is Grim: Kitimat's Reopened Methanol Plant May Not Survive*, VANCOUVER PROVINCE, May 31, 2001 at A35 (16 JS tab 69 at 1587).

[175] Methanex Corp. 2000 Annual Report at 6 (17 JS tab 79 at 1963).

[176] Methanex Corp. 2002 Annual Report at 1 (17 JS tab 82 at 2099).

in the first quarter of 2003 alone, Methanex reported a profit of $75.5 million.[177]

100. In contrast to the oversupply situation that existed in 1999, by 2003 there was *insufficient* supply in the global methanol market to meet demand.[178] In fact, Methanex was struggling to meet its contractual commitments to its customers. Methanex was running its plants at up to 99 percent of their capacity (in an industry that has never exceeded an average of 85 percent capacity);[179] Methanex had to purchase significant amounts of methanol on the spot market at a loss; and it had to keep the unprofitable Kitimat plant running, and even considered restarting one of its Medicine Hat plants at substantial cost.[180]

101. Methanex's supply situation became critical in early 2003 when Methanex received the news that the primary natural gas source for its New Zealand plants – which have a combined capacity of 2.4 million metric tons per year, or nearly 40 percent of the company's total production capacity – became unavailable.[181] As a result, Methanex had no choice but to significantly reduce the output of those plants. As Methanex stated in its

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[177] *See* Methanex Corp. 2003 First Quarterly Report at 5 (17 JS tab 83 at 2191).

[178] *See* Scotia Capital Speech at 34:12 (accompanying CD, 16 JS tab 38) ("*There simply just isn't enough supply* [in the global methanol market]. And how it's come about is the really interesting part. Because we participated in some of the major restructuring in the industry in the mid to late 1990s. It became a key part of our strategy to see if we could impact the fundamental structure of the industry. We shut down high cost plants. We worked with others who wanted to shut down high cost plants. . . . What that meant was as we got to 2001, 2002, we really started to feel the impact of this restructuring. We ended up with high capacity utilization. . . . We have an environment which is much better than what we had in the mid 90s.").

[179] Methanex Corp. 2002 Third Quarterly Report at 3 (17 JS tab 81 at 2181).

[180] Transcript of Methanex 2003 First Quarter Earnings Conference Call at 12 (18 JS tab 142 at 2688) ("[T]o meet our customers' expectation[s] . . . we have to go and buy a spot. We can't find the spot material at a price that we'd be willing to pay. So, what we've decided to do is work with our customers."); *see id.* at 10 (18 JS tab 142 at 2686) ("Our ability to go out and secure a large parcel of methanol is non-existent, unless we're prepared to pay outrageous prices, which we're not prepared to do."); *see id*. at 7 (18 JS tab 142 at 2683) ("In terms of Medicine Hat, our motivation there was really that we want to make absolutely sure that we can honor our contractual obligations to our customers globally. And with the capacity that we've lost in New Zealand, we currently are on order control.").

first quarter 2003 earnings conference call with investors, "with the capacity that we've lost in New Zealand, *we currently are on order control*."[182]

102. In light of these tight market conditions and Methanex's own supply constraints, it is not surprising that Methanex has repeatedly advised its shareholders that it will feel no effects from loss of the California methanol market at issue. Indeed, Methanex has even suggested that, to the extent the measures at issue have any market effect at all, they would provide some "welcome relief" as to Methanex's and the industry's unusually low inventories.

103. For example, in the second quarter 2002 earnings conference call, Mr. Choquette stated that in "the current supply and demand environment, we don't expect the impact of [the loss of California MTBE demand] to have much of an impact on pricing, *if at all*."[183] In that same call, Mr. Choquette stated that the loss of the California MTBE market "just happens to be coming at a time when it's *unlikely to have any significant impact*, because my God, the – you know, when I do my own calculations, I look at the impact of what might happen in California over the next year, *it gives the industry a bit of breathing room and opportunity to replenish our inventories*."[184] Similarly, in Methanex's fourth quarter 2002 earnings conference call, Mr. Choquette stated that "clearly, in the market that we're in today, if the conversion in California took place overnight, it would be fully absorbed. *It would give some welcome relief in terms*

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[181] *See* Methanex Corp. 2003 First Quarterly Report at 3 (17 JS tab 83 at 2193).

[182] Transcript of Methanex 2003 First Quarter Earnings Conference Call at 7 (18 JS tab 142 at 2683) (emphasis added).

[183] Transcript of Methanex 2002 Second Quarter Earnings Conference Call at 2 (18 JS tab 140 at 2659) (emphasis added).

[184] *Id.* at 9 (emphasis added).

of inventories in the system."[185] Likewise, in Methanex's first quarter 2003 earnings conference call, Mr. Choquette stated that "the reduction in [MTBE] consumption in the United States is taking place, but of course it's overshadowed by supply constraints, *so it's hard to see the impact of the reduction*."[186] In an interview in early 2003, Mr. Choquette stated that he was unconcerned about the MTBE ban in California because the highly favorable market conditions for methanol would "minimize the impact of the phase out of California gasoline producers."[187] And at an investor conference in Toronto in mid-2003, Mr. Choquette stated that "I always like to say that I wish they would eliminate [MTBE from the U.S. market] tomorrow morning so we could get on with life because *it's not that big a deal*."[188]

POINTS AT ISSUE

104. Under Article 24 of the UNCITRAL Arbitration Rules, Methanex "ha[s] the burden of proving the facts relied on to support [its] claim."[189] Article 24 recognizes the general principle – applied consistently by international arbitration tribunals – that the burden of proof rests on the claimant.[190]

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[185] Transcript of Methanex 2002 Fourth Quarter Earnings Conference Call at 8 (18 JS tab 141 at 2671) (emphasis added).

[186] Transcript of Methanex 2003 First Quarter Earnings Conference Call at 3 (18 JS tab 142 at 2679).

[187] *ADM, Methanex Face Drop in Quarterly Earnings*, 15:5 OXY-FUEL NEWS (Feb. 3, 2003) (14 JS tab 1 at 2) ("Choquette said he wasn't worried about the loss of methanol as a result of California phasing out MTBE. 'We believe that these tight [methanol supply and demand] market conditions, combined with MTBE demand growth in other parts of the world, will minimize the impact of the phase out of MTBE by California gasoline producers,' he said.").

[188] Scotia Capital Speech at 7:25 (accompanying CD, 16 JS tab 38) (emphasis added).

[189] UNCITRAL Arbitration Rules art. 24(1).

[190] *See, e.g.*, BIN CHENG, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS & TRIBUNALS 327 (1953) ("International judicial decisions are not wanting which expressly hold that there exists a general principle of law placing the burden of proof upon the claimant and that this principle is applicable to international judicial proceedings."); *id*. at 334 ("there is in substance no disagreement among international tribunals on the general legal principle that the burden of proof falls upon the claimant, *i.e.*, the

105. The initial burden borne by the claimant has often been described as the obligation to present *prima facie* evidence, or evidence "which, unexplained or uncontradicted is sufficient to maintain the proposition affirmed."[191] *Prima facie* evidence "does not create a moral certainty as to the truth of the allegation, but provides sufficient ground for a reasonable belief in its truth, rebuttable by evidence to the contrary."[192] Only if the claimant has presented *prima facie* evidence does the obligation arise for the respondent to cast doubt on the claimant's evidence.[193] And even when the claimant presents *prima facie* evidence, it retains the burden of convincing the Tribunal of the truth of that evidence.[194]

106. Where the claimant has failed to present even *prima facie* evidence, its claim must be dismissed for failure of proof.[195] The claim must also be dismissed if the

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plaintiff must prove his contention under penalty of having his case refused.") (internal quotation omitted); JACOMJIN J. VAN HOF, COMMENTARY ON THE UNCITRAL ARBITRATION RULES 160-61, nn.298-99 (1991) (citing cases where the Tribunal characterized Article 24 as a generally-accepted principle of international arbitration law); *Malek v. Iran*, Award 534-193-3 ¶ 111 (Iran-U.S. Claims Tribunal 1992) (*available in* Westlaw INT-IRAN database) ("It goes without saying that it is the Claimant who carries the initial burden of proving the facts on which he relies."); *Iran v. United States (Case No. A/20)*, 11 Iran-U.S. Cl. Trib. Rep. 271, 274 (1986) ("the Rules [UNCITRAL and Tribunal Rules at Articles 24 and 25] reflect generally accepted principles of international arbitration practice . . . ").

[191] MOJTABA KAZAZI, BURDEN OF PROOF AND RELATED ISSUES 328 (1996) (citing *Kling (U.S.) v. Mexico*, 4 R.I.A.A. 575, 585 (1930)); *see also* CHENG at 324 (same); *International Ore & Fertilizer Corp. v. Razi Chemical Co.*, 18 Iran-U.S. Cl. Trib. Rep. 98, 102 n.1 (1988) (Brower, dissenting) ("*Prima facie* evidence is evidence which is sufficient to establish a fact in the absence of any evidence to the contrary, but it is not conclusive. A '*prima facie* case' is a case sufficient to call for an answer.") (internal quotation omitted).

[192] CHENG at 324.

[193] KAZAZI at 339.

[194] *See Tradex Hellas S.A. v. Albania*, 14 ICSID REV-F.I.L.J. 197, 219 (1999) ("A Party having the burden of proof must not only bring evidence in support of his allegations, but must also convince the Tribunal of their truth, lest they be regarded for want, or insufficiency, of proof.") (internal quotation omitted).

[195] *See, e.g., J.I. Case Co. v. Iran*, 3 Iran-U.S. Cl. Trib. Rep. 62, 65 (1983) ("The Tribunal does not find the available evidence sufficient, even in the absence of any evidence to the contrary, to support the conclusion that the non-payment of the debts was due to the acts of the Government of Iran."); *Corfu Channel (U.K. v. Alb.)*, 1949 I.C.J. 4, 16 (Apr. 9) (because the claimant put forward no evidence in support of its allegation that Albania laid the mines that caused its alleged damage, the Court determined that it "need pay no further attention to this matter.").

evidence presented is insufficient or does not convince the Tribunal.[196] For example, the Iran-U.S. Claims Tribunal – applying Article 24 of the UNCITRAL Arbitration Rules – dismissed the portion of a claim seeking lost profits "for lack of proof," because the claimant corporation produced only the testimony of its officers to prove its losses, but provided no documentary evidence.[197] In addition, a tribunal may draw an adverse inference from the claimant's failure to submit in support of its claim evidence "likely to be at its disposal."[198]

107. In these particular proceedings, the time for Methanex to satisfy its initial burden of presenting *prima facie* evidence has passed. The Tribunal required Methanex to submit with its fresh pleading "copies of *all evidential documents on which it relies* . . . together with factual witness statements and expert witness reports of any person intended by Methanex to provide testimony at an oral hearing on the merits."[199] Methanex's Reply does not afford it an opportunity to supplement its evidence in an attempt to satisfy its burden of establishing a *prima facie* case because the parties and

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[196] *See, e.g.*, *Golshani v. Iran*, Award No. 546-812-3 at 52, 57 (Iran-U.S. Claims Tribunal 1993) (*available in* Westlaw INT-IRAN database) (claim dismissed for failure of proof where affidavits of the Claimant and his chief witness "lack[ed] coherence and consistency on several key aspects regarding the alleged transaction," and "d[id] not inspire the minimal degree of confidence . . . required to shift the burden of proof to the Respondent."); *Malek* ¶¶ 120-123 (claim "must be dismissed" where claimant's evidence is "unclear" and "insufficient" and "the deficiencies in the Claimant's presentation . . . are too important to accept that the burden of proof . . . has shifted to Respondent.").

[197] *See Avco Corp. v. Iran Aircraft Industries*, 19 Iran-U.S. Cl. Trib. Rep. 200, 209 (1988); *see also CMI International v. Ministry of Roads & Transportation*, 4 Iran-U.S. Cl. Trib. Rep. 263, 268 (1983) ("the burden of proving entitlement to lost profits . . . is on the Claimant.").

[198] *Malek* ¶ 106 ("the Tribunal has had recourse, on a number of occasions, to the principle that an adverse inference may be drawn from a party's failure to submit evidence likely to be at its disposal.") (citing *Levitt v. Iran*, 27 Iran-U.S. Cl. Trib. Rep. 145 ¶ 65 (1991)); *Arthur J. Fritz & Co. v. Sherkate TavoniaSherkathaye Sakhtemanie*, 22 Iran-U.S. Cl. Trib. Rep. 170, 180 ¶ 42 (1989); *see also Kling*, 4 R.I.A.A. at 582 ("certain inferences could be drawn from the non-production of available evidence . . . ."); *Parker (U.S.) v. Mexico*, 4 R.I.A.A. 35, 39 (1926) ("where evidence which would probably influence [the tribunal's] decision is peculiarly within the knowledge of the claimant or of the respondent Government, the failure to produce it, unexplained, may be taken into account by the Commission in reaching a decision.").

Tribunal have agreed that "second pleadings (Reply and Rejoinder) should take the form of *responses* to the adverse party's pleading."[200]

108. As demonstrated in the pages that follow, Methanex has failed to satisfy its burden of proof with respect to every aspect of each claim it has submitted to this Tribunal for decision. In addition, Methanex's arguments as to the legal standards governing those claims are without merit. Methanex's claims fail, therefore, both as a matter of law and a matter of fact.

I. THE TRIBUNAL LACKS JURISDICTION BECAUSE THE MEASURES AT ISSUE DO NOT "RELATE TO" METHANEX OR ITS INVESTMENTS

109. Methanex has failed to show that the measures at issue fall within the scope of the Tribunal's jurisdiction as circumscribed by Article 1101(1). The scope of NAFTA's investment chapter for the claims at issue here is limited to "measures adopted or maintained by a Party *relating to*: (a) investors of another Party; [or] (b) investments of investors of another Party in the territory of the Party."[201] As the Tribunal held in its First Partial Award, "the phrase 'relating to' in Article 1101(1) NAFTA signifies

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[199] First Partial Award ¶ 163 (emphasis added).

[200] *Minutes of Order of the First Procedural Meeting Held by Telephone Conference Call on Thursday, 29 June 2000* at 4 (Item 9 Pleadings) (emphasis added); *see also* Aug. 14, 2000 Letter to the Tribunal from J. Brian Casey and Mark A. Clodfelter regarding issues on which the parties have reached agreement at 2 ("The party submitting the reply shall simultaneously submit any additional documents and witness statements permitted by Articles 3.10 and 4.6 of the IBA Rules."); International Bar Association, Rules on the Taking of Evidence in International Commercial Arbitration, art. 3.10 (June 1, 1999) (allowing Parties to submit "any additional documents which they believe have become relevant and material as a consequence of the issues raised in documents, Witness Statements or Expert Reports submitted or produced by another Party or in other submissions of the Parties."); *id*. art. 4.6 (allowing Parties to submit "revised or additional Witness Statements, including statements from persons not previously named as witnesses, so long as any such revisions or additions *only respond* to matters contained in another Party's Witness Statement or Expert Report and such matters have not been previously presented in the arbitration.") (emphasis added).

[201] NAFTA art. 1101(1)(a)-(b) (emphasis added).

something more than the mere effect of a measure on an investor or an investment . . . it requires a legally significant connection between them . . . ."[202] Methanex's evidence fails to establish that the measures at issue satisfy the "relating to" requirement of Article 1101(1).

110. *First*, Methanex has not shown that the measures address, or were intended to address, methanol producers or Methanex. Rather, the measures relate to the use of MTBE in California gasoline and seek to eliminate the threat posed by MTBE to California groundwater. Contrary to Methanex's unsupported contentions, the record reflects no ill-will toward Methanex on California's part.

111. *Second*, there is no support for Methanex's argument that ill intent can be inferred because ethanol's gain is allegedly methanol's loss. Methanol is not interchangeable with MTBE and does not compete with ethanol in the market for oxygenates used in gasoline. Multiple distinct obstacles preclude methanol's use as an oxygenate in gasoline. Methanex's attempt to conflate methanol with MTBE is baseless. Thus, contrary to Methanex's claims, there is no binary choice between methanol and ethanol in the three oxygenate markets it identifies.

112. *Finally*, the record does not support Methanex's multitude of arguments that the measures at issue were really intended to benefit domestic ethanol producers. Contrary to Methanex's contentions, the 1999 Executive Order launched a coordinated campaign by California to *lift* the oxygenate requirement for reformulated gasoline in the state and thereby ensure that ethanol need not be used. California has energetically

[202] First Partial Award ¶ 147.

pursued this goal, going so far as to prosecute a claim against U.S. EPA in federal court to a partially successful conclusion.

113. Nor can ill intent be imputed to Governor Davis, much less to the California government, from the fact that the Governor received campaign contributions or met with supporters.

114. The decision to ban MTBE was firmly grounded in the administrative record and the recommendations and findings of the UC Report. No evidence suggests that California decision-makers had any reason to distrust the good faith of the recommendations and findings before them. Methanex's claim that the underlying science was merely a pretext for adopting measures to benefit the ethanol industry is without foundation. To the contrary, the expert reports of Drs. Graham Fogg, Anne Happel and Ed Whitelaw demonstrate that California's actions were amply supported by the scientific information available at the time of their adoption – and information available today confirms the wisdom of California's actions.

115. Methanex's contentions that the ban of MTBE relates to it are without substance. Its claims should be dismissed in their entirety on this ground alone.

A. The Measures At Issue Do Not, And Were Not Intended To, Address Methanol Producers Or Methanex

116. As the Tribunal held in its First Partial Award, California's ban of MTBE on its face does not address or relate to Methanex or its investments.[203] To the contrary, the measures on their face address and relate to the use of MTBE in California's gasoline. Methanex does not seriously argue to the contrary. Instead, its contention is that,

[203] *See* First Partial Award ¶ 150.

although the measures on their face address MTBE use in California gasoline, they were in fact *intended* to address producers and marketers of methanol, including Methanex and its U.S. investments.

117. Methanex's contention is without merit. Each of the measures at issue expressly states California's intent in adopting it. The ban and the related measures make clear on their face that their purpose is to protect California's drinking water supplies from a contaminant – MTBE – that made those supplies undrinkable.[204]

118. As recognized by the Tribunal in its First Partial Award, governmental acts such as these are presumed to be regular under international law.[205] The statement of purpose expressed in each of the measures is therefore imbued with that presumption of regularity. As the International Court of Justice stated in the *Fisheries* case, "[i]n the absence of convincing evidence to the contrary, the Court cannot readily find" that duly

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[204] *See supra* n.77 and accompanying text (stating the purpose of S.B. 521: "to provide the public and the Legislature with a thorough and objective evaluation of the human health and environmental risks and benefits, if any, of the use of methyl tertiary-butyl ether (MTBE), as compared to ethyl teriary-buytl ether (ETBE), tertiary amyl methyl ether (TAME) and ethanol, in gasoline, and to ensure that the air, water quality, and soil impacts of the use of MTBE are fully mitigated."); *supra* n.91 and accompanying text (stating the reason for the 1999 Executive Order: ". . . MTBE poses an environmental threat to groundwater and drinking water."); *supra* n.119 and accompanying text (stating the basis for the CaRFG3 Regulations: "the threat posed by MTBE to California's potential drinking water supplies, and the high estimated costs for the continuing costs of cleaning up MTBE groundwater contamination, make it necessary to prohibit the use of MTBE in California gasoline.").

[205] *See* First Partial Award ¶ 45 (noting "the legal doctrine of omnia praesumuntur rite esse acta . . . ."); ALWYN V. FREEMAN, INTERNATIONAL RESPONSIBILITY OF STATES FOR DENIAL OF JUSTICE 74 (1970) (explaining that the "responsibility of the state cannot ordinarily be called into question" and that there is "a general presumption *that the laws and their administration are satisfactory in the light of international requirements*") (emphasis in original); NGUYEN QUOC DINH, DROIT INTERNATIONAL PUBLIC 428 § 279(2) (6th ed. 1999) (noting that "*[t]he presumption of the regularity of governmental acts* is a[] direct consequence of the sovereignty of the State") (translation by counsel; emphasis in original) ("*La présomption de régularité des actes étatiques* est une autre conséquence directe de la souveraineté de l'État.").

adopted government measures such as these are other than what they purport to be.[206] Methanex has presented no evidence to overcome this presumption.

119. As the Tribunal anticipated in its First Partial Award, a multitude of actors was involved in promulgating the ban as well as the other relevant measures.[207] The 1999 Executive Order, as noted above, was based on "the findings and recommendations of the UC report, public testimony, and regulatory agencies . . . that . . . MTBE poses an environmental threat to groundwater and drinking water."[208] The more than 60 individuals who are named as authors of the UC Report, the members of the public who testified during the three days of hearings on the issue and the various regulatory agencies that submitted comments all contributed to the findings on which the Governor's 1999 Executive Order was based. Methanex, notably, offers no evidence to suggest any reason for Governor Davis or any other California decision-maker to believe that the UC Report was anything other than a good-faith effort by the respected scientists who authored it. Seventy-three members of the California Assembly and 25 Senators voted for Senate Bill 989, which contained a provision concerning MTBE substantially similar to that of the 1999 Executive Order and which served as authority for CARB to issue the CaRFG3 regulations. All 11 members of CARB approved the ban, which was drafted and presented by members of the CARB staff based on an extensive administrative record to which many members of the public and others contributed.

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[206] *Fisheries Case (U.K. v. Nor.)*, 1951 I.C.J. 116, 140 (Dec. 18).

[207] *See* First Partial Award ¶ 158 ("In particular, decrees and regulations may be the product of compromises and the balancing of competing interests by a variety of political actors. . . . Where a single governmental actor is motivated by an improper purpose, it does not necessarily follow that the motive can be attributed to the entire government.").

[208] 1999 EXECUTIVE ORDER pmbl. (1 JS tab 1(c)).

120. For Methanex's claim to succeed, at least a majority of the individual actors playing a decisive role in the adoption of the measures would have to have been acting in bad faith in preparing and subscribing to reports, recommendations, bills, orders and regulations that stated their purpose as addressing the problem of MTBE contamination of California's drinking water supplies – when, according to Methanex, the true purpose was to harm methanol producers. In short, Methanex's theory depends upon a vast conspiracy, involving hundreds of government officers and scientists, all of whom would have to have been acting in bad faith.

121. It is well-settled in international law, however, that bad faith may not be presumed.[209] And Methanex offers not a shred of evidence to support the existence of any such conspiracy. The evidence that Methanex does present cannot withstand scrutiny. The facts demonstrate that no prejudice against methanol producers in general or Methanex in particular can be attributed to the government of California.

1. The Record In No Way Supports Methanex's Assertion That The Measures Were Intended To Harm Methanol Producers

122. Methanex's assertion that the purpose of the measures at issue was to harm methanol producers is based principally on speculation as to what Archer Daniels Midland ("ADM") officers may have said to gubernatorial candidate Gray Davis during a dinner in August 1998[210] and on a witness statement by Robert Wright in which he

[209] *See, e.g., Lac Lanoux (Fr. v. Spain)*, 12 R.I.A.A. 281, 305 (1957) ("there is a well-established general principle of law according to which bad faith may not be presumed.") (translation by counsel) ("car il est un principe général de droit bien établi selon lequel la mauvaise foi ne se présume pas.").

[210] *See* Second Amended Statement of Claim ¶¶ 222-38 (inferring, from the mere fact that a short meeting between gubernatorial candidate Davis and ADM officials took place in August 1998, that ADM officials promoted ethanol at the meeting by labeling MTBE a foreign product).

purports to relate what unnamed persons told him concerning a supposed meeting with California Senator Burton.[211] We address each of these in turn.

123. As a preliminary matter, Methanex's attempt to ascribe bad faith to Governor Davis in issuing the 1999 Executive Order is misguided as well as unsupported. As the Order itself notes, the UC Report, public testimony and agency views all found that MTBE posed a threat to drinking water;[212] and the UC Report recommended consideration of a phase-out of MTBE use in gasoline.[213] Indeed, Methanex's own experts concede that Governor Davis issued the 1999 Executive Order in response to the UC Report's conclusion that MTBE posed significant risks and costs associated with water contamination.[214]

124. What would have been unusual, in light of these findings and recommendations and the public testimony that supported them, would have been for the Governor *not* to have issued the order he did. Issuance of an order entirely consonant with the findings, recommendations and testimony before the Governor (which was required by Senate Bill 521 to be the sole basis for his determination)[215] can hardly serve as a basis for an argument that he acted in bad faith.

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[211] *See* Affidavit of Robert T. Wright ("Wright Affidavit") ¶¶ 3-4 (attested Nov. 4, 2002) (attached to Second Amended Statement of Claim at Tab B); *see also* Supplemental Affidavit of Robert T. Wright ("Supplemental Wright Affidavit") ¶¶ 13-14 (attested Jan. 29, 2003) (12 JS tab A).

[212] 1999 EXECUTIVE ORDER, pmbl. (1 JS tab 1(c)).

[213] *See* UC Report, Vol. I at 13 (4 JS tab 36).

[214] *See* Exponent, *Evaluation of UST/LUST Status in California and MTBE in Drinking Water, Executive Summary* at xiii (12 JS tab E) ("In response to concerns over possible MTBE releases in the environment, the California legislature enacted SB 521 in 1997 . . . . [The UC Report] was a driving force in the governor's final decision to initiate such a ban.").

[215] S.B. 521, 1997-98 Reg. Sess., § 3(e) (Cal. 1997) (18 JS tab 125 at 2477).

125. In fact, Methanex offers no evidence at all of bad faith on the Governor's part. All it offers is a copy of a purported draft itinerary for a trip by gubernatorial candidate Davis to Illinois to meet with ADM officers.[216] Methanex does not attempt to authenticate the document or even to state where it came from – likely because it is a copy made from files of Regent International, duplicated without that company's knowledge or authorization.[217]

126. Gubernatorial candidate Davis did indeed meet with ADM officers in August 1998. He disclosed the use of ADM's airplane to travel to Decatur, Illinois before his election to the governorship, on his campaign disclosure forms dated October 6, 1998.[218] Once in Decatur, candidate Davis had dinner with several ADM officers. The dinner, intended to garner support for Mr. Davis's campaign, was an unremarkable event, like any of a number of such events routinely attended by candidates for public office in the United States. There was no discussion of methanol at the dinner, nor was there any discussion of Methanex.[219] The mere fact that this dinner took place provides no support for Methanex's assertion that Governor Davis acted in bad faith in issuing the 1999 Executive Order.

127. Nor can a finding of bad faith be based on the witness statement of Robert Wright, an officer of Methanex. That statement purports to describe what Mr. Wright

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[216] *See* Second Amended Statement of Claim ¶ 222.

[217] *See* Statement of Richard Vind ("Vind Statement") ¶¶ 12-15 (attested Nov. 21, 2003) (13A JS tab I).

[218] California Form 490 Schedule C for Gray Davis (Non-Monetary Contributions Received) (July 1, 1998 - Sept. 30, 1998) (16 JS tab 28 at 1255) ("Date Received: 08/04/98; Full Name and Address of Contributor: Archer Daniels Midland Company, 4666 E. Faries Pkwy., Decatur, IL 62525; Description of Goods or Services: Use of Plane; Fair Market Value: 2,400.00").

[219] *See* Statement of Roger Listenberger ¶ 7 (attested Oct. 24, 2003) (13 JS tab F); Vind Statement ¶ 10 (13A JS tab I); Statement of Daniel Weinstein ¶ 6 (attested Nov. 18, 2003) (13A JS tab J).

was told by unidentified persons who supposedly held a meeting with Senator John Burton "shortly before Executive Order D-5-99 was issued."[220] It is evident that a statement such as this, based entirely on hearsay by unnamed persons, is inherently unreliable.[221]

128. Moreover, the statement is of no weight because it lacks any context for the supposed remarks it sets forth. The Senator's alleged remarks could merely have been a frank assessment of the likelihood that Governor Davis would reject the findings and recommendations of the UC Report, the public testimony and the agencies consulted. Nor is it in any way clear from Mr. Wright's account that the Senator understood either what Methanex was or whether it produced methanol rather than MTBE. In short, such a slender reed as this statement certainly cannot serve as a basis for attributing bad faith to an entire government.

129. The remainder of Methanex's evidence falls into two categories: evidence that the measure at issue would benefit ethanol at the expense of MTBE,[222] and evidence

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[220] Wright Affidavit ¶ 3 (attested Nov. 4, 2002) ("It was reported to me that Senator Burton opened the meeting by saying, 'If you're here on the MTBE issue, you're [out of luck].'").

[221] *See, e.g., Corfu Channel (UK. v. Alb)*, 1949 I.C.J. 4, 16-17 (Apr. 9) ("The statements attributed by the witness . . . to third parties, of which the Court has received no personal and direct confirmation, can be regarded only as allegations falling short of conclusive evidence. A charge of such exceptional gravity against a State would require a degree of certainty that has not been reached here."); *Pomeroy's El Paso Transfer Company (U.S.) v. Mexico*, 4 R.I.A.A. 551, 553-554 (Mex.-U.S. Gen. Claims Comm'n 1930) ("[A]lthough it is to be presumed that the President of a corporation is acquainted with its affairs, the knowledge that he may have had of those events which took place before he assumed office, is, so to speak, second hand. The testimony . . . lacks the qualities of that of a qualified witness."); *Cervetti (Italy-Venez. Comm'n)*, 10 R.I.A.A. 492, 496-97 (1903) (referring to the Commission's summons of the claimant to testify where "the proof would not justify any recovery, the claimant's witnesses merely stating that the facts alleged by them were public and notorious, but stating nothing of their own knowledge."); *see also, e.g.*, 3 SHABTAI ROSENNE, LAW AND PRACTICE OF THE INTERNATIONAL COURT 1090 (1997) ("[T]he Court will normally exclude hearsay evidence; that is to say, evidence attributed by the witness or deponent to third parties of which the Court has received no personal and direct confirmation. Statements of that kind will be regarded as 'allegations falling short of conclusive evidence'.").

[222] *See, e.g.*, Second Amended Statement of Claim ¶¶ 89-110 (alleging that MTBE is a better product, suggesting that the only rational explanation for the measure is to benefit ethanol over MTBE); *id.* ¶¶ 111-

of sentiments concerning methanol or MTBE expressed by various persons outside of the California government.[223]

130. The first category is irrelevant. As the Tribunal held in the First Partial Award, the fact that the measures address MTBE, or might have the effect of benefiting ethanol producers, does not and cannot establish that the measures relate to producers and marketers of methanol like Methanex. As demonstrated below, Methanex's attempt to conflate methanol with MTBE is without support. This category of evidence can do nothing to show that the purpose of the measures at issue was to address methanol producers.

131. The second category is equally irrelevant. The fact that officers of ADM, or politicians in states of the United States other than California, may have expressed various sentiments concerning methanol or MTBE does nothing to prove that California officers shared those sentiments. This category of evidence also cannot establish that California intended to harm Methanex or methanol producers generally.

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27 (providing history of relevant measures with emphasis on how such measures allegedly favor ethanol over MTBE); *id.* ¶¶ 128-32 (alleging that the waiver request shows that ethanol would be the primary beneficiary of the MTBE ban, even were the waiver to be granted); *id.* ¶ 133 (alleging that the postponement of the MTBE ban demonstrates that ethanol would benefit from the ban); *id.* ¶¶ 134-41 (alleging that MTBE is being replaced with ethanol); *id.* ¶¶ 146-57 (arguing that California wanted to promote an in-state ethanol industry); *id.* ¶¶ 158-61 (alleging that the MTBE ban promoted only ethanol as a replacement for MTBE); *id.* ¶¶ 162-65 (alleging that the technical changes made to the MTBE ban would benefit ethanol); *id.* ¶¶ 174-90 (arguing that other jurisdictions and politicians have traditionally protected ethanol); *id.* ¶¶ 191-201 (arguing that ban of MTBE, but not other dangerous chemicals, leads to the inference that California intended to benefit ethanol); *id.* ¶¶ 202-220 (arguing that ADM, an ethanol producer, sought passage of measures benefiting its product); *id.* ¶¶ 220-27, 229-33, 235, 237-38 (alleging that ADM sought to promote ethanol at a meeting with gubernatorial candidate Gray Davis).

[223] *See, e.g., id.* ¶¶ 134-37 (statements made by California refiners); *id.* ¶¶ 184-87, 266-70 (statements by U.S. legislators); *id.* ¶ 188 (statement by former U.S. EPA Administrator, Carol Browner); *id.* ¶ 189 (statement of the Renewable Fuels Association); *id.* ¶¶ 212, 228, 273-74 (statements made by ADM officials); *id.* ¶¶ 228, 279 (letter from Regent International); *id.* ¶¶ 271-72 (statements by public interest groups); *id.* ¶¶ 276-77 (statements from governors of states other than California).

2. To The Contrary, The Record Shows That California Harbors No Ill Will Toward Methanex

132. Not only is the record devoid of any evidence of intent to harm Methanex, the record *belies* any intent on California's part to discriminate against Methanex. To the contrary, the record shows that Methanex was selected for participation in an important California initiative on fuel cells.

133. In April 1999, California initiated the California Fuel Cell Partnership, a collaboration of private industry and government, whose main objective is to promote the commercialization of fuel cell vehicles.[224]

134. Currently, the California Fuel Cell Partnership has twenty partners, who contribute financially to the partnership, and ten "associate partners," who contribute either expertise or equipment to the partnership.[225] Full partners include the world's leading auto manufacturers,[226] fuel suppliers,[227] and fuel cell technology companies,[228] as

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[224] The Fuel Cell Partnership, according to its website, aims to achieve four main goals:

> Demonstrate [fuel cell] vehicle technology by operating and testing the vehicles under real-world conditions in California;
>
> Demonstrate the viability of alternative fuel infrastructure technology, including hydrogen and methanol stations;
>
> Explore the path to commercialization, from identifying potential problems to developing solutions; and
>
> Increase public awareness and enhance opinion about fuel cell electric vehicles, preparing the market for commercialization.

About the California Fuel Cell Partnership (16 JS tab 49 at 1424).

[225] *See infra* notes 226-230.

[226] The Fuel Cell Partnership's automotive partners include Daimler Chrysler, Ford, General Motors, Honda, Hyundai, Nissan, Toyota and Volkswagen. *See* Fuel Cell Partnership-Automotive Partners (16 JS tab 49 at 1426-30).

[227] The Fuel Cell Partnership's fuel company partners include BP, ChevronTexaco, ExxonMobil and Shell Hydrogen. *See* Fuel Cell Partnership-Automotive Partners (16 JS tab 49 at 1431-32).

[228] The Fuel Cell Partnership's fuel cell technology partners include Ballard Power Systems and UTC Fuel Cells. *See* Fuel Cell Partnership-Automotive Partners (16 JS tab 49 at 1434).

well as United States government agencies at the federal, state and local level.[229] Associate partners include leaders in the energy industry, as well as three transit authorities.[230] The California agency partners, which include the CEC and CARB, not only contribute financial resources, but also time and services as needed.[231] The State of California is the largest single contributor to the California Fuel Cell Partnership's budget.[232]

135. In March 2000, Methanex was selected by the California Fuel Cell Partnership to be the Partnership's only associate partner from the methanol industry.[233] In the process of selecting Methanex, the California Fuel Cell Partnership rejected applications for partnership from the American Methanol Institute and other smaller methanol companies.[234] Methanex has touted its selection and participation in the Partnership in press releases.[235]

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[229] The Fuel Cell Partnership's government partners include CARB, the CEC, the South Coast Air Quality Management District, the U.S. Department of Energy, the U.S. Department of Transportation and the U.S. Environmental Protection Agency. *See* Fuel Cell Partnership-Automotive Partners (16 JS tab 49 at 1436-37).

[230] The Fuel Cell Partnership's associate partners include Methanex Corporation, Air Products and Chemicals, Inc., Pacific Gas & Electric, Praxair, Proton Energy Systems, Inc., Stuart Energy Systems Corporation, AC Transit, Sunline Transit Agency and Santa Clara Valley Transportation Authority. *See* Fuel Cell Partnership-Automotive Partners (16 JS tab 49 at 1426).

[231] Statement of Shannon Faith Baxter ("Baxter Statement") ¶ 3 (attested Dec. 3, 2003) (13 JS tab A).

[232] *Id.*

[233] *See* Press Release, Methanex Corp., Methanex Joins California Fuel Cell Partnership (Mar. 2, 2000) (17 JS tab 111 at 2271).

[234] *See* Baxter Statement ¶ 4 (13 JS tab A).

[235] *See* Press Release, Methanex Corp., Methanex Joins California Fuel Cell Partnership (Mar. 2, 2000) (17 JS tab 111 at 2271) (statement of Pierre Choquette, President and CEO of Methanex) ("The California Partnership is an excellent example of the type of multi-stakeholder collaboration that will be crucial in advancing the commercialization of fuel cell electric vehicles. We are pleased to be part of the Partnership and look forward to making a meaningful contribution to achieving the Partnership's objectives."); *see also* Press Release, Methanex Corp., California Opens Methanol Fueling Station for Fuel Cell Vehicles (Apr. 25, 2002) (17 JS tab 105 at 2265) (statement of Pierre Choquette, President and CEO of Methanex) ("This

136. The fact that Methanex was chosen to participate in a collaboration in which the State of California was one of the founding members and is the largest financial contributor evidences that California has no animus towards Methanex. It is notable that Methanex was chosen even though U.S. enterprises, such as the American Methanol Institute, were rejected. It is also noteworthy that the same agencies that coordinate the Partnership, the CEC and CARB, are the agencies that were principally responsible for the CaRFG3 regulations that Methanex challenges.

B. Methanex's Attempt To Conflate Methanol With MTBE Is Without Support

137. Methanex's argument that intent to harm methanol producers may be inferred from the measures' alleged benefit to ethanol producers fails on its own terms.[236] Methanex itself acknowledges that its argument applies only in instances of products that are "directly competitive or substitutable."[237]

138. Contrary to Methanex's assertions, however, methanol and ethanol are not "essentially interchangeable."[238] Rather, as the Tribunal observed in its First Partial Award, "[e]thanol is . . . an oxygenate that directly competes with MTBE"; methanol is not.[239]

139. Methanex, nonetheless, posits a "binary choice" between methanol and ethanol in three oxygenate markets: those for gasoline distributors, merchant oxygenate

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methanol fueling station represents an exciting milestone in the development of fuel cell technology and is made possible by the cooperation of members of the California Fuel Cell Partnership.").

[236] *See* Second Amended Statement of Claim ¶¶ 166-173.

[237] *Id.* ¶ 170 (relying on *Korea –Taxes on Alcoholic Beverages*, Panel Report, WT/DC75/R ¶ 10.101 (1998)).

[238] *Id.* at 25 (heading V(A)); *see also id.* ¶¶ 70, 159.

[239] First Partial Award ¶ 50 (citing Methanex Draft Amended Claim at 10-11).

producers and gasoline refiners.[240] As demonstrated below and in the expert report of Bruce Burke, this supposed "binary choice" between methanol and ethanol does not exist in reality in any of these three markets.[241]

140. Because methanol is not directly competitive with or substitutible for ethanol in any of the three oxygenate markets, Methanex's suggestion that ethanol's advantage is tantamount to methanol's disadvantage is without merit. And, therefore, the evidence offered by Methanex – which purports to show that the purpose of the measures at issue was to favor ethanol over MTBE – on its face cannot meet the standard for a showing of intent outlined in the First Partial Award. Below, we address in turn the reasons why methanol does not compete with ethanol in any of the three markets identified by Methanex.

1. Gasoline Distributors Do Not Have An Option Of Buying Methanol

141. Gasoline distributors acquire gasoline stock and sell it to gasoline stations that retail it to the public. In California, gasoline distributors presently rely on one of two means for distributing gasoline that meets the requirements of the CaRFG regulations.[242] Gasoline distributors may acquire gasoline already containing MTBE for resale.[243] Or gasoline distributors acquire gasoline basestock otherwise compliant with California regulations, purchase ethanol from ethanol producers and combine the ethanol with

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[240] Second Amended Statement of Claim at ¶¶ 77-81.

[241] *See* Burke Report ¶¶ 111-137 (13 JS tab B).

[242] *See id* ¶ 113.

[243] *See id.*

gasoline basestock at distribution terminals.[244] The two streams of ethanol and basestock are combined as the tank trucks are loaded in an operation referred to as "splash blending."[245] The blended product then is distributed as CaRFG gasoline. In the California gasoline-distributor market, only ethanol is splash-blended at distribution terminals.[246]

142. While, as a theoretical matter, MTBE could be splash-blended by gasoline distributors, in practice MTBE is not and has never been splash-blended in the California market.[247] The chemical properties of and distribution system for MTBE are sufficiently different from ethanol that it has not made commercial sense in California to splash-blend MTBE.[248] As a result, the only oxygenate purchased by California gasoline distributors as a separate product is ethanol.[249]

143. Methanol, on the other hand, is not splash-blended with gasoline basestock because methanol is not, and cannot legally or practically be, used as an oxygenate in gasoline.

144. As James Caldwell, a twenty-seven year veteran U.S. EPA environmental engineer involved in fuel additives regulation, describes in his statement, U.S. EPA

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[244] *See id.*

[245] *See id.* ¶ 115 & p. 42 (Glossary of Terms).

[246] *See id.* ¶¶ 116-18.

[247] *See id.* ¶ 118.

[248] *See id.* Ethanol, because of its solubility in water, cannot be transported through the pipelines that generally connect refineries to gasoline distribution terminals. MTBE can be so transported. Because it is more cost-efficient for refiners to transport product through the pipelines, they generally blend MTBE into gasoline at the refineries; it makes little commercial sense to separately transport the MTBE to the distribution terminals for splash blending. *See id.* ¶¶ 115, 118.

[249] *See id.* ¶¶ 116, 118.

regulations have long prohibited the use of methanol as an oxygenate to satisfy the oxygenated fuel programs that are in place in the United States.[250]

145. Under federal regulations, before a fuel or fuel additive may be used in gasoline in the United States, it must satisfy several criteria.[251] First, it must be shown to be "substantially similar" to fuels or fuel additives already in use.[252] This requirement may be waived if the applicant shows that the proposed fuel or fuel additive will not contribute to the failure of vehicle emissions control systems.[253] Second, the fuel or fuel additive must be registered with the U.S. EPA.[254] Finally, the fuel or fuel additive must undergo, and pass, testing for adverse health effects in humans.[255]

146. Because of methanol's highly corrosive nature, in 1981 U.S. EPA explicitly excluded methanol from the category of "substantially similar" additives such that it cannot be used to satisfy the requirements of the two oxygenated fuel programs.[256] No producer of methanol has obtained a waiver of the "substantially similar" rule to allow for methanol's use as an oxygenate in these programs.[257] Nor has any effort been

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[250] *See* Caldwell Statement ¶¶ 18-19, 30 (13 JS tab C).

[251] *See generally id.*

[252] *See id.* ¶¶ 17-19.

[253] *See id.* ¶¶ 20-22.

[254] *See id.* ¶ 23.

[255] *See id.* ¶¶ 24-26. Additives that were in use when U.S. EPA adopted the health effects testing requirements in 1994 may keep their registration so long as the required testing is underway. *See id.* ¶ 24. Although it is not yet complete, such testing is underway on MTBE, ETBE, TAME, DIPE, TBA and ethanol. *See id.* ¶ 26. U.S. EPA requires that new products undergo health effects testing prior to their registration. *See id.* ¶ 24.

[256] *See id.* ¶ 18 (quoting U.S. EPA's 1981 interpretation of the "substantially similar" rule determining that methanol cannot be used as an oxygenate because of "questions concerning the effects of methanol-gasoline mixtures upon fuel system components as well as water separation and evaporative emissions characteristics of such fuels.").

[257] *See id.* ¶ 22.

made by the industry to initiate health-effects testing to allow for the use of the chemical at levels required to satisfy oxygen content requirements of the programs.[258] Methanol therefore cannot legally be used as an oxygenate in gasoline in the United States today.[259]

147. It is not surprising that the methanol industry has left these regulatory requirements unaddressed. Bruce Burke, a chemical engineer with more than twenty-five years of experience with leading energy industry consultancy Nexant, Inc., makes clear in his expert report that methanol's chemical properties as well as industry practices preclude methanol's use as an oxygenate in gasoline.[260] Mr. Burke explains, for example, that methanol is highly corrosive and therefore incompatible with materials commonly used in the transportation infrastructure as well as vehicle components.[261] Indeed as he notes, vehicle manufacturers explicitly warn car buyers against the use of fuel containing methanol:

> "Your vehicle was not designed for fuel that contains methanol. Don't use fuel containing methanol. It can corrode metal parts in your fuel system and also damage plastic and rubber parts. That damage wouldn't be covered under your warranties."[262]

148. Several other factors impede methanol's use as an oxygenate. For example, blending even small amounts of methanol into gasoline results in a significantly

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[258] *See id.* ¶ 30.

[259] *See id.* ¶¶ 26, 30-31 (citing 40 C.F.R. 79). Thus, even assuming methanol satisfied other prerequisites to its use as an oxygenate, it is likely that health effects testing, once initiated, would take several years at least to complete. *See id.* ¶ 26 & n.28.

[260] *See generally* Burke Report (13 JS tab B).

[261] *See id.* ¶¶ 70, 117(c) (discussing three corrosion mechanisms exhibited by methanol); *see also* Caldwell Statement ¶ 19 (13 JS tab C) (reviewing U.S. EPA's determination in 1981 that methanol cannot be used as an oxygenate because of "questions concerning the effects of methanol-gasoline mixtures upon fuel system components as well as water separation and evaporative emissions characteristics of such fuels.").

[262] *See* Burke Report ¶ 106 (13 JS tab B) (quoting 2003 Automobile Manufacturer Fuel Recommendations, compiled by Herman & Assoc.).

adverse effect on the volatility – measured in terms of "Reid Vapor Pressure" or "RVP" – of the blended gasoline.[263] Methanol's effect on RVP makes it an undesirable component of gasoline.[264] In addition, methanol requires special handling and storage due to its toxicity and lack of luminosity when burning.[265]

149. Thus, Methanex's claim that it is "'necessary to assume that' California revised its reformulated gasoline regulations 'precisely because of' methanol's similarity to and ability to compete with ethanol" is without merit.[266] California had neither incentive nor need to take action adverse to methanol producers because methanol is not, and cannot legally or practically be, used as an oxygenate in California gasoline.[267] Contrary to Methanex's allegation, methanol does not compete with either ethanol or

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[263] *See id.* ¶¶ 87-90, 94, 117(d).

[264] *See id.*

[265] *See id.* ¶¶ 70, 117(e).

[266] Second Amended Statement of Claim ¶ 163 (quoting *E.C. Commission v. Denmark* [1981] 2 C.M.L.R. 688, 702 (Opinion of the Advocate General)).

[267] Methanex is correct that the CaRFG3 regulations, as amended effective May 1, 2003, list eleven chemical compounds, including methanol, as encompassed by the regulations' conditional prohibition (subject to multimedia testing). *See* CAL. CODE REGS. tit. 13 § 2262.6(c)(4)(2003) (14 JS tab 10 at 93). CARB amended the regulations in order to provide refiners and blenders with a verifiable means of complying with the conditional prohibition of other oxygenates. CARB noted that it had included compounds that could not necessarily be used as oxygenates in gasoline and explained its reason for listing the eleven compounds as follows:

> [T]he [eleven] listed oxygenates comprised all of the compounds listed in the test method for the presence of oxygenates in gasoline – [American Society of Testing and Materials ("ASTM")] D 4815-99 – except MTBE and ethanol. The existence of each listed oxygenate in Table 5 of ASTM D 4815-99 was the sole reason the oxygenates were included on the list of covered oxygenates in the regulation. The listing of an oxygenate is not intended to indicate that it has actually been used as an oxygenate in CaRFG in the past, or might reasonably be expected to be used as a gasoline oxygenate in California in the future.

California Environmental Protection Agency, Air Resources Board, *Final Statement of Reasons for Rulemaking* 3 (public hearing, Dec. 12, 2002) (14 JS tab 19 at 540). Of the eleven compounds listed in this subsection of the amended CaRFG3 regulations, only four are registered by the EPA as permitted for use in satisfying the requirements of oxygenated gasoline programs in place in the United States. *See* Caldwell Statement ¶ 27-28 & Exh. 1 (13 JS tab C).

MTBE as an oxygenate in reformulated gasoline in California or any other state – and has no prospect of doing so.

150. Indeed, Methanex's new assertions that methanol competes with ethanol (and MTBE) as an oxygenate stand in stark contrast to its earlier conduct and statements.

151. *First*, Methanex has never suggested in its public disclosures to its shareholders that it has sold or marketed methanol as an oxygenate in gasoline.[268] To the contrary, Methanex repeatedly told its shareholders that methanol *cannot* be sold as an oxygenate under the Clean Air Act: "MTBE, ethanol (which is produced from corn) and other substantially similar blends of ethers and alcohols (*except methanol*) constitute the oxygenates approved for use under the Clean Air Act."[269] Nor has Methanex suggested in such disclosures that the oxygenate market holds any potential for methanol other than as an ingredient used to manufacture MTBE.

152. *Second*, Methanex has repeatedly acknowledged in these proceedings, and again in its most recent fresh pleading, that methanol is not a competitor in the oxygenate market.[270] To the contrary, as Methanex has acknowledged, the market essentially has

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[268] *See, e.g.*, Methanex Corp. 2002 Annual Report (17 JS tab 82 at 2098-2178); *see also, e.g.*, Methanex Form F-10, May 21, 2003 at 10 (18 JS tab 135 at 2591) (addressing the business of the company, which does not include the production of methanol for use as an oxygenate). The absence of any suggestion that methanol could be a viable oxygenate stands in marked contrast to Methanex's animated discussion of methanol's application as a fuel or in fuel cells – markets that, if they are ever established, will only be so many years from now. *See* Methanex Corp. 2002 Annual Report at 40 (17 JS tab 82 at 2132) (caveat on forward-looking statements).

[269] Methanex Corp. 1997 Annual Report at 66 (17 JS tab 76 at 1721) (emphasis added); Methanex Corp. 1998 Annual Report at 85 (17 JS tab 77 at 1835) (same); Methanex Corp 1999 Annual Report at 73 (17 JS tab 78 at 1935) (same).

[270] *See* Macdonald Affidavit ¶ 8 (attested May 25, 2001) ("Gasoline blenders and distributors may oxygenate their reformulated gasoline with any oxygenate available on the merchant market, including ethanol, MTBE, ETBE and TAME. Typically, gasoline blenders have relied upon either MTBE or ethanol to meet their oxygenate needs."); *see also* Second Macdonald Affidavit ¶ 15 (attested Nov. 8, 2002) (noting that, "[f]or integrated refineries, the choice is either to buy methanol and produce MTBE, or to buy ethanol for either the production of ETBE or for splash blending. For blenders and distributors, the choice is to buy

been winnowed to two competing chemicals: ethanol and MTBE.[271] Indeed, prior to filing its Second Amended Statement of Claim, Methanex had never before suggested that methanol may be used as an oxygenate in gasoline.

153. *Finally*, Methanex's own evidence does not support the assertion that methanol is or can be used as an oxygenate in California gasoline. Indeed, Methanex itself states that the blending plants' choice includes only a "*theoretical* option" of buying methanol for use as an oxygenate that could be splash blended with gasoline.[272] Instead, Methanex's evidence shows only that, as a technical matter, methanol belongs to a class of chemicals known as oxygenates.[273]

154. Methanex's senior officer sums up the point well: "For blenders and distributors, the choice is to buy . . . MTBE from merchant producers, or to buy ethanol."[274] There is no binary choice between methanol and ethanol in this market.

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methanol-based MTBE from merchant producers, or to buy ethanol."); *id.* ¶ 19 ("Before the ban was announced, other oxygenates simply could not compete with MTBE's cost-effectiveness and other benefits under 'level playing field' conditions."); *id.* ¶ 22 ("Direct use of methanol as an oxygenate was also not seriously considered before the MTBE ban was announced because it made greater practical sense to convert methanol to MTBE, which is easier and more advantageous to blend with gasoline than either methanol or ethanol."); *id.* ¶ 28 ("Before the MTBE ban was announced . . . methanol was not seriously considered [as an oxygenate], as it was more advantageously used to make MTBE.").

[271] *See* Second Amended Statement of Claim ¶ 57 (In this case, "essentially only two competing products [*i.e.*, MTBE and ethanol] are vying for the same customers in the same market . . . ."); Second Macdonald Affidavit ¶ 14 ("Although blenders and refiners have always had the choice between all four oxygenates, subject to their technical requirements, these blenders and refiners have primarily chosen MTBE or, to a much lesser extent, ethanol.").

[272] *See* Second Amended Statement of Claim ¶ 82 (emphasis added).

[273] *See* Second Macdonald Affidavit ¶ 7; *cf.* Burke Report ¶ 20 (13 JS tab B) (explaining that although literally thousands of chemical compounds satisfy the American Petroleum Institute's definition of oxygenate as a compound "'containing hydrogen, carbon and oxygen atoms,'" only very few are used commercially in the United States or elsewhere).

[274] Second Macdonald Affidavit ¶ 15.

2. Merchant Oxygenate Producers Do Not Face A Choice Between Methanol And Ethanol

155. Merchant oxygenate producers manufacture oxygenates for resale to gasoline refiners and distributors.[275] There are essentially two categories of merchant oxygenate producers in the United States: ethanol producers and MTBE producers.[276] In the California gasoline market, merchant MTBE is sold only to gasoline refiners, and ethanol is sold only to gasoline distributors.[277] MTBE and ethanol are produced using very different processes.

156. Ethanol used as an oxygenate is produced from renewable, biological materials.[278] Corn is the most common raw material for ethanol production in the United States, although a wide variety of biological materials can also be used.[279] Most ethanol production in the United States is centered in the Mid-West, which is also where much agriculture in the United States is based.[280]

157. MTBE is produced by reacting methanol with isobutylene.[281] A little more than one unit of methanol goes into every three units of MTBE.[282] The producers buy methanol and produce isobutylene and react them at their facilities to produce

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[275] *See* Burke Report ¶ 120 (13 JS tab B).

[276] *See id.*

[277] *See id.*

[278] *See id.* ¶¶ 42, 123.

[279] *See id.* ¶ 42, n.20.

[280] *See id.* Exh. 9.

[281] *See id.* ¶ 23.

[282] *See id; see also* Methanex Corp. 2002 Annual Report, Fact Book at vi (17 JS tab 82 at 2174) (listing production conversion formula – *i.e.*, the "unit of methanol consumed per unit of product by weight" – for MTBE as 0.36).

MTBE.[283] Most merchant MTBE manufacturers in the United States are located on the Gulf Coast, where much of the petrochemical industry in the United States is based.[284]

158. Thus, there is no "binary choice" facing merchant oxygenate manufacturers. Ethanol manufacturers buy corn or other biological materials to make their oxygenate.[285] MTBE manufacturers produce isobutylene and purchase methanol to make theirs.[286] Neither can use the inputs used by the other.

159. In its discussion of the supposed "binary choice" facing merchant oxygenate producers, Methanex refers to merchant producers of the ether ETBE, pointing out that ETBE is produced by reacting ethanol with isobutylene.[287] Methanex's reference to ETBE is a red herring for two reasons.

160. *First*, as Methanex itself acknowledges, "there are currently no ETBE producers in the United States."[288] There is no market for ethanol as a feedstock to produce ETBE for use in California gasoline.[289] Ethanol and methanol can in no sense "compete" in a market that does not exist.

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[283] *See* Burke Report ¶¶ 23-30, 121 (13 JS tab B).

[284] *See id.* ¶ 34, n.12.

[285] *See id.* ¶ 124.

[286] *See id.*

[287] *See* Second Amended Statement of Claim ¶ 81.

[288] *See* Second Macdonald Affidavit ¶ 13; *see also id*. ¶ 15.

[289] *See* Burke Report ¶ 126 (13 JS tab B); *see also* California Environmental Protection Agency, Air Resources Board, *Final Statement of Reasons, Secondary Maximum Contaminant Level for Methyl tert-Butyl Ether and Revisions to the Unregulated Chemical Monitoring List, Title 22, California Code of Regulations* ("Final Reasons for MTBE MCL") at 5 (1997) (14 JS tab 20 at 550).

161. *Second*, there will be no such market in the future.[290] Indeed, the ban at issue, when it goes into effect, will prohibit the use of ETBE in gasoline just as it will ban the use of MTBE in gasoline.[291] As a result, contrary to Methanex's assertions, there is not and will be no "zero-sum" competition between methanol and ethanol in this market.[292]

3. Gasoline Refiners Do Not Have A Choice Between Methanol And Ethanol

162. Some vertically integrated gasoline refiners produce MTBE using isobutylene generated by the refining process.[293] They are commonly termed "captive" MTBE manufacturers because they use, rather than sell, the MTBE they produce.[294] Such plants produce relatively small amounts of MTBE and the availability of isobutylene dictates their capacity.[295] Like merchant MTBE producers, captive producers buy

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[290] Methanex's own witness, Kimmo Rahkamo, a general manager of a Canadian company's MTBE division, conceded as much. Mr. Rahkamo attests that his company "has decided to cease its production of MTBE, and to retool its production process to make *iso-octane*," not ETBE. Rahkamo Affidavit ¶ 3 (attested May 18, 2001) (emphasis added) (attached to Methanex Rejoinder to U.S. Reply Memorial on Jurisdiction, Admissibility and the Proposed Amendment (May 25, 2001) at Exh. 4); *see also* Burke Report ¶¶ 127-31 (13 JS tab B).

[291] The ban on ETBE is conditional in that, under the California regulations, it cannot be used as an oxygenate without its first undergoing a multimedia study. *See* California Environmental Protection Agency, Air Resources Board, *Final Regulation Order, Amendments to the California Reformulated Gasoline Regulations to Postpone Imposition of the CaRFG3 Standards and the Prohibition of MTBE and Oxygenates Other Than Ethanol in California Gasoline From December 31, 2002 to December 31, 2003*, § 2262.6(c)(1) (adopted Mar. 14, 2003) (codified at CAL. CODE REGS. tit. 13, § 2262.6(c)(1) (2003)) (14 JS tab 17 at 456).

[292] Second Amended Statement of Claim at 20 (heading IV(C)); *id*. ¶ 304. Even Methanex's witness, an MTBE producer, will not produce ETBE following the ban. *See* Rahkamo Affidavit ¶ 3 ("Because of the California ban on MTBE, AEF has decided to cease its production of MTBE, and to retool its production process to make iso-octane.").

[293] *See* Burke Report ¶ 133 (13 JS tab B).

[294] *See id*.

[295] *See id*.

methanol to manufacture MTBE.[296] There are captive MTBE producers throughout the United States.[297] A number of them are located in California and supply the California gasoline market.[298] In 2000, about 15 percent of the MTBE used in California gasoline was produced by captive plants located in California.[299]

163. Ethanol does not compete with methanol in the market for captive producers of MTBE.[300] First, as noted above, ethanol is not used to produce MTBE. Second, there are no producers of ETBE for use in California gasoline, whether captive or merchant.[301] Nor will there be any after the CaRFG3 regulations go into effect, because those regulations ban ETBE just as they ban MTBE.[302]

164. Third, Methanex's suggestion that captive refiners may choose to splash-blend ethanol instead of producing MTBE is without support.[303] Ethanol, because of its solubility in water, cannot be transported through the pipelines that generally connect refineries to gasoline distribution terminals.[304] Because it is more cost-efficient for refiners to transport the gasoline they produce to terminals through pipelines than by truck or rail, they do not mix ethanol with their gasoline at their refineries. For this

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[296] *See id.* ¶ 135.

[297] *See id.* ¶ 134 & Exh. 4.

[298] *See id.*

[299] *See id.* ¶ 38; s*ee also* California Energy Commission, *Quarterly Report Concerning MTBE Use In California Gasoline, January 1 through March 31, 2000* at 2 (May 2000) (14 JS tab 13 at 168).

[300] *See* Burke Report ¶ 135 (13 JS tab B).

[301] *See id.*

[302] *See* CAL. CODE REGS. tit. 13, § 2262.6(c)(1) (2003) (14 JS tab 10 at 93).

[303] *See* Second Amended Statement of Claim ¶ 79.

[304] *See* Burke Report ¶ 137 (13 JS tab B).

reason, captive refiners do not purchase ethanol.[305] Instead, as noted above, operators of distribution terminals splash blend ethanol into gasoline at the terminal.

165. Moreover, to produce MTBE-oxygenated gasoline, captive refiners must produce an MTBE-compatible gasoline basestock.[306] Refiners of such basestock have no use for ethanol.[307] Similarly, refiners that produce an ethanol-compatible gasoline basestock have no use for MTBE.[308] To produce gasoline basestock that can be oxygenated with ethanol, a captive MTBE refiner would be required to undertake significant steps, including operational changes, employee retraining, and certain capital investments.[309]

166. For these reasons, Methanex's contention that captive refiners face a choice of buying methanol or buying ethanol does not square with commercial reality. Its contention that there exists a "binary choice" in this market, like its contentions with respect to the other markets it identifies, is without support.[310]

C. In Any Event, Methanex's Suggestion That The Measures' Purpose Was To Benefit Ethanol Is Without Merit

167. The foregoing discussion establishes that the purpose of the measures at issue was not to harm or even address methanol producers or Methanex. The purpose of

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[305] *See id*.

[306] *See id*. ¶ 136.

[307] *See id.*

[308] *See id.*

[309] *See id.*

[310] The United States notes that it, like Methanex, sought a witness statement from captive refiners of MTBE in California. No such refiner provided such a statement – no doubt because of fear of retaliation from Methanex. *Cf.* Second Amended Statement of Claim ¶ 4 ("Methanex had intended to supply another factual affidavit from one of the California refiners affected by the California measures. That refiner, however, ultimately declined to provide Methanex with that affidavit, informing Methanex that it had made that decision because it feared retaliation from the State.").

the measures, as stated on their face, was to address MTBE, not harm methanol producers. And Methanex's argument that the measures' supposed benefit for ethanol producers gives rise to an inference of intent with respect to methanol fails on its own terms, given that methanol and ethanol do not compete in the oxygenate market. On these grounds alone, Methanex has failed to demonstrate that the measures "relat[e] to" it or its investments within the meaning of NAFTA Article 1101(1).

168. The United States nevertheless observes that the evidence in the record in any event is at odds with Methanex's assertion that the purpose of the measures at issue was to benefit ethanol at the expense of MTBE. As noted above, California is vigorously seeking a waiver to the federal RFG oxygenate requirement which, if successful, would would eliminate the requirement that oxgygenates be used in most of the gasoline sold in the state. Moreover, although a future ban on the use of MTBE in California gasoline might have the consequence of benefiting ethanol producers, benefiting such producers was not California's *intent* in adopting the ban. As demonstrated above, California adopted the ban on MTBE in gasoline in order to address contamination of its drinking water.

169. The 1999 Executive Order states Governor Davis's intent to remedy the threat of MTBE contamination of California's drinking water supply. The Governor's intent *not* to benefit the ethanol industry is also apparent on the face of the Executive Order – that Executive Order directed the CARB to request "an immediate waiver" from the federal RFG oxygenate requirement for California gasoline.[311]

170. A press statement issued by the Governor simultaneously with the 1999

Executive Order further evidences the Governor's intent *not* to benefit the ethanol industry. In that press release, the Governor explained that he had ordered a study of the possible risks and benefits of ethanol so that California would not make the mistake of rushing to replace MTBE with ethanol without knowing the consequences of doing so.[312]

171. Contrary to Methanex's allegations, California did not adopt the ban as a gift to the ethanol industry.[313] The record simply does not support the strained inferences and arguments that Methanex attempts to draw from it, as demonstrated below.

1. California's Request For A Waiver And The 2002 Executive Order

172. The 1999 Executive Order launched a campaign by California to *lift* the oxygenate requirement for reformulated gasoline in the state and thereby ensure that ethanol need not be used. California's relentless pursuit of a waiver of the federal oxygenate requirement demonstrates its absence of intent to benefit the ethanol industry.[314] Governor Davis, who was actively involved in the waiver request, argued that "it does not make sense for Washington to dictate that [ethanol] be used in every single gallon of gas."[315] A grant of the waiver sought by California would *harm* the interests of the ethanol industry, as sellers of gasoline in California would not be

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[311] 1999 EXECUTIVE ORDER pmbl., ¶¶ 2-3 (1 JS tab 1(c)).

[312] *Certification of Human Health or Environmental Risks of Using Gasoline Containing MTBE in California* at 2-3 (Mar. 26, 1999) (16 JS tab 35 at 1289-90).

[313] *See, e.g.*, Press Release, Office of the Governor of California, Governor Davis Statement Regarding Federal Court's MTBE Ruling (July 17, 2003) (17 JS tab 116 at 2278) ("To our friends in the Midwest I want to say, California is not anti-ethanol. However, it does not make sense for Washington to dictate that it be used in every single gallon of gas."); *see also* Simeroth Statement ¶¶ 16-17 (13A JS tab H).

[314] *See supra* at 23-25.

[315] Press Release, Office of the Governor of California, Governor Davis Statement Regarding Federal Court's MTBE Ruling (July 17, 2003) (17 JS tab 116 at 2278).

compelled to add ethanol to gasoline to comply with the federal oxygenate requirement. As Methanex also notes, "the U.S. ethanol industry bitterly opposed the waiver."[316]

173. In addition, Governor Davis issued the 2002 Executive Order, which postpones the date of the ban on the use of MTBE in California gasoline by one year.[317] As the Executive Order notes, the Governor took this step because implementing the ban without the federal oxygenate waiver in place would require California to use large quantities of ethanol as a replacement oxygenate, which, in the near term, would negatively impact the supply and availability of gasoline in California.[318] In his accompanying statement, the Governor made clear that his intent was not to benefit the ethanol industry: "I am not going to allow Californians to be held hostage by another out-of-state energy cartel."[319]

174. Not surprisingly, ethanol advocates opposed and criticized the issuance of the 2002 Executive Order[320] – and the MTBE and methanol industry loudly applauded it.[321]

175. As demonstrated above, California had no intent to benefit ethanol through the MTBE ban. In California's view, reliance solely on ethanol would be

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[316] Second Amended Statement of Claim ¶ 131.

[317] Executive Order D-52-02 by the Governor of the State of California ("2002 EXECUTIVE ORDER") pmbl. (16 JS tab 46 at 1415).

[318] *Id.* at 1.

[319] Press Release, Office of the Governor of California, Governor Davis Allows More Time for Ethanol Solution (Mar. 15, 2002) (17 JS tab 115 at 2276).

[320] *See* Press Release, Renewable Fuels Association, Gov. Davis' Decision to Delay Ban a Mistake; RFA Urges California Refiners to End MTBE Use Voluntarily (Mar. 15, 2002) (17 JS tab 120 at 2285).

[321] *See* Methanol Institute, Annual President's Report at 9 (Dec. 9, 2002) (17 JS tab 89 at 2228) ("As a Result of Combined Lobbying Effort of Methanol and MTBE Industries, CA Gov. Davis extends MTBE ban by one year to January 1, 2004").

costly and deny refiners a choice.[322] California made every effort to avoid relying on ethanol, and continues to fight for the oxygenate waiver.[323] Methanex's claim that California intended to benefit ethanol producers is baseless.

2. Campaign Contributions From And Contacts With ADM

176. Then-gubernatorial candidate Davis's meeting with executives from ADM does not support Methanex's assertion that Governor Davis issued the Executive Order to benefit the ethanol industry.

177. Political campaigns in the United States, particularly for governorships of major states such as California, are expensive.[324] It is therefore commonplace in the United States for candidates for elected office to meet with constituents and potential contributors who may support their campaign. There is nothing improper or even

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[322] *See, e.g.*, Letter from Governor Gray Davis, Governor of California, to Carol M. Browner, Administrator, U.S. EPA at 1-2 (April 12, 1999) (16 JS tab 65 at 1568-69) ("[U.S. EPA's] action to allow the required emissions reductions to be achieved without using a minimum oxygen content in every gallon of fuel would allow us to reduce risks of future water contamination sooner, meet California's growing demand for fuel and allow flexibility to make more economical blends of gasoline."); Letter from Gray Davis, Governor of California to Carol Browner, Administrator, U.S. EPA at 1 (Dec. 15, 1999) (16 JS tab 66 at 1581-82) ("MTBE poses an unacceptable risk to California's water resources. . . . With the flexibility provided by a waiver, California refiners will have a choice of producing reformulated gasoline using ethanol or fuel without any oxygen at all. . . . They need to know whether they have the option to produce non-oxygenated gasoline.").

[323] *See supra* at 23-25. On July 17, 2003, the United States Court of Appeals for the Ninth Circuit vacated the U.S. EPA's denial of California's oxygenate waiver request. *See Davis v. U.S. EPA*, 336 F.3d 965 (9th Cir. 2003) (16 JS tab 41 at 1325). The court remanded the case to the U.S. EPA "with instructions to review California's waiver request with full consideration of the effects of a waiver on both the ozone and the [particulate matter National Ambient Air Quality Standards]." *Id.* at 36 (16 JS tab 41 at 1333).

[324] For example, Governor Davis's 1998 gubernatorial campaign expenditures exceeded $28 million and his competitor, Republican Dan Lungren's expenditures reached nearly $24 million. *See* California Secretary of State, *1998 California General Election Campaign Receipts, Expenditures, Cash On Hand and Debts for State Candidates and Officeholders, July 1, 1998 Through December 31, 1998: Candidates for Constitutional Offices Complete Financial Activity* (16 JS tab 32 at 1275).

remarkable about a political candidate receiving contributions from individuals or companies or meeting with potential supporters.[325]

178. No inference as to Governor Davis's motivation may be drawn from the mere fact that he received campaign contributions from ADM, any more than such an inference can be drawn from the fact that a broad base of supporters, including ARCO (an MTBE producer) and other petrochemical companies and interests,[326] Zenith Insurance Company,[327] Ameriquest Capital Corporation,[328] the California Teachers Association,[329]

[325] *See, e.g., McCormick v. United States*, 500 U.S. 257, 272 (1991) ("Serving constituents and supporting legislation that will benefit the district and individuals and groups therein is the everyday business of a legislator. It is also true that campaigns must be run and financed. Money is constantly being solicited on behalf of candidates, who run on platforms and who claim support on the basis of their views and what they intend to do or have done. . . . . election campaigns are financed by private contributions or expenditures, as they have been from the beginning of the Nation.").

[326] California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (Oct. 1, 1998 – Oct. 17, 1998) at 14 (16 JS tab 29 at 1260) (contribution of Atlantic Richfield Co); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (Oct. 18, 1998 – Dec. 31, 1998) at 24 (16 JS tab 30 at 1266) (contribution of Atlantic Richfield Co); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (July 1, 1999 – Dec. 31, 1999) at 12 (16 JS tab 31 at 1272) (contributions of ARCO Products); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (Oct. 18, 1998 – Dec. 31, 1998) at 413 (16 JS tab 30 at 1268) (contribution of Ultramar Diamond Shamrock Corp.).

[327] California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (May 17, 1998 – June 30, 1998) at 148 (16 JS tab 27 at 1250).

[328] California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (May 17, 1998 – June 30, 1998) at 8 (16 JS tab 27 at 1247); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (July 1, 1998 – Sept. 30, 1998) at 17 (16 JS tab 28 at 1253); California Form 490 Schedule C (Non-Monetary Contributions Received) (July 1, 1998 – Sept. 30, 1998) at 677 (16 JS tab 28 at 1255); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (Oct. 18, 1998 – Dec. 31, 1998) at 16 (16 JS tab 30 at 1265).

[329] California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (May 17, 1998 – June 30, 1998) at 25 (16 JS tab 27 at 1249); California Form 490 Schedule C for Gray Davis (Non-Monetary Contributions Received) (July 1, 1998 – Sept. 30, 1998) at 682 (16 JS tab 28 at 1257); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (Oct. 1, 1998 – Oct. 17, 1998) at 40 (16 JS tab 29 at 1262); California Form 490 Schedule C for Gray Davis (Non-Monetary Contributions Received) (Oct. 1 1998 – Oct. 17 1998) at 337 (16 JS tab 29 at 1262).

and the California State Employees Association,[330] among many others, all made contributions to his campaign.

179. Nor may any inference as to an official's views be drawn from the mere fact that Governor Davis or any other official met with potential supporters or lobbyists. The fact that a political decision-maker is willing to listen to the views of an interested party does not necessarily mean that the decision-maker agrees with those views.[331] Indeed, the participants in the alleged meeting that Methanex claims took place with Senator Burton supposedly included three lobbyists hired by Methanex, one lobbyist hired by an MTBE producer and one lobbyist from a trade association.[332] Bad faith can no more be inferred from candidate Davis's meeting with executives involved in the ethanol industry, including ADM and Regent, than it could be inferred based on an alleged meeting between Methanex's lobbyists and Senator Burton.

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[330] California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (Mar. 18, 1998 – May 16, 1998) at 16 (16 JS tab 26 at 1244); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (May 17, 1998 – June 30, 1998) at 25 (16 JS tab 27 at 1249); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (July 1, 1998 – Sept. 30, 1998) at 80 (16 JS tab 28 at 1254); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (Oct. 1, 1998 – Oct. 17, 1998) at 40 (16 JS tab 29 at 1262); California Form 490 Schedule C for Gray Davis (Non-Monetary Contributions Received) (July 1, 1998 – Sept. 30, 1998) at 681 (16 JS tab 28 at 1254); California Form 490 Schedule A for Gray Davis (Monetary Contributions Received) (Oct. 18, 1998 – Dec. 31, 1998) at 70 (16 JS tab 30 at 1267); California Form 490 Schedule C for Gray Davis (Non-Monetary Contributions Received) (Oct. 1, 1998 – Oct. 17, 1998) at 337 (16 JS tab 29 at 1262).

[331] *See Times Mirror Co. v. Superior Court of Sacramento County*, 53 Cal.3d 1325, 1354 (1991) (Kennard, J., dissenting) ("[I]nformation that the governor met with an advocate for a particular position reveals little about how the governor is inclined to decide the issue. Governors do not meet only with advocates whose views they are inclined to favor. A governor may wish to test a tentative decision or inclination against the arguments of those advocating a different course, or the governor may choose to hear the opposing arguments as a matter of courtesy, political expediency, or public relations."); *see also, e.g., Bruce v. Riddle*, 631 F.2d 272, 280 (4th Cir. 1980) ("Meeting with 'interest' groups, professional or amateur, regardless of their motivation, is a part and parcel of the modern legislative procedures through which legislators receive information possibly bearing on the legislation they are to consider.").

[332] *See* Wright Affidavit ¶¶ 3-4; *see also* Supplemental Wright Affidavit ¶¶ 13-14 (12 JS tab A).

180. It is significant, in considering the inferences that Methanex urges the Tribunal to draw from these meetings and contributions, that Methanex disavows any suggestion that Governor Davis engaged in any illegal activity either during his campaign or while in office. Specifically, Methanex states that it is not alleging that Governor Davis solicited or received any bribe, which would constitute a federal offense.[333] Therefore, Methanex does not contend that Governor Davis issued the Executive Order in return for receiving campaign contributions from ADM or anyone else. Furthermore, all of Governor Davis's campaign contributions, including those made by ADM, were disclosed pursuant to law.[334]

181. Methanex has thus provided no basis for its assertion that an intent to favor ethanol may be inferred from the fact of campaign contributions from or a meeting with ethanol executives.

3. Supposed Reaction To "Public Hysteria" Over MTBE

182. Methanex also suggests that bad faith can be inferred from the fact that the California measures accorded with strong public concern over the problem of MTBE contamination. Methanex describes that strong public concern as "public hysteria"

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[333] *See* Second Amended Statement of Claim ¶ 143; First Partial Award ¶ 70; Transcript of July 13, 2001 Hearing on Jurisdiction and Admissibility (Uncorrected) at 486-88.

[334] In accordance with the Online Disclosure Act of 1997 (9 Cal. Gov. Code § 84600 et seq.), the California Secretary of State provides public access to campaign disclosure statements through the internet. *See* California Secretary of State: CalAccess (16 JS tab 33 at 1285) (providing searchable local and state campaign contribution information); California Secretary of State: Political Reform Division Home Page, (16 JS tab 34 at 1286) (providing public access to campaign and lobbying finance data and analysis for California state and local elections).

inspired by environmentalists and ethanol producers.[335] Methanex's suggestion that this supports a finding of bad faith is untenable.

183. In democracies like those of the NAFTA Parties, the public sometimes will act directly in deciding matters of public policy, such as when referenda are held.[336] In most cases, however, the public does not act directly. Rather, it elects officials who act on its behalf. Those officials are entrusted by the public to act as its representatives.[337]

184. The Governor of California is, of course, one such elected official.[338] As such, it is the Governor's responsibility to take public opinion into account when making decisions. Like any elected official, the Governor may sometimes choose to take action that a majority of his constituents disfavor. It is, however, unremarkable that an elected official, such as the governor of a state, would gauge public opinion when formulating positions on a matter of public policy, especially when that matter concerns something as fundamental as drinking water. And it is entirely legitimate for an elected representative to take action demanded by the citizens of the state he represents. Indeed, Methanex's contention that the Governor issued the 1999 Executive Order in response to public concern that MTBE was contaminating California's water supply supports the conclusion

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[335] *See* Supplemental Wright Affidavit ¶ 4 (12 JS tab A) ("The assault on the use of MTBE in California has been the product of a well financed, organized, negative media and public profile campaign orchestrated by Archer Daniels, Midland's top executives [and industry allies], and the resulting hysteria.").

[336] *See, e.g.*, CAL CONST. art. 2, § 9 (providing for referendum, the power of the public to approve or reject certain statutes or parts of statutes). In addition, the citizens of California may "propose statutes or amendments to the constitution and adopt or reject them." *See id.* art. 2, § 8 (providing for initiative).

[337] *See, e.g., id.* art. 4, § 1.5 ("The people find and declare that the Founding Fathers established a system of representative government based upon free, fair, and competitive elections.").

[338] *See generally id.* art. 5 §§ 1-8 (setting forth the role of California's Governor).

that the Governor's actions were taken in response to those concerns, and not with the intent to harm any company or industry.[339]

185. In effect, Methanex urges this Tribunal to find that California acted in bad faith merely because Methanex's views were not upheld in the court of public opinion in California, while views that it attributes to environmentalists and the ethanol industry prevailed. It is not the place of this Tribunal, however, to second-guess the democratic process in California. To put the point in legal terms, the United States is not responsible for the views expressed by any private person on the issues of the day, whether those views be expressed by environmentalists, MTBE producers or anyone else – and whether or not the public finds those views persuasive.[340]

4. Lobbying By Ethanol Supporters

186. As an initial matter, Methanex's evidence of lobbying by certain ethanol industry supporters is wholly inadequate. Although Methanex claims that pro-ethanol lobbyists drafted certain essential legislation, Methanex nowhere offers any evidence from which one could conclude whether or to what extent the California legislature adopted such initiatives.[341]

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[339] The rapid spread of MTBE into groundwater was cause for alarm in many communities. The UC Report referenced at least 22 resolutions passed by various agencies across California, including municipalities and water purveyors, either requesting or supporting a ban of MTBE in gasoline or requesting limited, or discontinued, use of MTBE in gasoline out of concern over water contamination. These resolutions range in date from March 19, 1997 to October 6, 1998. *See* UC Report, Vol. IV, *Impacts of MTBE on California Groundwater* at 69-71 (4 JS tab 39).

[340] *See, e.g.*, United Nations, *Report of the International Law Commission* (53rd Sess.), Supp. No. 10, U.N. Doc. A/56/10, art. 8, cmt. 1 (2001) ("As a general principle, the conduct of private persons or entities is not attributable to the State under international law" unless such persons act "on the instructions of the State" or "under the State's direction or control.").

[341] Supplemental Wright Affidavit (12 JS tab A) (attaching documents). In his Supplemental Affidavit at paragraph 9, Robert Wright claims "the ethanol industry enlisted lobbyists in California to draft pro-ethanol, anti MTBE bills that would be introduced in the state legislature." The few letters Methanex

187. In any event, Methanex's allegations concerning any ethanol lobbyist's advocacy in the legislative process provide no basis to infer an intent by California to benefit ethanol producers. Lobbyists regularly urge and propose the adoption of measures by the legislature.[342] Given the nature of the United States' political system, no negative inference may be drawn from such advocacy.[343]

188. Nor may any inference as to the legislature's intent be inferred from remarks made by any single legislator.[344] For this reason alone, the remarks made by Senator Mountjoy in the debates leading to the enactment of SB 521 are of no consequence. In any event, Methanex's reliance on those remarks is misplaced. Read in context, the Senator's statements reflect his concern that MTBE poses a threat to the environment, and in no way are indicative of an intent to discriminate on the basis of nationality.[345]

189. Methanex's assertion that any intent may be drawn from the fact of

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submits as evidence do not include the substance of any draft bill, nor do they show whether such bills were introduced or adopted by the California legislature.

[342] BLACK'S LAW DICTIONARY 938 (6th ed. 1990) (defining "lobbying" as: "All attempts including personal solicitation to induce legislators to vote in a certain way or to introduce legislation. It includes scrutiny of all pending bills which affect one's interest or the interests of one's clients, with a view towards influencing the passage or defeat of such legislation.").

[343] *See Mazurek v. Armstrong*, 520 U.S. 968, 973 (1997) ("The fact that [a special interest] group drafted the [state] law . . . says nothing significant about the legislature's purpose in passing it.").

[344] *See* First Partial Award ¶ 158 ("Where a single governmental actor is motivated by an improper purpose, it does not necessarily follow that the motive can be attributed to the entire government.").

[345] Methanex, quoting the Senator's remarks out of context, suggests that Senator Mountjoy displayed discriminatory intent by referencing the foreign origin of MTBE. *See* Supplemental Wright Affidavit ¶ 3 (12 JS tab A). Read in context, those remarks display no such sentiment. Rather, aware that MTBE travels rapidly in water, does not biodegrade and is very difficult to remediate, Senator Mountjoy cautioned that "[i]f a tanker were to spill, MTBE could not be contained like other gasoline components. The effects of MTBE on coastal marine life, or any aquatic life, are unknown. MTBE is shipped from Latin America, Saudi Arabia, Malaysia, Canada, and other places from around the world. We have no technology to remediate a spill from one of these vessels." *See* Letter from Senator Mountjoy to Governor Wilson of Sept. 22, 1997, attached at tab 4 to Supplemental Wright Affidavit (12 JS tab A).

lobbying by ethanol supporters is without merit.

5. The Best Available Scientific Information Amply Supported The California Measures, And Continues To Do So

190. Methanex's suggestion that the science supporting the ban was so faulty that it could only be viewed as pretextual is at best farfetched. No intent to benefit ethanol producers – nor to harm methanol producers – can be founded on the purported insufficiency of the science underlying the ban. To the contrary, the scientific record amply supported the California measures at the time of their adoption.

191. In particular, the UC Report concluded that there are significant risks and costs associated with water contamination due to the use of MTBE.[346] The UC Report also determined that if the use of MTBE were to continue at its current level, there would be an increased danger of surface and groundwater contamination.[347] The UC Report found that the cost of treatment of MTBE-contaminated drinking water sources in California could be enormous.[348] As a result, the UC Report recommended consideration of phasing out MTBE in gasoline over a several year period. [349]

192. No fewer than 60 individuals are listed as authors of the various sections of the UC Report, most of whom hold advanced degrees from top research universities, teach at such institutions, or both.[350] The UC Report's authors presented and discussed

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[346] *See* UC Report, Vol. I at 11-12 (4 JS tab 36).

[347] *See id.* at 12, 32.

[348] *See id.* at 12, 47.

[349] *See id.* at 13.

[350] *See id.* (Tbl. of Contents for Vols. I-V).

widely in public fora the basis for their recommendation, and considered comments from industry representatives and scientists from the private and public sectors alike.[351]

193. Only several months after the issuance of the UC Report, U.S. EPA's Blue Ribbon Panel on Oxygenates in Gasoline issued in July 1999 similar recommendations.[352] Specifically, the Blue Ribbon Panel called for a substantial reduction in the use of MTBE to minimize current and future threats to drinking water.[353]

194. Thus, not even Methanex can deny that several qualified and respected sources, including, among others, U.S. EPA and several dozen tenured professors at major U.S. research universities, offered specific scientific support for California's actions.[354]

195. Moreover, as demonstrated in the expert reports that accompany this pleading, Methanex's assertion that the MTBE ban lacked a scientific basis is erroneous and without support. The accompanying expert reports demonstrate that, to the contrary, California's ban of MTBE was supported by the best available scientific information at the time of its adoption – and is confirmed by the best information available today.

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[351] *See supra* nn.84-90 and accompanying text.

[352] *See* Dan Greenbaum et al., *The Blue Ribbon Panel on Oxygenates in Gasoline, Executive Summary and Recommendations* ("Blue Ribbon Panel Findings") at 3 (July 27, 1999) (16 JS tab 50 at 1440); *see also generally* Dan Greenbaum, et al., *Achieving Clean Air and Clean Water: The Report of the Blue Ribbon Panel on Oxygenates in Gasoline* ("Blue Ribbon Panel Report") (2 JS tab 2).

[353] *See id.*

[354] *See European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R ¶ 178 (Mar. 12, 2001) ("*Asbestos* A/B") ("responsible and representative governments may act in good faith on the basis of what at a given time, may be a *divergent* opinion coming from qualified and respected sources. [citation omitted] . . . [A] Member may also rely, in good faith, on scientific sources which, at that time, may represent a divergent, but qualified and respected, opinion. A Member is not obliged, in setting health policy, automatically to follow what at a given time, may constitute a majority scientific opinion.") (emphasis in original).

196. Dr. Graham Fogg, Professor of Hydrogeolgy at the University of California at Davis and co-author of the volume of the UC Report addressing groundwater issues, establishes in his expert report that in September 2000 California's MTBE contamination problem was known to be widespread, as well as difficult and costly to address.[355] As Dr. Fogg explains, by 1998, MTBE had been detected at more than 4,000 leaking underground fuel tanks sites, 50 percent of which were within one-half mile (800 meters) of public drinking water wells.[356] Dr. Fogg further explains that MTBE's unique properties, combined with its high-volume use in California gasoline as compared to that of other countries, render it an especially potent threat to California groundwater, the source of drinking water for nearly half of all Californians.[357]

197. Dr. Anne Happel, a molecular biologist and member of U.S. EPA's Blue Ribbon Panel on oxygenates, concurs that the threat posed in September 2000 by MTBE to California groundwater warranted immediate action.[358] Dr. Happel's expert report also establishes that, contrary to Methanex's claims, the UC Report's estimates of the extent of the MTBE problem were conservative.[359] She further establishes that government mandates that underground storage tanks be upgraded by 1998 were inadequate to address the threat MTBE poses to groundwater – a threat that is significantly greater than that which may result from the use of ethanol.[360]

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[355] *See generally* Fogg Report (13 JS tab D).

[356] *See id*. ¶ 16.

[357] *See id.* ¶¶ 11, 39-42.

[358] *See generally* Happel Report (13 JS tab E).

[359] *See id*. at 7, 30.

[360] *See id*. at 10-39, 58, 64-65.

198. Both Drs. Fogg and Happel also make clear that information that has become available since September 2000 only confirms the wisdom of California's action.[361] Dr. Fogg, for example, demonstrates that the percent of groundwater sources with MTBE detections have increased in 2001 and 2002, and that further research confirms MTBE's recalcitrance.[362] Dr. Happel's analysis of, for example, current data regarding leaking underground storage tanks and MTBE dectections also confirm the wisdom of California's decision to ban MTBE.[363]

199. Dr. Ed Whitelaw, Universtiy of Oregon professor of economics, responds in his expert report to Methanex's evaluation of the cost-benefit analysis of the MTBE ban that was presented in the UC Report.[364] Dr. Whitelaw identifies several significant flaws in the varying analyses presented by Methanex's Dr. Gordon Rausser.[365] Further, Dr. Whitelaw points out that the issues with the UC Report's cost-benefit analysis identified by Dr. Rausser were addressed in the public comment process on the UC Report. Dr. Whitelaw concludes that the weight of economic evidence available at the time California adopted the measures demonstrates that it was rational for California to act as it did, and that current evidence confirms that the information on which California based its decision was not anamolous.[366]

200. Dean Simeroth, the chief of the Criteria Pollutants Branch of the California Air Resources Board, explains that, contrary to Methanex's contention, the ban

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[361] *See* Fogg Report ¶¶ 99-119 (13 JS tab D). *See also* Happel Report at 4 (13 JS tab E).

[362] *See* Fogg Report ¶¶ 145-55 & tbl. 6 (13 JS tab D).

[363] *See* Happel Report at 4 (13 JS tab E).

[364] *See generally* Whitelaw Report (13A JS tab K).

[365] *See id.* at 12-34.

on MTBE in California gasoline will have no detrimental effect on air quality in California. In addition, Mr. Simeroth explains why Methanex's allegation that California adopted various regulatory provisions to benefit ethanol producers is based on faulty assumptions and is incorrect.[367]

201. Thus, contrary to suggesting support for Methanex's claims that the measures were pretextual, the science underlying the measures strongly supported California's action to ban MTBE.

202. This conclusion is reinforced by the fact that other states and the federal government in this country, as well as governments of other countries, have independently also taken steps to reduce or eliminate the use of MTBE in gasoline.[368]

203. As of the date of this Amended Statement of Defense, action has been taken or proposed in at least 19 states to restrict or ban the use of MTBE in gasoline or to mandate the use of a substitute oxygenate.[369] For example, on May 24, 2000, New York

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[366] *See id*. at 45-49.

[367] *See generally* Simeroth Statement (13A JS tab H).

[368] Contrary to Methanex's unsupported allegation of other governments blindly ensnared in the supposed California conspiracy with ethanol producers, it is recognized that "[g]overnment actions of a general or policy character enjoy, implicitly, a presumption of disconnectedness and regularity." *See* AMERICAN SOCIETY OF INTERNATIONAL LAW, THE IRAN-UNITED STATES CLAIMS TRIBUNAL: ITS CONTRIBUTION TO THE LAW OF STATE RESPONSIBILITY 319 (Richard Lillich & Daniel Magraw eds., 1998) (citations omitted).

[369] *See* CAL. HEALTH AND SAFETY CODE §§ 43013.1-43013.3 (2003) (14 JS tab 12 at 161); COLO. REV. STAT. ANN. § 25-7-139 (West 2003) (16 JS tab 39 at 1323); CONN. GEN. STAT. ANN. § 22a-450a (West 2003) (16 JS tab 40 at 1324); 415 ILL. COMP. STAT. ANN. 122/1, 122/5, 122/15, 122/20, 122/99 (2003) (16 JS tab 59 at 1558); IND. CODE ANN. § 16-44-2-8 (West 1997) (16 JS tab 60 at 1567); IOWA CODE ANN. § 214A.18 (West 2003) (16 JS tab 61 at 1563); KAN. STAT. ANN. § 55-527 (2002), (16 JS tab 63 at 1565); KY. REV. STAT. ANN. §§ 363.9051-363.9053 (Banks-Baldwin 2003) (16 JS tab 64 at 1567); ME. REV. STAT. ANN. tit. 38, § 585-H (West 2003) (16 JS tab 71 at 1595); MICH. COMP. LAWS ANN. § 290.643 (West 2003) (17 JS tab 90 at 2243); MINN. STAT. ANN. § 239.761 (17 JS tab 91 at 2244-45); MO. ANN. STAT. § 414.043 (West 2003) (17 JS tab 92 at 2247); NEB. REV. STAT. § 66-1227 (2003) (17 JS tab 95 at 2251); N.H. REV. STAT. ANN. § 485:16-d (2003) (17 JS tab 97 at 2253); N.Y. AGRIC. & MKTS. LAW § 192-g (McKinney 2003) (17 JS tab 98 at 2254); OHIO REV. CODE ANN. § 3704.12 (West 2003) (17 JS tab 99 at 2255); S.D. CODIFIED LAWS § 37-2-33 (Michie 2003) (18 JS tab 130 at 2518); WASH. REV. CODE ANN. § 19.112.100 (West 2003) (18 JS tab 149 at 2746); WIS. STAT. ANN. § 168.04 (West 2003) (18 JS tab 150 at 2747). Arizona has adopted various clean air incentives and eliminated oxygenate requirements in a large

State banned the use of MTBE in gasoline sold in New York as of January 2004,[370] and on June 1, 2000, the State of Connecticut also adopted a prohibition on the use of MTBE in gasoline in Connecticut, which is to take effect no later than July 2004.[371]

204. The U.S. EPA issued an Advance Notice of Proposed Rulemaking under Section 6 of the Toxic Substances Control Act as a first step toward potential regulatory action to eliminate or limit the use of MTBE in gasoline. The U.S. EPA issued the advance notice to begin a process to ensure that the nation's water resources would be protected in the absence of congressional action.[372] Congress has since actively considered several bills proposing to reduce or eliminate the use of MTBE in gasoline.[373]

205. Other countries use MTBE in gasoline, if at all, in substantially smaller volumes than the United States has used it. For example, in Germany, the average concentration of MTBE in gasoline is 1.3% by volume.[374] In recent years, for example, California alone consumed on average up to double the amount of MTBE consumed in sixteen European countries combined.[375] Despite this comparatively limited use of MTBE outside of the United States, governments in other countries, including in

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part of the state. *See* AZ. REV. STAT. ANN. § 41-2124 (West 2003) (14 JS tab 4 at 55). A list of states and actions taken as of March 27, 2003 is available at Energy Information Agency: Status and Impact of State MTBE Bans, tbl. 1 (16 JS tab 45 at 1410).

[370] *See* N.Y. AGRIC. & MKTS. LAW § 192-g. (17 JS tab 98 at 2254).

[371] *See* CONN. GEN. STAT. ANN. § 22a-450a. (16 JS tab 40 at 1324).

[372] *See* 65 Fed. Reg. 16094 (Mar. 24, 2000) (18 JS tab 146 at 2714).

[373] *See, e.g.*, Energy Policy Act, H.R. 6, 108th Cong. (2003) (16 JS tab 55 at 1468-84) (resolving differences in Conference Committee as of Oct. 29, 2003); H.R. 837, 108th Cong. (2003) (16 JS tab 56 at 1485); H.R. 2136, 108th Cong. (2003) (16 JS tab 57 at 1542); H.R. 2253, 108th Cong. (2003) (16 JS tab 58 at 1553); S. 385, 108th Cong. (2003) (18 JS tab 123 at 2298); S. 791, 108th Cong. (2003) (18 JS tab 124 at 2355).

[374] *See* Fogg Report ¶ 203 (13 JS tab D).

[375] *See id.* ¶ 199.

Australia and Denmark, have promulgated regulations limiting the use of MTBE.[376] In addition, gasoline refiners in Canada have chosen voluntarily to reduce their use of MTBE.[377]

206. Thus, contrary to Methanex's assertions, these independent actions by other governments and actors confirm what the record clearly shows: that, far from a pretext for a plot to harm methanol producers, the scientific findings on which the California measures were based were serious, substantial and capable of confirmation elsewhere in the country and in the world.

6. Ethanol Was And Remains As "Foreign" To California As Methanol

207. Finally, Methanex's claim that California was motivated to take action adverse to Methanex and methanol producers because methanol is "foreign" to California is without foundation.[378] Ethanol is no less "foreign" to California than methanol. Thus, California's decision-makers had no motive to conspire against "foreign" methanol to benefit producers of ethanol – another product "foreign" to California under Methanex's view.

208. As Methanex concedes, California "has historically had no significant ethanol industry within its borders."[379] For 1999, revenues from California's ethanol

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[376] *See id.* ¶ 201.

[377] *See id.* ¶¶ 20, 25.

[378] *See* First Partial Award ¶ 157; *see also* Second Amended Statement of Claim ¶ 236.

[379] Second Amended Statement of Claim ¶ 87. In 1999, there was only one active producer of ethanol in California, Parallel Products in Rancho Cucamonga. *See* Burke Report Ex. 9 (13 JS tab B). Parallel Products' production capacity in 1999 was nine thousand metric tons per year. This represented 0.15 percent of total U.S. ethanol capacity of 5,974,000 metric tons that year. *Id.* Currently, there are only two ethanol producers in California: Golden Cheese Company and Parallel Products, with combined capacity of 27 thousand metric tons of ethanol per year. *See id.* ¶ 55; *see also* Renewable Fuels Association ("RFA"), *U.S. Fuel Ethanol Production Capacity* at 2 (Oct. 2003) (17 JS tab 122 at 2296) (identifying Golden

production are estimated to be $2.75 million.[380] This amounts to an infinitesimal 0.0002 percent of California's gross state product of $1.213 trillion in 1999.[381] For 2000, ethanol revenues are an estimated $4.39 million,[382] or 0.0003 percent of California gross state product for that year of $1.33 trillion.[383]

209. Contrary to Methanex's suggestion, information available at the time of the 1999 Executive Order did not suggest that development of an in-state ethanol industry was likely. The CEC preliminary report in February 1999 on "Supply and Cost of Alternatives to MTBE in Gasoline," excluded the possibility that additional ethanol supplies could come from California sources in either the short or long term.[384]

210. There is little prospect today of developing California's ethanol production industry. A 2001 report by the CEC considered the proposals for ethanol projects in

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Cheese Co. with capacity of 5 million gallons per year and Parallel Products with capacity of 4 million gallons per year); California Energy Commission, *Staff Report: Ethanol Supply Outlook for California* 10 (Oct. 2003) ("CEC 2003 Report") (14 JS tab 15 at 392) (California's two small ethanol producers produce a total of less than ten million gallons of ethanol per year). Parallel Products uses residuals from the food and beverage industry to produce ethanol. *See* California Energy Commission, *Staff Report: Costs and Benefits of a Biomass-to-Ethanol Production Industry in California* ("CEC 2001 Report") 9 (Mar. 2001) (14 JS tab 14 at 207). Golden Cheese Co.'s primary business is the production of cheese, but it can produce ethanol using cheese whey residue, a waste product of its cheese processing activities. *See* CEC 2001 Report at 10 (14 JS tab 14 at 208). These existing producers are unable to significantly expand their capacity, regardless of the demand for ethanol in California, due to the limited supply of the waste products that are their feedstocks. This total existing ethanol production capacity in California represents 0.4 percent of total existing U.S. capacity of 7.3 million metric tons per year. Burke Report ¶ 55 (13 JS tab B); *see also* RFA, *U.S. Fuel Ethanol Production Capacity* (17 JS tab 122) (Golden Cheese Co. and Parallel Products' combined 9 million gallons per year, out of total U.S. capacity of 2914.8 million gallons per year).

[380] *See* Burke Report ¶ 55 & n. 26 (13 JS tab B).

[381] *See* Press Release, U.S. Bureau of Economic Analysis, Gross State Product by Industry for 2001 ("BEA GSP News Release") (May 22, 2003) (17 JS tab 121 at 2293) (GSP of California for 1999 in millions of current dollars was 1,213,355).

[382] *See* Burke Report ¶ 55 & n. 26 (13 JS tab B).

[383] *See* BEA GSP News Release (California GSP for 2000 was $1,330,025) (17 JS tab 121 at 2293).

[384] California Energy Commission, *Staff Report: Supply and Costs of Alternatives to MTBE in Gasoline* 19, 26 (Feb. 1999) ("CEC 1999 Report") (14 JS tab 16 at 26, 438) (finding that "the production costs of new facilities using corn were not competitive with either existing or new ethanol plants in the Midwest," and

California in response to a mandate from the California legislature.[385] The CEC concluded that ethanol "*could* be produced"[386] in California, but that each of the proposed projects was variously "still under study,"[387] or "in its early stages,"[388] or relied on technology that was "just developing."[389] In fact, each of the proposed new ethanol facilities in California identified in the 2001 report has stalled. As of October 2003, not a single new ethanol production facility had broken ground or committed to begin construction.[390]

211. Thus, contrary to Methanex's assertion, the record does not support its strained assertion that California intended to harm "foreign" methanol in favor of ethanol, for ethanol is no less "foreign" to California than methanol is.

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212. For all the reasons stated above, Methanex has failed to show that the measures at issue "relat[e] to" Methanex or its investments within the meaning of Article 1101(1). Methanex's claims therefore fall outside of the scope of NAFTA's investment chapter and this Tribunal has no jurisdiction under that chapter to decide those claims.

"production costs of potential new ethanol plants in California using alternative biomass resources . . . have not yet been quantified on a commercial scale basis").

[385] CEC 2001 Report at viii (14 JS tab 14 at 193).

[386] *Id*. (emphasis added).

[387] *See id*. at 10 (14 JS tab 14 at 208) (referring to the proposal by Imperial Bioresources LLC to grow sugar cane to supply an ethanol production plant).

[388] *See id*. at 11 (14 JS tab 14 at 209) (referring to the proposal by BC International Corp. and the Collins Pine Co. to build an ethanol production facility that would use forest thinnings and wood wastes as feedstocks).

[389] *See id*. at 17 (14 JS tab 14 at 215) (referring to all the proposals to use biomass or cellulose-based feedstocks to produce ethanol).

[390] CEC 2003 Report at 10 (14 JS tab 15 at 392).

II. METHANEX HAS FAILED TO ESTABLISH ANY LOSS PROXIMATELY CAUSED BY A SUPPOSED BREACH

213. Chapter Eleven authorizes claims for damages only if the claimant establishes that it, in fact, incurred some actual loss or damage, with respect to its investments, that was proximately caused by the measures at issue. Methanex fails, as a matter of both law and fact, to establish these elements of a cognizable claim under Articles 1116(1) or 1117(1).

214. *First*, and as anticipated in the United States' memorials on jurisdiction and admissibility, Methanex has not established, and cannot establish, any loss proximately caused by the measures at issue. Instead, all of Methanex's claimed losses are founded on a highly attenuated causal chain – one that relies upon the impact of the measures on gasoline producers and distributors, who will purchase less MTBE from MTBE producers, who will purchase less methanol from methanol producers like Methanex. Under established principles of international law, a claim based on such remote consequences cannot stand.

215. *Second*, and in any event, Methanex has utterly failed to prove any loss at all that is cognizable under Chapter Eleven. Whether its claimed damages are considered individually or as a whole, Methanex's failure to prove any cognizable loss – particularly in light of its own statements *denying* any adverse impact of the measures – warrants dismissal of its claims in their entirety.

A. The Chain Of Causation Is Far Too Attenuated Here To Establish Proximate Causation

216. In its memorials on jurisdiction and admissibility, the United States demonstrated that Articles 1116(1) and 1117(1) incorporate the principle of proximate

causation that is well-established in customary international law. The United States further demonstrated that Methanex's claims – which at best were based on the effects of the measures on contractual counterparties of counterparties of Methanex – as a matter of law could not meet the standard of proximate causation. In its First Partial Award, however, the Tribunal found that it lacked authority to address this objection of the United States until Methanex had an opportunity to submit evidence on the point.[391]

217. The evidence – such as it is – is now in, and it shows a causal chain that is, if anything, even more attenuated than that anticipated in the United States' earlier memorials. Below we first summarize, for the Tribunal's convenience, the legal authorities earlier briefed that establish Chapter Eleven's incorporation of the proximate cause standard. We then demonstrate that Methanex has failed to meet the proximate cause requirement of Articles 1116(1) and 1117(1).

1. Articles 1116(1) And 1117(1) Incorporate The Established Standard Of Proximate Causation

218. A claim can be established under Articles 1116(1) or 1117(1) only if the investor or its enterprise, respectively, has "incurred loss or damage by reason of, or arising out of" a Party's breach of one of the listed NAFTA provisions.[392] The meaning of "by reason of, or arising out of" is discerned by applying the general rule of treaty interpretation codified in Article 31(1) of the Vienna Convention on the Law of Treaties:

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[391] First Partial Award ¶ 86.

[392] *See* NAFTA art. 1116(1); *id.* art. 1117(1); *see also* Second Amended Statement of Claim ¶ 321 (asserting claims under each of those articles).

"A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose."[393]

219. *First*, the ordinary meaning to be given to the terms "by reason of, or arising out of" in this context – that of a provision specifying the relationship between an alleged breach and the alleged loss or damage – is the universally-recognized idea of a close and direct causal link: the proximate cause standard. The terms of Articles 1116(1) and 1117(1) are similar to those that have been used in numerous other treaties, each of which has been interpreted to require proximate causation.[394]

220. *Second*, the object and purpose of the NAFTA in general, and Articles 1116(1) and 1117(1) in particular, support interpreting those articles as an incorporation of the customary international law standard of proximate cause. The relevant objectives of the NAFTA are to "increase substantially investment opportunities in the territories of

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[393] Vienna Convention on the Law of Treaties, May 23, 1969, art. 31(1), 1155 U.N.T.S. 331 (the "Vienna Convention"). The International Court of Justice has determined that Article 31 is reflective of customary international law. *See, e.g., Kasikili/Sedudu Island (Bots. v. Namib.)*, 1999 I.C.J.1 ¶ 18 (Dec. 13).

[394] *See, e.g.*, Declaration of Algeria Concerning the Settlement of Claims (Claims Settlement Declaration), Jan. 19, 1981, U.S.-Iran, art. II(1), 20 I.L.M. 230, 230-31 (1981) (granting Iran-U.S. Claims Tribunal jurisdiction over claims that "*arise out of*" measures affecting property rights) (emphasis added); *Hoffland Honey Co. v. Nat'l Iranian Oil Co.*, 2 Iran-U.S. Cl. Trib. Rep. 41 (Jan. 26, 1983) (considering damages alleged to "arise out of" measures affecting property rights, as required by the Algiers Accords, and interpreting that language to require the international law standard of proximate causation); *Administrative Decision No. II (U.S. v. Germ.)*, 7 R.I.A.A. 23, 29-30 (Germ.-U.S. Mixed Claims Comm'n 1923) (interpreting language in post-war treaties with Germany and in Joint Resolution of Congress granting jurisdiction over claims for loss suffered "directly or indirectly" through the acts of Germany to require consideration of whether loss could be attributed to Germany's act as a proximate cause); *U.S. Steel (U.S. v. Germ.)*, 7 R.I.A.A. 44, 55 (Germ-U.S. Mixed Claims Comm'n 1923) (referring to treaty language fixing liability for losses "caused by" (Treaty of Berlin) the acts of Germany and interpreting that language to require proximate cause); *id*. at 59 (referring to treaty language covering losses "growing out of" (Treaty of Washington) acts of government as equally requiring proximate cause); Convention for Reciprocal Settlement of Claims, Sept. 8, 1923, U.S.-Mex., art. I, 43 Stat. 1730 (providing, among other things, for arbitration of "all claims for losses or damages *originating from* acts of officials or others acting for either Government and resulting in injustice . . . .") (emphasis added); *H.G. Venable*, 4 R.I.A.A. 219, 225 (1925) (holding, by commission established under Sept. 8, 1923 Convention, that "only those damages can be considered as losses or damages caused by [the official] which are immediate and direct results of his [action].").

the Parties" and to "create effective procedures for . . . the resolution of disputes."[395] The objective of increasing investment opportunities is well-served by protecting investments from injuries proximately caused by wrongful state action. The objective of creating effective procedures for dispute resolution is well-served by applying the proximate cause standard, which has proven to be effective in numerous other international dispute resolution fora. Abandoning the proximate cause standard would not serve these NAFTA purposes well, but, instead, could lead to uncertainty, defensive actions by States that would discourage foreign investment and a disproportionate and unintended burden upon States as insurers against all forms of investment risk.

221. *Third*, in accordance with Article 31(3)(c) of the Vienna Convention, "relevant rules of customary international law" should be taken into account together with the context in interpreting the language of a treaty.[396] The rule in international law that States are responsible for injuries only if they are proximately caused by their actions, not for indirect or remote effects, must be taken into account in interpreting the language of Articles 1116(1) and 1117(1) of the NAFTA. The proximate cause standard has been applied repeatedly by a variety of tribunals adjudicating international claims, including the Iran-U.S. Claims Tribunal,[397] the Mexican-United States General Claims

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[395] NAFTA Art. 102(1)(c), (e).

[396] NAFTA Article 1131(1) also directs that the Tribunal should "decide the issues in dispute in accordance with . . . applicable rules of international law."

[397] *See, e.g.*, *Hoffland Honey Co.*, 2 Iran-U.S. Cl. Trib. Report 41 (damage to property caused by chemicals derived from Iranian oil was not proximately caused by Iran selling the oil because law "declines to trace a series of events beyond a certain point."); *see also* CHARLES N. BROWER & JASON D. BRUESCHKE, THE IRAN-UNITED STATES CLAIMS TRIBUNAL 459 (1998) ("Even where the claimant can prove that actions attributable to the Government of Iran were a cause of damages, recovery still will be denied unless its actions were the *proximate* cause."); AMERICAN SOCIETY OF INTERNATIONAL LAW, THE IRAN-UNITED STATES CLAIMS TRIBUNAL: ITS CONTRIBUTION TO THE LAW OF STATE RESPONSIBILITY 318 (Richard Lillich & Daniel Magraw eds., 1998) ("the Tribunal in *Hoffland Honey* endorsed the general limiting principle of

Commission,[398] the German-United States Mixed Claims Commission[399] and the American-Venezuelan Commission,[400] among others. In addition, scholars of international law recognize proximate causation as a requirement for international claims.[401] The NAFTA parties would have needed to make explicit any intention to abandon such a well-settled rule of international law as the proximate cause standard.[402]

222. *Fourth*, the Vienna Convention instructs that a treaty should not be interpreted in a manner that "leads to a result which is manifestly absurd or unreasonable."[403] Extending the scope of responsibility beyond those effects which are

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'proximate cause,' which requires that the link between action and compensable harm be reasonably direct and obvious.").

[398] *See, e.g., H.G. Venable*, 4 R.I.A.A. at 225 ("only those damages can be considered as losses or damages caused by Rochín [government agent] which are immediate and direct results of his telegram").

[399] *See, e.g., Administrative Decision No. II*, 7 R.I.A.A. at 29 (referring to "the familiar rule of proximate cause—a rule of general application both in private and public law—which clearly the parties to the Treaty had no intention of abrogating."); *U.S. Steel*, 7 R.I.A.A. at 55 ("But where the causal connection between the act complained of and the loss is broken, or so involved and tangled and remote that it can not be clearly traced, there is no liability.").

[400] *See, e.g., Dix (U.S. v. Venez.)*, 9 R.I.A.A. 119, 121 (Am.-Venez. Comm'n, undated decision) ("Governments like individuals are responsible only for the proximate and natural consequences of their acts. International as well as municipal law denies compensation for remote consequences . . .").

[401] *See, e.g.*, James Crawford, Special Rapporteur, *Third Report on State Responsibility*, U.N. Int'l Law Comm'n, 52nd Sess. 15 ¶ 28, U.N. Doc. A/CN.4/507(2000) (State practice, arbitral decisions and literature use a variety of terms for proximate cause, but require more than mere "factual causality;" "There is a further element, associated with the exclusion of harm that is too "remote" or "consequential" to the subject of reparation."); United Nations, *Report of the International Law Commission on the Work of its 52nd Session* at 32 ¶ 97, U.N. Doc. No. A/55/10 30-34 (2000) (referring to the "customary requirement of a sufficient causal link between conduct and harm . . ." and stating that "only direct or proximate consequences and not all consequences of an infringement should give rise to full reparation."); Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens (Draft No. 12), Art. 14(3) at 18 (Harvard L. Sch. 1961) ("An injury is 'caused,' as the term is used in this Convention, by an act or omission if the loss or detriment suffered by the injured alien is the direct consequence of that act or omission.").

[402] *See, e.g., Sambiaggio (Italy v. Venez.)*, 10 R.I.A.A. 499, 521 (Italy-Venez. Mixed Cl. Comm'n of 1903).

[403] Vienna Convention art. 32(b); *see also, e.g.*, SIR ROBERT JENNINGS & SIR ARTHUR WATTS, 1 OPPENHEIM'S INTERNATIONAL LAW § 554(1), (3) (9th ed. 1992) ("All treaties must be interpreted according to their reasonable, in contradistinction to their literal, sense. . . . If, therefore, the meaning of a provision is ambiguous, the reasonable meaning is to be preferred to the unreasonable, the more reasonable to the less reasonable."); *Amoco Int'l Fin. Corp. v. Iran*, 15 Iran-U.S. Cl. Trib. Rep. 189 ¶ 109 (1987) (treaty interpretation that leads to manifestly absurd or unreasonable result "cannot be admitted.").

proximately caused by a State's acts would lead to absurd and unreasonable results. An enormous number of local, state, provincial and federal regulatory and other measures are routinely promulgated that, by directly affecting one line of business, indirectly impact many other contractually related lines of business. Methanex's construction of Articles 1116(1) and 1117(1) would allow not only the party directly affected by a government regulation, but any other downstream entity selling products to that party, to have recourse under Chapter Eleven. Such an interpretation of the NAFTA would flout decades of State practice, numerous precedents in international law and the intention of the NAFTA Parties. In short, under Methanex's expansive reading of Article 1116(1), "'no treasury would be rich enough to make payment'" to all potential claimants.[404]

2. The Effect Of The Ban On Suppliers To Suppliers To The Persons Regulated Is Far Too Remote To Be Cognizable

223. In its Memorial on Jurisdiction and Admissibility, the United States summarized the chain of causation pleaded by Methanex as follows:

- California gasoline distributors now selling gasoline containing MTBE will stop making or buying such gasoline as a result of a ban on the sale or supply of gasoline containing MTBE;
- these decreased sales will cause refineries and blenders now producing California gasoline to stop making or buying MTBE for such gasoline;
- the decreased purchases or production of MTBE for California gasoline will result in fewer purchases of methanol as a feedstock for MTBE production;
- the decreased purchases of methanol will – if there are no offsetting increases in demand for methanol – affect the profits of

[404] 3 MARJORIE M. WHITEMAN, DAMAGES IN INTERNATIONAL LAW 1784 (1943) (quoting 1911 decision of Nicaraguan Mixed Claims Commission denying claims for indirect damages, including claims for "'paralyzation of [the claimants'] business during the war'") (further internal quotation omitted).

> Methanex and possibly Methanex US by lowering the price and diminishing sales of methanol, and will possibly prolong the period of time the Methanex Fortier plant remains idle.[405]

The causal chain established by the record is no more direct than that anticipated by the United States three years ago: it depends upon consequences upon consequences upon consequences.[406] This chain of events is too remote to be cognizable under the NAFTA and the international rule of proximate cause it incorporates.[407]

224. To consider the United States responsible for the supposed injuries incurred by Methanex would require this Tribunal to consider the "causes of causes and their impulsions one on another."[408] International law contemplates no such inquiry. To the contrary, a long line of precedents holds that where the act complained of affects a third party with whom the claimant had a contractual relationship, the claimant has no right to recovery based on that act.

225. For example, life insurance companies had no claim against Germany to recover forgone premium payments by virtue of the fact that the insureds were killed as

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[405] U.S. Memorial on Jurisdiction and Admissibility at 22-23 (Nov. 13, 2000).

[406] *Cf. Oil Platforms (Iran v. U.S.)*, 2003 I.C.J. __ at ¶ 97 (Nov. 6), *available at* http://www.icj-cij.org/icjwww/idocket/iop/iopjudgment/iop_ijudgment_20031106.PDF (rejecting as too "indirect" to constitute commerce between Iran and the U.S. a claim based on "a series of commercial transactions: a sale by Iran of crude oil to a customer in Western Europe, or some third country other than the United States; possibly a series of intermediate transactions; and ultimately the sale of petroleum products to a customer in the United States. This is not 'commerce' between Iran and the United States, but commerce between Iran and an intermediate purchaser; and 'commerce' between an intermediate seller and the United States.").

[407] As noted in Part B below, Methanex has failed to prove a number of elements of the causal chain it alleges. That failure, however, is immaterial to the defect addressed here.

[408] *Administrative Decision No. II*, 7 R.I.A.A. at 30 ("[T]he law cannot consider . . . the 'causes of causes and their impulsions one on another.' Where the loss is far removed in causal sequence from the act complained of, it is not competent for this tribunal to seek to unravel a tangled network of causes and of effects, or follow, through a baffling labyrinth of confused thought, numerous disconnected and collateral chains . . .").

an incidence of Germany's war-time actions.[409] Likewise, the seller of property had no claim against Mexico when his Mexican buyer was rendered unable to pay by the actions of Mexico's armed forces affecting the buyer's company operations.[410] In another case against Germany, the claimant's injuries were deemed too remote when claimant had contracted with a shipping company to deliver its goods and the shipper was prevented from reaching its destination by the German wartime blockade.[411] A claim based on an alleged expropriation by Yugoslavia was denied because the Yugoslav government's nationalization of paper companies only indirectly affected the claimant, which had contracts with those companies for the supply of paper.[412] A similar claim based on Hungary's nationalization of its motion picture industry was denied where the claimant

[409] *See Provident Mutual Life Ins. (U.S. v. Germ.)*, 7 R.I.A.A. 91, 113 (U.S.-Germ. Mixed Claims Comm'n 1924) (life insurance companies with policies on the lives of passengers lost in sinking of *Lusitania* by Germany had no claim against Germany: "*this effect* so produced was a circumstance incidental to, but not flowing from, such act as the normal consequence thereof, and was, therefore, in legal contemplation remote—not in time—but in natural and normal sequence. The payments made . . . were based on . . . their contract obligations. To these contracts Germany was not a party, of them she had no notice, and with them she was in no wise connected.").

[410] *See Fink (U.S. v. Mex.)*, SPECIAL MEXICAN CLAIMS COMM'N: REPORT TO THE SECRETARY OF STATE 408, 408 (1940) (undated decision) (loss of purchase price by claimant who sold property to Mexican company rendered unable to pay by acts of armed forces affecting purchaser was "not deemed to be a loss proximately resulting from the acts of forces involving Mexican liability . . .").

[411] *See M.A. Quina Export Co. (U.S. v. Germ.)*, 7 R.I.A.A. 363, 363 (Germ.-U.S. Mixed Claims Comm'n 1926) (no claim against Germany by export company that contracted with shipping company when ship was prevented from reaching its destination by German blockade: "Germany is not liable . . . for such remote and consequential damages . . .").

[412] *See Fraenkel*, SETTLEMENT OF CLAIMS BY THE FOREIGN CLAIMS SETTLEMENT COMM'N OF THE UNITED STATES AND ITS PREDECESSORS FROM SEPT. 14, 1949 TO MAR. 31, 1955 156, 157 (1954) (claim denied where "[w]hatever was done by the Government of Yugoslavia which adversely affected claimant's business was not directed specifically at his particular business.") (claimant had contracts for supply of paper with Yugoslav paper companies that were nationalized).

entered into contracts with theaters to show American-made films, and those theaters would be unable to uphold the contracts after nationalization.[413]

226. This principle that proximate cause is lacking when the State's actions affect a party to a contract with the claimant, rather than the claimant directly, was expressed generally in *Dickson Car Wheel*:

> [A] State does not incur international responsibility from the fact that an individual or company of the nationality of another state suffers a primary injury as the corollary or result of an injury which the defendant State has inflicted upon an individual or company irrespective of nationality when the relations between the former and the latter are of a contractual nature.[414]

227. Methanex's claim is based on measures that affect it only indirectly, through its customers in California, who are gasoline refiners and MTBE producers.[415] The situation is directly analogous to the cases cited above, where the claimant's former customer or contractual partner was directly impacted by government actions, but the claimant was only indirectly impacted.

228. Accordingly, Methanex's claims fail because the causal chain on which they rely is too remote to be sustained under established principles of international law.

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[413] *See Motion Picture Export Ass'n of America*, FOREIGN CLAIMS SETTLEMENT COMMISSION OF THE UNITED STATES: TENTH SEMIANNUAL REPORT TO THE CONGRESS FOR THE PERIOD ENDING JUNE 30, 1959 62-63 (1958).

[414] *Dickson Car Wheel Co. (U.S. v. Mex.)*, 4 R.I.A.A. 669, 681 (Mex.-U.S. Gen. Claims Comm'n 1931); *see also*, A.H. FELLER, THE MEXICAN CLAIMS COMMISSIONS 123-24 (1935) (discussing *Dickson Car Wheel Co.*).

[415] *See* Second Amended Statement ¶¶ 78, 81; *see also* Second Macdonald Affidavit ¶ 5 (providing Methanex's sales volumes to California refiners and merchant MTBE producers); *id*. ¶ 23 (listing California refiners and merchant oxygenate producers that allegedly purchased methanol from *Methanex* for the manufacture of MTBE).

B. Each Of Methanex's Alleged Categories Of Damages Fails As A Matter Of Law And Fact To Establish Proximate Causation

229. In its Second Amended Statement of Claim, Methanex enumerates the categories of damages it and its U.S. investments supposedly sustained "by reason of, or arising out of" the United States' actions.[416] None of these allegations justifies a finding of liability in this case for at least two reasons. First, each fails as a matter of law to be cognizable under Articles 1116(1) or 1117(1). Second, each fails as a matter of fact because Methanex has not met its burden of demonstrating that it has actually incurred any such damage[417] or of providing any evidence of any causal link between any damages and the measures at issue. We address each of Methanex's alleged categories of damages in turn.

1. Alleged Deprivation Of Methanex US's Customer Base, Goodwill And Market

230. Methanex's claim for loss of Methanex US's customer base, goodwill and market is without merit. As noted in Part A above, these supposed losses are based on an attenuated causal chain that cannot establish them as a proximate result of the ban. This claim for loss is also infirm for a number of additional reasons.

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[416] Second Amended Statement of Claim ¶¶ 321-327.

[417] Methanex cannot excuse itself from its burden of establishing the fact of damages, even though the Tribunal relieved Methanex of the burden of producing evidence relating to "quantum" of damages at this stage. *See* First Partial Award ¶ 163 (deferring issue of quantum). In *ADF Group Inc. v. United States*, for example, the tribunal dismissed claims concerning certain construction projects on the ground that the claimant failed to provide any evidence concerning the alleged loss or injury to those projects, even though the *quantum* of those damages was to be addressed in a subsequent stage of the proceeding, if necessary. ICSID Case No. ARB(AF)/00/1, 15:3 WORLD TRADE & ARB. MATERIALS 55 ¶¶ 141, 143 (June 2003) (Award of Jan. 9, 2003). The tribunal stated that "the failure of evidence on the part of the Investor relates not simply to the quantum of damages said to have been sustained . . . [but] to both the *factual basis* of the Investor's claims . . . and the fundamental aspect of liability of the Respondent." *Id.* ¶ 143 (emphasis added); *see also Avco Corp. v. Iran Aircraft Industries*, 19 Iran-U.S. Cl. Trib. Rep. 200, 209 (1988) (dismissing claimant's allegations concerning lost profits "for lack of proof" because the claimant failed to provide documentary evidence).

231. *First,* it fails for lack of proof of any loss to Methanex US. The record is silent as to whether Methanex US was ever profitable as a stand-alone operation, much less whether it ever realized a profit on its sales to California MTBE producers. Indeed, what the record does suggest is that Methanex organized Methanex US so that it did *not* realize any profits on its sales that could be subject to taxation in the United States.[418] If, as it appears, Methanex US's operations were structured so that it made no profits regardless of the amounts it sold, it is difficult to see how a measure that allegedly reduced the amounts sold, albeit slightly, could cause it any loss. The record sheds no light on the subject.

232. The record also contains no evidence suggesting that Methanex US had any recognized goodwill. Nor does it document any effect on such supposed goodwill from the MTBE ban. It was in similar circumstances that the *Trail Smelter* tribunal rejected allegations of impaired goodwill as "too indirect, remote, and uncertain to be appraised and not such for which an indemnity can be awarded."[419]

233. *Second,* while Methanex does offer testimony on the number of tons of methanol Methanex US sold to California MTBE producers in the years 1998 through 2001, it fails either to demonstrate any loss or that any such loss was proximately caused by the ban. It is doubtful, as an initial matter, whether testimony such as this, unsupported by any documentary evidence, can on its face satisfy a claimant's burden of

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[418] *See* Second Macdonald Affidavit ¶ 5 ("For legal reasons, all shipments by Methanex and its subsidiaries in or to the United States are booked through Methanex [US]").

[419] *Trail Smelter (U.S. v. Can.)*, 3 R.I.A.A. 1906, 1931 (first decision, 1938) (government action at issue affected customers of the claimant directly, but affected the claimant only by virtue of the impact on those customers).

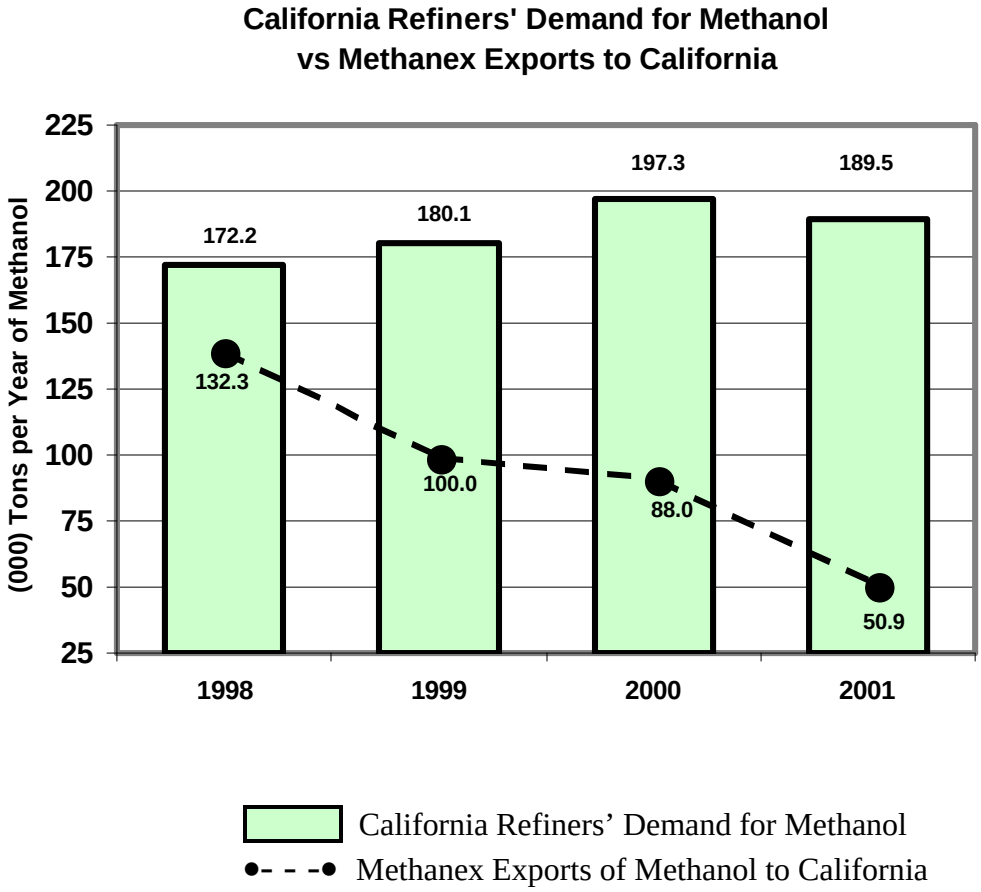
proof.[420] In any event, there is, of course, a critical distinction between decreased sales and lost profits; information as to the quantity of product shipped says nothing about whether any profit at all was lost. The record, as noted above, is silent as to any loss of profits to Methanex US.

234. Nor does the record in any way show that Methanex US sold less methanol to California MTBE producers in 1998-2001 *because of* the ban, as opposed to other factors. To the contrary, as shown in the chart that follows, during that period methanol demand by California MTBE producers *increased* at the same time that Methanex US's sales were declining. According to Methanex, Methanex US's sales volumes to California refiners declined from 132,322 tons in 1998 to 99,973 tons in 1999 to 88,000 tons in 2000 to 50,895 tons in 2001.[421] In those same years, however, California refiners' demand for methanol for use in producing MTBE *increased* from 172,200 tons in 1998 to 180,100 tons in 1999 to 197,300 tons in 2000, declining only slightly to 189,457 tons in 2001.[422]

[420] *See Avco Corp.*, 19 Iran-U.S. Cl. Trib. Rep. at 209 (dismissing the portion of a claim seeking lost profits "for lack of proof," because the claimant corporation produced only the testimony of its officers to prove its losses, but provided no documentary evidence); *see also CMI International v. Ministry of Roads and Transportation*, 4 Iran-U.S. Cl. Trib. Rep. 263, 268 (1983) ("the burden of proving entitlement to lost profits . . . is on the Claimant.").

[421] Second Macdonald Affidavit ¶ 5.

[422] Miller Report ¶ 5 (13A JS tab G).



235. The record thus does not even establish a positive *correlation* between Methanex's alleged loss of customers and market in California and the demand for methanol for production of MTBE in California. It therefore does not begin to show any causation.

236. Notably, during the same time period, 1998-2001, Methanex almost halved its production of methanol from its Kitimat, British Columbia plant – the plant closest to the California market.[423] Methanex's stated reasons for reducing production at the plant had nothing to do with the measures. In mid-2000, for example, it announced

[423] *See* Methanex Corp. 2002 Annual Report, Factbook at iv (17 JS tab 82 at 2172) (Kitimat plant production, in thousands of metric tons, was 407 in 1998, 468 in 1999, 243 in 2000 and 250 in 2001).

that it decided temporarily to close the plant because it had been "losing a substantial sum of money for some time due primarily to the very high natural gas costs."[424]

237. In short, the record suggests no causal relationship between the California measures and Methanex US's reduced sales to California MTBE producers. Such a causal relation, of course, cannot be presumed. Methanex's customers may have had any number of reasons for ending their contracts with Methanex for methanol supply, including Methanex's voluntarily abandoning the market, or the availability of more competitively priced methanol from other sources. Some may have decided to cease MTBE production for reasons other than the ban.[425] Far more is required to establish proximate causation than this record shows.

238. *Third*, Methanex admits that its declining sales in California are attributable to its own actions, thereby undermining its claim that these losses were proximately caused by the measures at issue. Methanex Senior Officer Michael Macdonald states in his affidavit that the causes of Methanex's declining sales are "difficult to separate" and at least one cause (if not the only cause) was "Methanex's

[424] Press Release, Methanex Corp., Statement to the Local Media Regarding Kitimat Methanol Plant (May 24, 2000) (17 JS tab 113 at 2273).

[425] Indeed, many refiners ceased using MTBE well before the ban's deadline of year-end 2003. *See* California Energy Commission, *Staff Report: Ethanol Supply Outlook for California* 3 (Oct. 2003) (14 JS tab 15 at 385) ("Conoco Phillips proceeded in advance of the original MTBE phaseout date in 2002. . . . In early 2003, Exxon Mobil, ChevronTexaco in Southern California, BP and Shell commenced ethanol blending."). Some refiners may have been motivated by their concern about potential lawsuits and the negative publicity associated with MTBE. *See infra.* at 140 (discussing preference of gasoline refiners for ethanol over MTBE because of justifiable concern over groundwater contamination and enumerating lawsuits filed against oil companies and MTBE producers asserting product liability for selling MTBE).

proactive decision to reduce its exposure to MTBE demand in an effort to mitigate the damage caused by California's ban of MTBE."[426]

239. Methanex's willful and deliberate forsaking of potential business opportunities in California before any expected impact of government regulation does not give rise to recoverable damages under international law. When a claimant's own actions lead to its damages, there can be no State responsibility.[427] Thus, when a property owner sold his cattle at an inadequate price to avoid losing them to revolutionary forces, but without any duress or constraint by military authorities, his loss was too remote to be compensated.[428] And claimants who feared possible injury during war and incurred the expense of war-risk insurance premiums had no claim to recover those expenses paid in anticipation of potentially harmful action by the State.[429] Nor could a claimant recover for the value of property voluntarily abandoned before the approach of enemy troops.[430]

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[426] Second Macdonald Affidavit ¶ 26; *see also id*. ¶ 23 ("the absolute volume of sales of methanol by Methanex for the manufacture of MTBE in California has decreased in subsequent years as Methanex has deliberately reduced its exposure to MTBE to mitigate its damages from California's MTBE ban.").

[427] *See, e.g.*, *Davis (Gr. Brit. v. Venez.)*, 9 R.I.A.A. 460, 462-63 (1903) (where claimant's goods were improperly given by a third party to Venezuelan customs officials for sale at public auction, claimant's failure "to not forward the bill of lading with the goods to a responsible Venezuelan resident agent . . . was the real and primary cause of the conditions which followed, and the least that can be said is that this negligence was directly and proximately contributory to the injuries complained of."); *State Responsibility: International Responsibility*, [1958] II Y.B. INT'L L. COMM'N 54, U.N. Doc. A/CN.4/111 ("[I]t is inconceivable that the State should have an unqualified duty to make reparation if the injury is the result of acts provoked by the alien himself.").

[428] *See Dix*, 9 R.I.A.A. at 121.

[429] *See U.S. Steel*, 7 R.I.A.A. at 63; *see also Eastern Steamship Lines, Inc. (U.S. v. Germ.)*, 7 R.I.A.A. 71 (Germ.-U.S. Mixed Claims Comm'n 1924) (same scenario as *U.S. Steel*; "expenses incurred by [claimant] in taking such measures [to preserve its business], on its own volition and in the exercise of its own discretion, were simply incident to the existence of a state of war . . . and in no sense losses, damages, or injuries caused by Germany or her allies . . .").

[430] *See Barbes (U.S.) v. Turkey*, AMERICAN-TURKISH CLAIMS SETTLEMENT UNDER THE AGREEMENT OF DEC. 24, 1923: OPINIONS AND REPORT 155, 157 (undated opinion) ("The prudent flight of persons from the theatre of military operations does not entail responsibility on a belligerent government to make compensation for property left behind . . .").

240. *Finally*, Methanex's claim that Methanex US lost a valuable market as a result of the ban is difficult to credit in any event. The California market at issue, which represented less than one percent of Methanex's overall sales, was served by a plant that, as noted above, was "losing a substantial sum of money."[431] Moreover, in 2002 and 2003, Methanex was running its plants at full capacity and could only meet its customers' demand by buying methanol on the spot market at a loss.[432] After the loss of a significant amount of its production capacity in early 2003, Methanex was on "order control."[433] It is difficult to see how Methanex could have produced and profitably sold an additional gallon of Methanol in California in the absence of the ban.[434] A showing such as this cannot establish proximate cause.

2. Continued Idling Of Methanex Fortier

241. Methanex alleges that the measures at issue "have also contributed to the continued idling of the Methanex Fortier plant."[435] This damages claim also fails the proximate cause test on legal and factual grounds additional to its remoteness.

242. First and foremost, the claim fails for lack of any proof that the California measures caused the closure or continued closure of the Fortier plant. Notably, Methanex does not contend that the California measures contributed to its decision to close the Fortier plant in 1999 – a decision that was announced *before* the March 25, 1999

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[431] Press Release, Methanex Corp., Statement to the Local Media Regarding Kitimat Methanol Plant (May 24, 2000) (17 JS tab 113 at 2273).

[432] *See, e.g.*, Transcript of Methanex 2003 First Quarter Report Earnings Conference Call at 12 (18 JS tab 142 at 2688).

[433] *See id.* at 7 (18 JS tab 142 at 2683).

[434] *Cf. Pope & Talbot Inc. v. Canada* (May 31, 2002) (Damages Award) ¶ 84 (rejecting claim for lost profits based on shutdown of plant where "the Investment at all relevant times had inventory sufficient to meet all its sales requirements, notwithstanding that shutdown.").

Executive Order.[436] Instead, Methanex suggests that it would have re-opened the plant, but determined not to because of the measures. If Methanex had in fact decided to keep idled its only U.S. manufacturing facility for this reason, one would expect evidence of such a corporate decision to be readily at hand. Methanex, however, has failed to provide a shred of evidence in support of this supposed decision. Its failure to adduce any such evidence renders this claim untenable as a matter of law.[437]

243. Methanex's failure of proof on this subject is not surprising, for its own statements identify economic and strategic factors completely unrelated to the California measures as its motivations for keeping Fortier idle. *First*, Methanex has publicly attributed the closure and idling of the Fortier plant to its strategy of lowering its cost structure and reducing its exposure to the North American natural gas market. For example, Methanex stated in its annual report that it closed the Fortier plant as part of its strategy of "restructur[ing] assets and reduc[ing] costs."[438] At the time of the plant closure, Methanex's senior officer, Michael Macdonald stated "[w]e are not making money there. In fact, *we are hurting*. . . . If it were in our control, we would have had the plant down earlier."[439] Mr. Choquette expressly confirmed that the decision to close the

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[435] Second Amended Statement of Claim ¶ 322.

[436] *See, e.g., Poor Economics Shuts Down Methanex/Cytec JV Methanol Plant*, 11:10 OXY FUEL NEWS (Mar. 15, 1999) (17 JS tab 101).

[437] *Malek v. Iran*, Award 534-193-3 ¶ 106 (Iran-U.S. Claims Tribunal 1992) (*available in* Westlaw INT-IRAN database) ("the Tribunal has had recourse, on a number of occasions, to the principle that an adverse inference may be drawn from a party's failure to submit evidence likely to be at its disposal."); *see also* authorities cited *supra* n.198.

[438] Methanex Corp. 1999 Annual Report at 14 (17 JS tab 78 at 1876).

[439] *Poor Economics Shuts Down Methanex/Cytec JV Methanol Plant*, 11:10 OXY FUEL NEWS (Mar. 15, 1999) (17 JS tab 101) (emphasis added).

plant was "not directly related" to California's measures.[440] Likewise, when Methanex announced the write-off of the Fortier facility in November 2002, it attributed the decision to its "low-cost strategy of reducing [its] reliance on North American production by expanding methanol production capacity in Trinidad and Chile."[441] Methanex has never associated the closure or idling with the California measures – except in this arbitration.

244. *Second*, contrary to Methenex's assertion that the measures had the effect of directly "seizing . . . Fortier's share of the California oxygenate market,"[442] the Fortier plant did not sell methanol to producers of MTBE used in California gasoline. Rather, the plant produced methanol that was sold locally, primarily for the production of chemical derivatives. It is difficult to see how a ban of MTBE in California could impact a plant that did not serve the California market. The record sheds no light on this mystery. Likewise, Methanex's assertion that the measures *indirectly* affected the Fortier plant by "worsen[ing] a tendency toward oversupply in the methanol industry"[443] is refuted by Methanex's own statements that the industry is in an *undersupply* situation, and that no market effects will be felt from the measures.

245. *Third*, Methanex's suggestion that it would have reopened the Fortier plant but for the ban is at odds with Methanex's strategy of moving its production out of the high-cost North American market. The cost of the Fortier plant's natural gas supply was

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[440] *See* Peter Morton, *Methanex Sues U.S. Over Additive Ban: Linked to Cancer*, FINANCIAL POST, Jun. 16, 1999 at C01 (17 JS tab 94 at 2250).

[441] *See* Press Release, Methanex Corp., *Methanex Announces Write-off of Fortier Methanol Facility* (Nov. 25, 2002) (17 JS tab 107 at 2267).

[442] Second Amended Statement of Claim ¶ 318.

[443] *Id.* ¶ 16.

significantly more expensive than offshore natural gas and more expensive than that of any other Methanex plant.[444] After Methanex closed the plant in early 1999, North American natural gas prices only continued to rise relative to the methanol sales price, and became increasingly volatile, making methanol production in that market even more untenable.[445] Thus, if the Fortier plant was "hurting" in 1999 when it was closed, its prospects only grew dimmer thereafter, for reasons having nothing to do with the California measures.

246. In light of the above, Methanex's suggestion that the California measures caused Methanex to keep the Fortier plant closed cannot be sustained as a factual matter.

247. Methanex's allegations regarding Fortier fail as a legal matter as well. Methanex asserts only that the measures "contributed to" the continued idling of Fortier.[446] Such an allegation is too speculative to be recognized. Methanex asks the Tribunal to imagine what might have happened or what its managers might have done if circumstances were altogether different. International tribunals decline invitations to engage in such sheer speculation.[447]

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[444] *See* Karl Greenberg, *New Capacity Hits Outlook for Methanol and Methyl Tertiary Butyl Ether*, CHEMICAL MARKET REPORTER, at 56 (Mar. 27, 2000) (showing average spot price for natural gas in the U.S. Gulf was over $2.00 per million BTUs versus approximately $.50 in Chile) (16 JS tab 51 at 1451); *see also* Methanex Corp. 1997 Annual Report at 39 (showing Fortier plant's gas supply more expensive than that for Kitimat or Medicine Hat) (17 JS tab 76 at 1694); *see also* Methanex Corp. 1998 Annual Report at 53 (same) (17 JS tab 77 at 1803); Methanex Corp. 1999 Annual Report at 46 (same) (17 JS tab 78 at 1908).

[445] *See* Methanex Corp. 2000 Annual Report at 7 (17 JS tab 79 at 1965) (showing that North American natural gas prices rose from $2.50 to $6.00 per million BTUs between the first and second half of 2000); *see also* Fertilizer Institute, The Current U.S. Natural Gas Crisis, Statement of Mike Bennett, Chief Executive Officer, Terra Industries Inc., Before the United States Department of Energy Natural Gas Summit, at 2 (June 26, 2003) (stating that it has become very difficult, if not "virtually impossible," to produce methanol in the United States due to the extreme price volatility of natural gas in that market) (16 JS tab 48 at 1420).

[446] Second Amended Statement of Claim ¶ 322.

[447] *See, e.g.*, 3 WHITEMAN at 1784 (quoting 1911 decision of Nicaraguan Mixed Claims Commission denying claim for value of cheese cattle ranchers would have made with the milk they would have obtained

3. Decreased Exports From Methanex's Overseas Plants

248. In articulating its supposed damages, Methanex fails to specify whether each loss or damage it identifies relates to its U.S. investments (Methanex Fortier and Methanex US) as opposed to Methanex in its capacity as an exporter of a global commodity.[448] To the extent that Methanex has suffered injury because sales by Methanex of "methanol to California from Methanex's other production facilities, including facilities in Canada, have . . . decreased,"[449] such damages cannot, as a matter of law, be considered to arise out of a breach within the ambit of Article 1116(1).

249. A claimant may submit a claim to investor-State arbitration under Chapter Eleven of the NAFTA only for breaches of obligations contained in Section A of Chapter Eleven.[450] The provisions of Section A of Chapter Eleven are all obligations pertaining to investment, as Chapter Eleven itself is concerned solely with investment.

250. Methanex alleges breaches of three provisions of Chapter Eleven: Articles 1102, 1105(1) and 1110. The obligations contained in Articles 1105 and 1110 solely address treatment of an investor's *investment*. Article 1105(1) provides that *investments* are to be accorded a minimum standard of treatment, and Article 1110 provides that

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if they had not abandoned their ranches during war); *American Chicle Co. (U.S. v. Mex.)*, SPECIAL MEXICAN CLAIMS COMMISSION: REPORT TO THE SECRETARY OF STATE 591 (1940) (undated decision) ("No allowance can be made for losses resulting from increased cost of chicle consequent upon the inability of the company to operate normally from 1913 to 1915 [during time of raids by revolutionaries]. Such losses are too speculative and, moreover, were repercussions of general revolutionary conditions and not proximately due to acts of specified forces . . .").

[448] *See* Second Amended Statement of Claim ¶ 322 (alleging generally that "Methanex and its U.S. investments" have sustained a variety of losses and damages).

[449] Second Macdonald Affidavit ¶ 26.

[450] *See* NAFTA art. 1116(1) (limiting claims to those that the respondent has breached Section A "and that the investor has incurred loss or damage by reason of, or arising out of, *that breach*") (emphasis added). Claims may also be submitted for breaches of certain provisions of Chapter Fifteen of the NAFTA (which themselves require a breach of Section A of Chapter Eleven), but those provisions are not at issue here.

investments are not to be expropriated, except under certain conditions. Thus, while Methanex may claim that its investments in the United States have been denied a minimum standard of treatment or have been expropriated under those articles, it cannot claim that *it* has been denied a minimum standard of treatment or has been expropriated.

251. Unlike Articles 1105(1) and 1110, Article 1102 applies to the treatment of both investors and their investments. Methanex claims that its investments have been denied national treatment. While it may also claim that it has been denied national treatment, it may do so only if it can demonstrate that it has been accorded less favorable treatment *with respect to its investments*.[451] As the Tribunal noted in its decision on place of arbitration, "[t]he fact that the investor's parent company (the Claimant) is based in Vancouver, Canada does not displace the fact that the Claimant's effective claim is based on alleged actions in the USA affecting a US enterprise."[452]

252. Methanex has not shown that any loss or damage it allegedly sustained because of a decline in sales of methanol to California from outside the United States is "with respect to" its U.S. investments. Instead, Methanex's allegation to this effect relates solely to its role as a cross-border supplier of goods. That role, however, is not governed by Chapter Eleven: rules governing cross-border trade in goods are contained in Parts Two and Three of the NAFTA.[453]

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[451] *See* NAFTA art. 1102(1) ("Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors *with respect to* the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.") (emphasis added).

[452] The Written Reasons For The Tribunal's Decision Of 7th September 2000 On The Place Of The Arbitration ¶ 33 (Dec. 31, 2000).

[453] Part Two of the NAFTA is entitled "Trade in Goods" and Part Three "Technical Barriers to Trade." The investment chapter, by contrast, is found in Part Five of the treaty. Notably, the dispute-resolution provisions of the treaty for Parts Two and Three are markedly different from those of Part Five. If a person

253. The intent of the NAFTA Parties to exclude claims based solely on cross-border trade from the ambit of the investment chapter is illustrated by Article 1139's definition of the term "investment." That article provides that "investment" does *not* mean any "claims to money that arise solely from . . . commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party." Thus, the NAFTA Parties intended to exclude from the investment chapter claims for money damages such as those asserted by Methanex based on "[s]ales of methanol to California from Methanex's other production facilities, including facilities in Canada."[454]

254. Nothing in Chapter Eleven gives an investor the right to convert a supposed breach of any other part of the NAFTA, including Parts Two and Three, into a Chapter Eleven claim merely by virtue of the fact that the claimant is an investor. The claim itself must relate to the investor's treatment *as an investor* in order for a Chapter Eleven claim to succeed.

255. Methanex has not demonstrated that the California measures in any way addressed or even impacted Methanex as an investor in the United States. This conclusion is confirmed by a consideration of each of the investment activities referenced in Article 1102(1).[455] For example, Methanex has not shown that the California measures

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or entity believes that any of the provisions in Parts Two or Three have been violated, that person's or entity's recourse is to petition its government to seek consultations with the other NAFTA Party or bring a State-to-State claim under Chapter Twenty of the NAFTA. A private person or entity, however, has no right to bring a direct claim against a NAFTA Party for breaches of Parts Two or Three.

[454] Second Macdonald Affidavit ¶ 26.

[455] *See* NAFTA art. 1102(1) ("Each Party shall accord to investors of another Party treatment no less favorable than it accords in like circumstances, to its own investors *with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.*") (emphasis added).

imposed any restrictions on its ability to establish or acquire an investment in the United States. Nor has Methanex demonstrated that the California measures restricted its ability to expand, operate, manage or conduct its investments in the United States.[456] Finally, Methanex has failed to demonstrate that the California measures have affected its ability to sell or otherwise dispose of its investments in the United States.[457]

256. Any foreign producer of methanol could claim, as Methanex does, that, it is injured by the California measures because those measures have resulted in decreased demand for imports of methanol into the United States. Foreign producers would suffer from any alleged decrease in demand whether or not they had any investment in the United States. The decrease in exports to the United States alleged here by Methanex is not an injury that is related in any way to Methanex's status as an investor in the United States or to the treatment of Methanex with respect to its investments in the United States. Rather, this alleged injury relates solely to Methanex's role as a cross-border supplier of goods. A claim for such loss or damage is not cognizable under Chapter Eleven of the NAFTA.

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[456] Methanex does not dispute, for example, that the California measures in no way restrict Methanex US's ability to sell methanol throughout the United States. Nor do the measures inhibit Methanex Fortier from producing methanol.

[457] In fact, the record demonstrates otherwise. The fact that Methanex Fortier's previous joint venture partner was able to sell its 30% ownership share in Methanex Fortier to Methanex *after* the measures were adopted, is evidence that Methanex's ability to sell its ownership rights in Methanex Fortier remains unrestricted. Similarly, the measures in no way restrict Methanex's ability to sell or otherwise dispose of its investment in Methanex US.

4. Alleged Deprivation Of Methanex's Customer Base, Goodwill, And Market

257. Methanex claims that the measures at issue "have deprived and will continue to deprive Methanex . . . of a substantial portion of [its] customer base, goodwill, and market for methanol in California."[458]

258. This claim is without merit for several reasons. *First*, as noted above, these supposed damages could not have been the proximate result of California's measures, which are directed at MTBE and affect the methanol market only indirectly.

259. *Second*, as also noted above, to the extent that Methanex's supposed decline in goodwill, customer base and market derives from decreased exports of methanol to the United States, these are not damages with respect to its investments in the United States, and are therefore not cognizable under Chapter Eleven.

260. *Third*, it fails for utter lack of proof. No evidence of record even attempts to show that Methanex – the parent company – even had any recognized goodwill. No evidence attempts to quantify or document such goodwill. Similarly, the record is silent as to Methanex's customer base and market or any impact on either from the measures.

261. Methanex's failure even to attempt to carry its burden of proof on these points is not surprising given its own public statements. Methanex's Chief Executive Officer, Pierre Choquette, has recently stated on several occasions that, given the tight supply and demand conditions in the methanol market and Methanex's own supply constraints (especially after the loss of most of its production in New Zealand) the loss of the California market at issue will have no measurable effect on Methanex.

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[458] Second Amended Statement of Claim ¶ 322.

262. Notably, in early 2003, Mr. Choquette informed shareholders that "clearly, in the market that we're in today, if the conversion in California took place overnight, it would be fully absorbed. *It would give some welcome relief in terms of inventories in the system.*"[459] And at an investor conference in Toronto in mid-2003, Mr. Choquette stated that "I always say that I wish they would eliminate [MTBE from the U.S. market] tomorrow morning so we could get on with life because *it's not that big a deal*."[460]

263. If, by Methanex's own admission, the *immediate* elimination of MTBE demand from the *entire* U.S. MTBE market would be "not that big a deal" for Methanex, and the immediate loss of the California MTBE market would in fact provide some "welcome relief" for a company struggling to meet its supply commitments and maintain inventory levels, it is difficult to see how any claim of loss from the California measures at issue could be sustained. It is thus easy to appreciate the record's silence on this point. Methanex's claim for loss of its goodwill, customer base and market is entirely without support.

5. Reduced Return On, And Value Of, Investments And Increased Cost Of Capital

264. Methanex also alludes – without any elaboration or substantiation – to reduced return on capital investments made by Methanex, Methanex US, and Methanex Fortier; increased cost of capital for those enterprises; and reduced value of their investments.[461] These alleged losses are even more remote than the categories of supposed losses discussed above: these are based on the financial markets' supposed

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[459] Transcript of Methanex 2002 Fourth Quarter Earnings Conference Call at 8 (18 JS tab 141 at 2671) (emphasis added).

[460] Scotia Capital Speech at 35:33 (accompanying CD, 16 JS tab 38) (emphasis added).

perception that the measures will likely cause sellers of California gasoline to buy less MTBE, MTBE producers to buy less methanol and Methanex to sell less methanol. For the reasons discussed in Part A above, these supposed losses plainly fail to meet the standard of proximate cause.

265. Methanex's claim for these losses also fails as a matter of proof. The record, again, is utterly silent as to the existence of any such reduced return or value or increased cost of capital. Nor is there any evidence of record suggesting that any such loss was proximately caused by the ban.

266. This absence of evidence is significant. A number of factors contribute to a company's success in making a favorable return on investments, or achieving a certain value for those investments. Several variables go into determining a company's cost of capital as well. Methanex has not proven that the California measures, as opposed to any of these other factors, were the proximate cause of any negative impact on its return on, or value of, investments or cost of capital.

267. Operating a business selling a globally-traded commodity is an inherently volatile and risky venture. Merely asserting that the business failed or fared poorly at the time when some government action happened to have taken place does not establish a claim for compensation by the government.[462] Of course, the record in this case could not support such a showing in any event – Methanex's results have continuously *improved*

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[461] Second Amended Statement of Claim ¶ 322.

[462] *See, e.g.*, *Hickson*, 7 R.I.A.A. 266, 267 (Germ.-U.S. Mixed Claims Comm'n 1924) (claim against Germany for failure of business for which passenger lost in sinking of *Lusitania* was key employee; holding that "[i]t is by no means clear from the records that these difficulties [experienced by claimant's apparel business] resulted from the loss to the business of Mrs. Kennedy's genius. The strong inferences are that they resulted from the improvidential financial ventures of the claimant."); *see also American Chicle Co*. at

since the 1999 Executive Order, and its plants are now operating at or around full capacity.[463]

6. Downward Pressure On Methanol Price

268. Methanex next asserts that it has been damaged because the California measures have caused, and will continue to cause, "downward pressure on the global methanol price."[464] This assertion stretches Methanex's thin causal chain well past the breaking point: it postulates that the measures will cause sellers of California gasoline to buy less MTBE, MTBE producers to buy less methanol from *other* methanol producers, those *other* methanol producers will lower their selling prices and Methanex will be forced to lower its prices as well to remain competitive. Merely to state the proposition shows that it fails the test of proximate causation stated in Part A above.

269. Also, as discussed above, this category of damages is not cognizable under Chapter Eleven because it has nothing to do with Methanex's investments in the United States. Rather, it relates only to Methanex's role as a global supplier and exporter to the United States of methanol.

270. Moreover, holding a government responsible under international law for a regulation's effect on the global price of a commodity would be a significant departure from international precedent. Governments every day take measures that have broad effects on the movement of commodities markets. A small change in energy policy, for

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591 (dismissed as "too speculative" a claimant's alleged losses resulting from the increased cost of operating its business during a time of general civil unrest).

[463] *See supra* at 37 *et seq.* ("Methanex's Recent Economic Performance").

[464] Second Amended Statement of Claim ¶ 323

example, can have dramatic short- or long-term effects on the direction of the markets. Imposing State responsibility with respect to such effects would be unprecedented.

271. Even aside from these broader concerns, Methanex has failed to prove that any change in the price of methanol – a global commodity subject to price volatility dependent on numerous factors – was proximately caused by the California measures directed at MTBE.

272. *First*, the record belies Methanex's assertion that the measures proximately caused any damage in the form of decreased methanol prices. After the 1999 Executive Order, from mid-2000, the price of methanol has significantly *increased*.[465] In addition, the global methanol price is characterized by long-term price cycles, with overall industry capacity exerting significant pressure on price.[466] Indeed, Methanex itself has attributed low methanol prices in 1999 to capacity additions rather than the 1999 Executive Order.[467] And Methanex itself has conceded that it did not expect the loss of the California market at issue "to have much of an impact on [methanol] pricing, if at all."[468]

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[465] Methanex Corp. 2002 Annual Report at 9 (17 JS tab 82 at 2107) (Methanex's realized methanol price was $105/ton in 1999, $160/ton in 2000, and $172/ton in 2001).

[466] *See supra* at 32; *see also* Methanex Corp. 1999 Annual Report at 44 (17 JS tab 78 at 1906).

[467] Methanex Corp. 1999 Annual Report at 50 (17 JS tab 78 at 1877).

[468] Transcript of Methanex 2002 Second Quarter Earnings Conference Call at 2 (18 JS tab 140 at 2659) (emphasis added); *see supra* at 37 *et seq.* ("Methanex's Recent Economic Performance"); *see also* Methanex Corp. 2000 Annual Report at 17 (17 JS tab 79 at 1975) ("We believe that overall global methanol demand growth should more than offset the impact of any reduction, even if MTBE is removed from gasoline in California by 2003.").

273. *Second*, given the wide variety of factors that influence commodity prices, the record cannot establish the ban as the proximate cause of a change in methanol prices in any event.[469]

7. MTBE Bans By Other States

274. Methanex next claims that the California measures may have triggered decisions of other government bodies to regulate MTBE.[470] Even Methanex distances itself from this claim, alleging only that "*[t]o the extent* that the MTBE bans and restrictions in other U.S. states . . . can be traced to the California measures at issue here, they constitute additional harms to Methanex . . . ."[471] Methanex in essence throws up its hands in defeat, admitting that it has not and cannot trace MTBE measures in other jurisdictions to the California measures at issue. Yet, it is Methanex's burden – not that of the Tribunal or the United States – to trace that chain of cause and effect. On its face, therefore, this claim is unworthy of consideration.

275. Methanex has supplied no evidence that California's example motivated regulators in other jurisdictions to address MTBE's harmful effects. It would be unreasonable to speculate that if California had not instituted its measures to safeguard against MTBE contamination, other jurisdictions would have had no cause to take measures of their own. In fact, individual state measures outside of California and activity at the national level regarding MTBE concerns had commenced prior to the California measures at issue here. Alaska's government responded to complaints about

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[469] *See Skins Trading Corp*., FOREIGN CLAIMS SETTLEMENT COMM'N OF THE UNITED STATES: DECISIONS AND ANNOTATIONS 402, 404 (1960).

[470] Second Amended Statement of Claim ¶ 324.

[471] *Id*. (emphasis added).

MTBE as early as 1994 and Maine acted on its discovery of MTBE contamination in 1998.[472] Thus, the facts do not support Methanex's half-hearted assertion that California was the first-mover leading a trend of state regulations.

8. Drop In Stock Price

276. The final item in Methanex's summary list of damages is an alleged twenty percent drop in its stock value in the ten days following the issuance of the Executive Order.[473] This category of damages likewise fails as a matter of law and fact because, even if the drop in value or stock price occurred, no such loss was incurred by reason of, or arising out of, the California measures.

277. *First*, as a matter of law, the change in Methanex's stock price is too remote because – like return on investments, value of investments and cost of capital – it depends on the financial markets' *perception* of the results of the already attenuated causal chain in this case. At best, it represents some shareholders' fleeting speculation that Methanex's future profitability might be adversely affected. Stock price movements are inherently remote and unreliable because they are based on predictions about future performance and do not, therefore, reflect any current loss or damage.

278. Moreover, as a thinly-traded stock trading at single-digit prices on a regional stock exchange, Methanex's stock price was highly volatile. Price swings of twenty percent within the course of a week or two were not uncommon for Methanex's

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[472] *See* U.S. Environmental Protection Agency, *Approval and Promulgation of State Implementation Plans: Alaska*, 61 Fed. Reg. 24712 (May 16, 1996) (18 JS tab 147); State of Alaska, *Potential Illness Due to Exposure to Oxygenated Fuel*, Bulletin No. 1 (Jan. 6, 1993) (18 JS tab 147); Department of Human Services, *et al*., *A Preliminary Report: Presence of MTBE and Other Gasoline Compounds in Maine's Drinking Water* (Oct. 13, 1998) (16 JS tab 42).

[473] Second Amended Statement of Claim ¶ 325.

stock; the record in no way establishes that the share activity Methanex points to was a deviation from the norm.[474] To the extent that the Tribunal attributes any significance to the short-term price swing alleged by Methanex, it should be viewed as part of the general downtrend of Methanex's stock caused by the historically low methanol prices in early 1999.[475]

279. *Second*, a decline in a company's stock price is not, on its face, a loss to the company. A decrease in the market value of corporate shares following issuance – *i.e.*, after the corporation has received the funds raised by the offering – cannot give rise to a cognizable claim for the corporation issuing the shares since the corporation does not own stock in itself. In fact, Methanex previously conceded that its "damage claim is not based on a loss of share value."[476] Methanex's apparent attempt in its recent pleading to

[474] In the seven trading days between January 29, 1999 and February 9, 1999, for example, Methanex's stock price declined from CAN $7.75 to CAN $6.10, or more than 21 percent. Methanex also tries to attach importance to the fact that the day after the issuance of the March 25, 1999 Executive Order, the trading volume of Methanex's stock was one million shares. *See* Second Amended Statement of Claim ¶ 325. Single-day trading volume of over one million shares, however, were also not uncommon. On March 18, 1999, for example, nearly 1.4 million shares traded, and on March 11, 1999, over 1.2. million shares traded. *See* Methanex Corp., *Quotes & Info: Historical Prices (Jan. 15, 1999 – Apr. 30, 1999)* (TSE) (17 JS tab 86). This trading volume – representing a tiny fraction of Methanex's 173 million outstanding shares – does not reflect a sudden market reaction to bad news. Notably, no significant price decline or volume spike occurred with respect to Methanex's stock trading on the NASDAQ exchange. On March 26, 1999, the day following the announcement, the trading volume was *below* the average of the prior four days, and the stock was down only slightly. *See* Methanex Corp., *Quotes & Info: Historical Prices (Jan. 15, 1999 – Apr. 30, 1999)* (NASDAQ) (17 JS tab 85).

[475] Ironically, this decline was attributable in part to Methanex's having brought on line a significant amount of new methanol production capacity at that time. As Methanex stated in its 1999 Annual Report, "[t]his new supply is the primary factor responsible for the current low [methanol] price environment." Methanex Corp. 1999 Annual Report at 50 (17 JS tab 78 at 1912). Unsuprisingly, Methanex's stock price fully recovered as the price of methanol increased, rising from around CAN $4 in early 1999 to over CAN $13 in early 2001 – about where it trades today.

[476] Reply to the U.S. Statement of Defense, dated Aug. 28, 2000, ¶ 86 (emphasis added).

resurrect a claim based on an alleged decline in share price as a "loss . . . suffered by *Methanex*" should therefore be rejected.[477]

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280. For the foregoing reasons, Methanex's claims do not, and cannot, meet the standard of proximate causation incorporated by Articles 1116(1) and 1117(1). Its claims should be dismissed in their entirety on this ground alone.[478]

III. METHANEX AND ITS INVESTMENTS RECEIVED TREATMENT NO LESS FAVORABLE THAN THAT ACCORDED THEIR U.S. COUNTERPARTS

281. The 1999 Executive Order and the CaRFG3 regulations accord Methanex and its investments precisely the same treatment that they accord U.S. investors and U.S.-owned investments that produce, market and sell methanol. Faced with this undisputed fact, Methanex is left to argue that it is entitled to the same treatment that is accorded to U.S. *ethanol* producers and marketers. U.S. investors and U.S.-owned investments that produce or market ethanol, however, are not in like circumstances with Methanex and its U.S. investments. Methanex's argument, in effect, is that it is entitled to treatment *better than* that accorded to the methanol producers and marketers that are in like circumstances with it and its affiliates. This is not, however, what Article 1102 prescribes. Methanex's national treatment claim is without merit.

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[477] Second Amended Statement of Claim ¶ 325. In its recent pleading, Methanex also attempts to inflate the value of its alleged losses concerning its stock price. In the Reply to the U.S. Statement of Defense, Methanex considered the drop in stock price on the day following the March 25, 1999 announcement, deriving a loss of US $70 million, or ten percent of its stock value. *See* Reply to U.S. Statement of Defense ¶ 6. In its recent pleading, however, Methanex averages the *ten* days following the announcement to derive a loss of CAN $180 million, or twenty percent of its stock value. *See* Second Amended Statement of Claim ¶ 325.

282. We begin by demonstrating that Methanex and its U.S. investments have received the same treatment that U.S. investors and their investments in like circumstances have received. We then show that Methanex's attempt to characterize it and its U.S. investments as in like circumstances with ethanol producers is without merit. We establish that Article 1102 does not set out a "like products" test and that neither the article's text and context nor the NAFTA's object and purpose do not support Methanex's attempt to transfer GATT "like products" jurisprudence to the NAFTA's investment chapter. Methanex's failure to prove less favorable treatment than U.S. investors or investments in like circumstances therefore disposes of its claim under Article 1102.

283. We nevertheless go on to demonstrate that, even considered on its own terms, Methanex's "like products" analysis fails. Under the GATT provision Methanex relies upon, neither methanol nor MTBE would be considered to be "like" ethanol for purposes of the measures at issue in this case. Thus, whether considered under the "in like circumstances" test in Article 1102 that applies here, or under the "like products" test that does not apply, Methanex's national treatment claim is without legal or factual substance.

A. Methanex And Its Investments Received The Same Treatment As U.S. Investors And Their Investments In Precisely The Same Circumstances

284. Article 1102 requires that the NAFTA Parties accord to investors of another Party and to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors and investments "with

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[478] Methanex's assertions that it has established proximate causation by showing an intent to discriminate against methanol producers are without merit for the reasons discussed in Section I above.

respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."[479] To establish a national treatment violation, Methanex must identify U.S. investors and U.S.-owned investments that are or would be in like circumstances with it and its investments. Methanex must also prove that it or its investment has been or would have been accorded less favorable treatment in comparison to the U.S. investor or U.S.-owned investment with respect to the activities specified in Article 1102.

285. Methanex fails to carry either burden here. This is not surprising, since U.S. investors and their investments exist that are in like circumstances with Methanex and its investments – and those investors and investments have received treatment that is *precisely the same* as that accorded Methanex and its U.S. investments. Below, we address in turn the treatment accorded by Methanex Fortier, Methanex US and Methanex.

1. Methanex Fortier

286. The sole asset of Methanex Fortier is apparently an idled methanol factory located in Louisiana. An investment in like circumstances with Methanex Fortier would be a U.S.-owned company with a similarly-located methanol factory. Methanex does not deny the existence of U.S.-owned methanol plants in such circumstances. Methanex does not do so because such plants do indeed exist.

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[479] NAFTA Article 1102 provides

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

287. As of 1999, when the Executive Order was promulgated and Methanex submitted its claim to arbitration, there were 16 methanol production plants located in the United States.[480] At that time, of these 16 plants, several were owned or controlled by U.S. companies. For example, Borden Chemical Inc. (formerly Borden Inc.), a New Jersey corporation headquartered in Ohio[481] and privately held by the U.S. investment firm Kohlberg Kravis Roberts & Company (KKR),[482] owned and operated a plant in Louisiana with a capacity that was among the largest of any methanol plant in the United States.[483] Lyondell Methanol Company, L.P., a Texas limited partnership that is controlled by Lyondell Chemical Company, a Delaware corporation headquartered in Texas,[484] owned and operated a methanol plant near Houston, Texas.[485]

288. As of 1999, each of these plants produced methanol and each was owned or controlled by a U.S. company. For purposes of Methanex's claim, each of the companies owning these methanol plants is in like circumstances with Methanex Fortier.

289. To the extent that the California measures accorded any treatment to Methanex Fortier at all, those measures accorded precisely the same treatment to each of the aforementioned U.S.-owned methanol plants in the United States. The measures do not discriminate among Methanex Fortier and U.S.-owned methanol plants located in the

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[480] *See* Burke Report ¶¶ 63, 65, Exh. 12, n.35 (13 JS tab B).

[481] *See* Securities & Exchange Commission, Company Information: Borden Chemicals (18 JS tab 131 at 2519).

[482] *See* Borden Chemical: About Us (14 JS tab 9 at 68) ("Borden Chemical is an operating company of the investment firm Kohlberg Kravis Roberts & Company (KKR)."). KKR is a New York corporation headquartered in New York. *See* Securities & Exchange Commission, Company Information: KKR (18 JS tab 132 at 2522).

[483] Burke Report ¶ 63, Exh. 12 (13 JS tab B).

[484] *See* Securities & Exchange Commission, Company Information: Lyondell Chemical Co. (18 JS tab 133 at 2524).

U.S. To the extent that demand for methanol allegedly is diminished or the price for methanol declines as a result of the California measures, each of these plants will be similarly affected. The record in no way suggests differential treatment of Methanex Fortier on the basis of nationality.

2. Methanex US

290. Methanex US, allegedly a Texas general partnership, is the sales and trading arm of Methanex in the United States. It sells methanol produced by Methanex's facilities outside of the United States to customers in the United States, and it purchases methanol on the spot market for sale to Methanex's U.S.-based customers. Methanex US is a small operation in Dallas, Texas, which employs approximately 30 people.[486]

291. Methanex, again, has made no attempt to identify any U.S.-owned or controlled company in like circumstances with Methanex US. It has failed to do so for the simple reason that U.S.-owned methanol marketers have received treatment no different from that which Methanex US received.

292. For instance, like Methanex US, Atlantic Methanol Marketing, based in Houston, Texas, sells methanol.[487] Like Methanex US, Atlantic Methanol Marketing's business consists primarily of marketing methanol produced by an affiliated plant located overseas.[488] While Methanex US allegedly is indirectly owned by Methanex Corp., a

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[485] Burke Report ¶ 63, Exhibit 12 (13 JS tab B).

[486] *See supra* n.136 and accompanying text.

[487] *See* Atlantic Methanol Company History (14 JS tab 5 at 59).

[488] *See* Atlantic Methanol Plant Site (14 JS tab 7 at 62). Atlantic Methanol's plant is located in Equitorial Guinea.

Canadian company, Atlantic Methanol Marketing is owned by U.S. companies.[489] Atlantic Methanol Marketing is thus a domestically-owned counterpart to Methanex US for Article 1102(2) purposes: it performs the same function as does Methanex US.

293. To the extent that the California measures accord methanol marketers any treatment at all, the treatment accorded to U.S. companies such as Atlantic Methanol Marketing is no different from the treatment accorded Methanex US. The measures do not on their face differentiate among methanol marketers, and Methanex does suggest that they so differentiate in fact. Methanex's Article 1102(2) claim as to Methanex US therefore has no foundation.

3. Methanex Corporation

294. It follows from the foregoing that Methanex's claim that *it* has been denied national treatment is baseless as well. Methanex, of course, is in like circumstances with the U.S. owners of the methanol producers and methanol marketing companies just discussed. In other words, Methanex, like Borden and Lyondell, allegedly indirectly owned or controlled a methanol plant on the Gulf Coast of the United States. Like Samedan and Marathon Oil, Methanex allegedly owns or controls a U.S. company that markets in this country methanol produced by overseas affiliates.

295. Again, to the extent the California measures accord any treatment to owners of methanol plants and marketers at all, the treatment they accord to Methanex is no different than that accorded to any of these U.S. companies. The record, in sum, contains no evidence suggesting that Methanex was accorded less favorable treatment

[489] *See* Atlantic Methanol Ownership, (14 JS tab 6 at 61) (stating that Atlantic Methanol Marketing is 50% owned by Samedan (a U.S. company) and 50% owned by Marathon Oil Corporation (a U.S. company)).

than that accorded to any U.S. investor in like circumstances with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of its investments.[490] Methanex's claim under Article 1102(1) is fatally defective as well.

296. Thus, the record establishes that Methanex and its investments received precisely the same treatment as that accorded to U.S. investors and investments in the methanol industry – investors and investments that, undeniably, are in like circumstances with Methanex and its investments. This showing, in itself, establishes that Methanex's national treatment claim is fatally defective.[491]

B. Methanex's Argument That It Should Be Compared To Investors And Investments In Other Industries Is Without Legal Or Factual Merit

297. Methanex asks this Tribunal to compare the treatment it and its U.S. investments are accorded with that accorded to companies that produce and market a product it does not produce and does not market – ethanol. Methanex, in short, asks this

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[490] *See* NAFTA art. 1102(1) ("Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.").

[491] Methanex erroneously asserts that finding no national treatment violation where nationals in like circumstances received the same supposedly adverse treatment "would be nothing more than a resurrection of the Calvo Doctrine." Second Amended Statement of Claim ¶ 309. Methanex misapprehends the nature and history of the Calvo Doctrine. That doctrine, at one time espoused by many Latin American countries, centered *not* on the kind of *relative* standard of treatment embodied in Article 1102, but on the *absolute* minimum standard of treatment consistently advocated by the United States and embodied in Article 1105(1) of the NAFTA. *See* Detlev Vagts, *Minimum Standard*, *in* 3 ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 408 (Bernhardt ed. 1997). The Calvo Doctrine rejected the notion that foreigners were entitled to an absolute minimum standard of treatment. *See id*. There is, however, no support in international law – whether in the views of adherents to the Calvo Doctrine, its detractors or others – for the position that Methanex advances here: that a national treatment violation can be established even though the State accords the same treatment to aliens as to its own nationals in like circumstances.

Tribunal to compare it to investors and investments that are *not* in like circumstances with it.

298. In the discussion that follows, we demonstrate, *first*, that the NAFTA's text, context and object and purpose provide no support for Methanex's contention. Methanex's argument is based on a "like products" provision of the GATT – a different treaty with a different text and a different object and purpose. A GATT "like products" analysis does not translate to NAFTA Article 1102, which requires a determination of whether investors and investments are in like circumstances and not whether products are "like." Methanex has introduced no evidence that could support a conclusion that owners of ethanol producers or marketers are in like circumstances with it.

299. Second, we demonstrate that, even if a "like products" analysis were relevant to show "like circumstances" of investors and investments, Methanex's "like products" analysis fails on its own terms. Methanol and ethanol are not like products for purposes of the market for oxygenates in California gasoline; nor are MTBE and ethanol. Methanex's claim of denial of national treatment is, in short, without substance.

1. Neither Article 1102 Nor The Record Supports Methanex's Contention That It Is In Like Circumstances With ADM

300. There is no merit to Methanex's argument based on GATT "like products" jurisprudence that it should be compared to investors and investments in a different industry on the ground that the industry produces a product that is "like" methanol. Article 1102, unlike the GATT, makes no reference to "like products." Instead, it refers to treatment, "in like circumstances," of "investors" and "investments."[492] The ordinary

[492] NAFTA art. 1102(1); *id.* art. 1102(2).

meaning of treatment "in like circumstances" of "investors" and "investments" is not the same as that of treatment of "like products."[493] The terms used in Article 1102 demonstrate an overriding concern with the activity of investment and the circumstances of the investment and the treatment. By contrast, the terms used in the GATT demonstrate a concern with the activity of importation of goods and their "sale, offering for sale, purchase, transportation, distribution or use," and whether the goods can be considered "like products."[494]

301. The use of the phrase "in like circumstances," as well as its placement in the provision so that it could modify either the treatment accorded or the investor or the investments, indicates that Article 1102 contemplates that broad account be taken of the circumstances of the treatment, the investor and the investment.[495] Depending on the treatment in question, the product produced by an investment might be *part* of the relevant circumstances contemplated by Article 1102 – or it might not be. By contrast, the GATT provision narrowly focuses on the good in question and whether it is like other goods. Nothing in the ordinary meaning of Article 1102 supports Methanex's contention that Article 1102 contemplates a singular focus on the goods produced or marketed by an

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[493] *See* Vienna Convention on the Law of Treaties, May 23, 1969, art. 31(1), 1155 U.N.T.S. 331 ("Vienna Convention") (treaty must be interpreted "in accordance with *the ordinary meaning* to be given to the terms of the treaty in their context and in the light of its object and purpose") (emphasis added).

[494] Article III:4 of the GENERAL AGREEMENT ON TARIFFS AND TRADE 1994 ("GATT") provides, in relevant part:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

[495] *See, e.g.*, NAFTA art. 1102(1) ("Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.").

investment and whether those goods are sufficiently similar to others to be considered "like products."

302. Nor does the context of Article 1102 support Methanex's contention.[496] The NAFTA Parties were well aware of how to draft a national treatment provision addressing "like products" and, in fact, did so in Article 301 of the NAFTA (which *cannot* be the subject of an investor-State claim).[497] The fact that the NAFTA Parties did not draft Article 1102 to address "like products" confirms that they meant something other than what they intended in Article 301, which expressly does address "like products." Indeed, in the GATT context it is recognized that "like products" may not necessarily have the same meaning in different provisions of that agreement.[498] The context of the NAFTA provides no basis for importing the content of "like products" in one article of the GATT into a provision of a different agreement addressing a different subject (investment) using terms that little resemble those in the GATT (in like circumstances).

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[496] *See* Vienna Convention art. 31(1) (treaty must be interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty *in their context* and in the light of its object and purpose") (emphasis added); *id.* art. 31(2) ("The context for the purposes of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes . . . .").

[497] *See* NAFTA art. 301(1) ("Each Party shall accord national treatment to the goods of another Party in accordance with Article III of the *General Agreement on Tariffs and Trade* (GATT), including its interpretative notes, and to this end Article III of the GATT and its interpretative notes, or any equivalent provision of a successor agreement to which all Parties are party, are incorporated into and made part of this Agreement").

[498] *See European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R ¶ 88 (Mar. 12, 2001) ("*Asbestos* A/B") ("the term [like products] must be interpreted in light of the context, and of the object and purpose, of the provision at issue, *and of the object and purpose of the covered agreement in which the provision appears*.") (emphasis added); *see also id.* ¶ 89 ("while the meaning attributed to the term 'like products' in other provisions of the GATT 1994, or in other covered agreements, may be relevant context in interpreting Article III:4 of the GATT 1994, the interpretation of 'like products' in Article III:4 need not be identical, in all respects, to those other meanings."); *id.* ¶ 95 ("th[e] textual difference between paragraphs 2 and 4 of Article III has considerable implications for the meaning of the term 'like products' in these two provisions.").

303. Finally, the relevant object and purpose of the NAFTA is significantly different from that of the GATT.[499] The objective of the NAFTA relevant to the investment chapter is to "increase substantially investment opportunities in the territories of the Parties."[500] By contrast, the GATT is concerned entirely with international trade in goods.[501] Managing the flow of goods between the NAFTA Parties, however, is not the objective of the NAFTA's investment chapter, which, naturally, centers on *investment*, not trade in goods.

304. As the tribunal in the *OSPAR* case recently observed:

> "[T]he application of international law rules on interpretation of treaties to identical or similar provisions of different treaties may not yield the same results, having regard to, *inter alia*, differences in the respective contexts, objects and purposes, subsequent practice of the parties and *travaux préparatoires*."[502]

Given the significant differences between the texts, the contexts and the objects and purposes here, there is no basis for reading Article 1102 to incorporate a GATT "like products" analysis. For these reasons, the GATT and WTO authorities cited by Methanex are inapposite.

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[499] *See* Vienna Convention, art. 31(1) (treaty must be interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and *in the light of its object and purpose*") (emphasis added).

[500] NAFTA art. 102(1)(c). Because of the broad scope of the NAFTA, its objectives also include ones related to trade in goods, but those are addressed in Part Two of the treaty ("Trade in Goods"), not by Part Five ("Investment, Services and Other Matters").

[501] *See* GATT, preamble ("Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to . . . expanding the production and exchange of goods, Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce . . . .").

[502] *Access to Information under Article 9 of the OSPAR Convention (Ireland v. U.K.)* (July 2, 2003) (Final Award) ¶ 141 (quoting *MOX Plant (Ire. v. U.K.)*, ITLOS Case No. 10, *Order on Provisional Measures*, ¶ 51 (Int'l Trib. for the Law of the Sea Dec. 3, 2001)).

305. Considered in terms of the test actually provided for in Article 1102, rather than the GATT authorities Methanex invokes, the record provides no support for Methanex's argument that it and its investments – Methanex Fortier and Methanex US – are in like circumstances with ADM or any other U.S.-owned company that produces or markets ethanol.

306. First, Methanex offers neither evidence nor, indeed, even argument to support the proposition that ADM is in like circumstances with *its investments*. Methanex does not attempt to explain, for example, how ADM, an agricultural conglomerate that procures, transports, stores, processes and sells a wide-range of agricultural products, one of which is ethanol,[503] could possibly be considered to be in like circumstances with Methanex Fortier, an idled factory that once produced methanol. It is clear that it cannot be. Nor could ADM be considered to be in like circumstances with Methanex US, a small marketing company whose sole purpose is to market methanol in the United States.

307. Furthermore, Methanex makes no attempt to explain how ADM could be considered to be in like circumstances with it. Among the many differences between it and ADM is the fact that there is no relevant overlap in the investments of the two companies or even the products that either produces or markets. Methanex's sole commodity is methanol; ADM produces and markets an abundance of products, none of which is methanol.

308. Second, Methanex's allegation that it should be deemed to be in like circumstances with ADM because the product it produces – methanol – is "like" the

product ADM produces – ethanol – is without factual, as well as legal merit. As demonstrated above, Article 1102 does not set out a "like products" test and, therefore, Methanex's argument is legally unsound. However, as demonstrated below and in any event, Methanex's argument fails on the facts because, even under the GATT test that Methanex posits, methanol and ethanol cannot be considered "like products."

2. The Record Does Not Support Methanex's Claim That Methanol And Ethanol Are "Like Products" Even If Such A Test Were Relevant

309. In interpreting Article III:4 of the GATT, GATT and WTO panels and the WTO Appellate Body have often considered the following four factors to determine whether products are like one another:

> (1) the properties, nature and quality of the products; (2) the end-uses of the products; (3) consumers' tastes and habits – more comprehensively termed consumers' perceptions and behaviour – in respect of the products; and (4) the tariff classification of the products.[504]

Applying these factors, it is apparent that methanol and ethanol are not like products even under a GATT analysis.

(a) The Property, Nature And Qualities Of Methanol And Ethanol Are Dissimilar

310. Methanex does not contend that methanol and ethanol are the same product. Nor are the products "like." To make such a determination, the physical properties of the products, such as the products' molecular structure and chemical attributes, must be examined.[505]

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[503] *See* Archer Daniels Midland Company 2003 Annual Report at 2, 14 JS tab 3 at 6.

[504] *Asbestos* A/B ¶ 101 (citations omitted).

[505] *See id.* ¶ 114.

311. Methanol is a chemical compound that consists of one atom of carbon, one atom of oxygen and one atom of hydrogen.[506] Ethanol, on the other hand, consists of two carbon atoms, one atom of oxygen and three hydrogen atoms, making it heavier than methanol.[507]

312. The production processes for methanol and ethanol are very different. Currently, most methanol is produced from methane, which is the primary component of natural gas.[508] Most methanol is produced in a complex, two-step chemical reaction.[509] Ethanol, on the other hand, is made primarily from the fermentation of corn.[510] Corn is processed into a "mash" and yeast is added.[511] After fermentation, the resulting "beer" is transferred to distillation columns where the ethanol is separated from the rest of the material.[512]

313. Furthermore, methanol is a deadly poison, while ethanol – the form of alcohol found in wine, beer and other spirits – has been consumed by humans for millennia.[513] While both chemicals are flammable, methanol burns with an invisible

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[506] Burke Report ¶ 58 (13 JS tab B).

[507] *Id.* ¶ 41.

[508] *Id.* ¶ 58.

[509] *Id.* ¶¶ 58-62, n. 30, Exhibits 10-11 (detailing production process for methanol).

[510] *Id.* ¶¶ 42-49, Exhs. 7-8 (detailing production process for ethanol). Ethanol also may be derived from other feedstocks. *See id.* n.20.

[511] *Id.* ¶ 45.

[512] *Id.*

[513] *Id.* ¶¶ 70, 45.

flame; ethanol does not.[514] Methanol also has a greater polarity than ethanol, which renders it more corrosive than ethanol.[515]

314. As is evident, methanol and ethanol are significantly different chemical compounds "which means that, in purely physical terms, [they do not have] the same nature or quality."[516] As the WTO Appellate Body has observed,

> where the evidence relating to properties establishes that the products at issue are physically quite different . . . in order to overcome this indication that products are *not* "like," a higher burden is placed on complaining Members to establish that, despite the pronounced physical differences, there is a competitive relationship between the products such that *all* of the evidence, taken together, demonstrates that the products are "like" . . . .[517]

As demonstrated below, Methanex has not, and cannot, meet this burden.

(b) Methanol And Ethanol Have Different End Uses

315. Methanol and ethanol have different end uses for purposes of the measures at issue here. Ethanol is used as an oxygenate in gasoline. Methanol, on the other hand, is used for a variety of purposes and is *not* used as an oxygenate in gasoline. Consequently, methanol and ethanol do not compete with one another in the gasoline oxygenate market.

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[514] *Id.* ¶¶ 70, 93.

[515] *Id.*

[516] *Asbestos* A/B ¶ 134 (citing Panel Report, ¶ 8.121). Methanex, for its part, relies on an *unsupported* statement made by its expert, Prof. Ehlermann, who states that "[I]t appears that, overall, the physical properties of methanol and ethanol are not 'very different,' in the meaning of *Asbestos.* Accordingly, the competitive relationship between the two products would be more easily evidentiary of a 'like product' relationship between methanol and ethanol than in other cases, notably, *Asbestos*, where the physical characteristics of the products were found to be 'very different.'" Opinion of Professor Claus-Dieter Ehlermann ("Ehlermann Opinion") ¶ 43 (attached to Second Amended Statement of Claim). Prof. Ehlermann, however, bases his opinion on facts which he has been asked to *assume*, namely, that ethanol and methanol are similar products. *See id.* ¶ 2.

[517] *Asbestos* A/B ¶ 118 (emphasis in original).

316. As demonstrated earlier, methanol is not and cannot be used as an oxygenate in reformulated gasoline.[518] First, methanol's highly corrosive nature precludes its use as a fuel oxygenate.[519] Second, methanol cannot legally be used as an oxygenate in gasoline in the United States.[520] There is, thus, no merit to Methanex's assertion that methanol and ethanol each "are capable of serving as oxygenates in their own right."[521]

317. Indeed, the *sole* citation for this allegation by Methanex is the report of Professor Ehlermann, a former member of the WTO Appellate Body. Professor Ehlermann, however, not only does not purport to have any expertise in chemical engineering or the energy industry, but also acknowledges that his opinion "*assumes the facts in evidence, as presented by the complainant*, and focuses on the legal analysis."[522] Methanex's allegation is thus built on an assumption, which is in turn based on the allegations. A self-referential house of cards such as this cannot stand.

318. Methanex also strains logic when it suggests that because MTBE and ethanol, both gasoline oxygenates, compete with one another, methanol – a feedstock for MTBE – should be deemed to compete with ethanol.[523] Even a cursory analysis of that allegation reveals its flaws. As ChevronTexaco, a major, vertically integrated oil company, logically notes:

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[518] *See supra* Section I(B); Burke Report ¶¶ 13-15, 94 (13 JS tab B).

[519] *Id.* ¶ 94.

[520] *See generally* Caldwell Statement (13 JS tab C); Burke Report ¶¶ 95, 100 (13 JS tab B).

[521] Second Amended Statement of Claim ¶ 305 ("[M]ethanol and ethanol are capable of serving the same or similar end uses.") (citing Ehlermann Opinion ¶ 56, exhibit D).

[522] Ehlermann Opinion ¶ 2 (emphasis added).

[523] *See, e.g.*, Second Amended Statement of Claim ¶ 76. *See also, id.* ¶¶ 82 – 84, 88, 111, 120, 127, 133, 141, 181, 183, 212, 229, 246, 274-275, 279, 304, 324 (referring to MTBE as "methanol-based MTBE").

> Although made from methanol, MTBE does not have a significant amount of free methanol and does not have methanol properties. As a comparison, water is made from hydrogen and oxygen, but water is very different from either hydrogen or oxygen.[524]

It is demonstrably false to conclude that every feedstock for a product is "like" the product for which it is an ingredient. Applying Methanex's logic, corn – a feedstock for ethanol – is "like," and should be deemed to compete, with MTBE. Simply stating the proposition exposes its absurdity.

319. In any event, use for the production of MTBE is only one – and not even the predominant – use for methanol. Methanol is used for a variety of purposes, including the manufacture of resins, adhesives, paints, inks, foams, silicones, plastic bottles, polyester, solvents, Spandex, windshield washer fluid and fuel cells.[525] Methanol is also used as a feedstock for MTBE, a gasoline oxygenate. Methanex itself acknowledges, in a webpage in its "investor center," that it "manufacture[s] and market[s] methanol, not MTBE. And the derivatives of methanol are much more diversified than MTBE's single use in gasoline."[526]

320. Even if methanol and ethanol did have similar end-uses – which they do not since methanol is not, and cannot be, used as an oxygenate in gasoline – the WTO Appellate Body has found that:

> [w]here products have a wide range of end-uses, only some of which overlap, we do not believe that it is sufficient to rely solely on evidence

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[524] Chevron Gasoline Questions and Answers - Methyl Tertiary Butyl Ether (MTBE) (16 JS tab 36 at 1291).

[525] *See* American Methanol Institute, *Methanol: North America's Clean Fuel and Chemical Building Block*, 14 JS Tab 2 at 3-4 (methanol used to produce MTBE; alternative fuel; formaldehyde resins used in engineered wood products like particle board and in products like seat cushions and Spandex fibers; acetic acid used in making plastic bottles and polyester fiber in clothing and carpets; principal ingredient in windshield wiper fluid; ingredient in chlorine-free bleaches, paints, solvents, refrigerants and disinfectants).

[526] Methanex Corp.: MTBE, 17 JS tab 84 (emphasis removed).

> regarding the overlapping end-uses, without also examining evidence of the nature and importance of these end-uses in relation to all of the other possible end-uses for the products. [527]

321. The majority of the methanol produced, marketed and sold by Methanex and its U.S. affiliates is used for a wide variety of end-uses that do not include MTBE production.[528] This is further reason that one could not conclude that methanol and ethanol have similar end-uses.

(c) Consumer Tastes And Habits Are Not A Factor Because Methanol And Ethanol Do Not Compete With One Another

322. The third factor considered by WTO panels – consumers' tastes and habits – is not relevant here since methanol and ethanol do not compete with one another in the marketplace for oxygenates in gasoline. Thus, to the extent that a WTO panel were to consider it, this factor would weigh in favor of finding that the products are not like.

(d) Methanol And Ethanol Have Different Tariff Classifications

323. Finally, methanol and ethanol do not have the same tariff classification under the Harmonized System of tariffs. When two products have different tariff classifications, "it does tend to indicate that [those products] are not 'like products' under Article III:4 of the GATT 1994."[529] In fact, the WTO Appellate Body has found that products are *not* like even when those products have the same tariff classification.[530]

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[527] *Asbestos* A/B ¶ 138; s*ee also id.* ¶ 99 ("We are not saying that *all* products which are in *some* competitive relationship are 'like products' under Article III:4") (emphasis in original).

[528] *See* Second Amended Statement of Claim ¶ 12 ("Roughly one-third of the methanol marketed by Methanex is utilized in the fuel sector, principally for use in the creation of MTBE . . . .").

[529] *Asbestos* A/B ¶ 140.

[530] *See id.* ¶¶ 146-48.

324. Methanol is assigned HS code number 2905.11 and is found under the subheading "Alcohols and Their Halogenated, Sulfonated, Nitrated or Nitrosated Derivatives," in Section II of Chapter 29 of the Harmonized System.[531] Ethanol is assigned the heading number 2207, HS Code number 2207.20 and is classified as "Beverages, Spirits and Vinegar" in Chapter 22 of Harmonized System.[532] Thus, the fact that methanol and ethanol do not share a common tariff classification further supports a conclusion that methanol and ethanol are not like products.

325. Thus, *none* of the factors considered by GATT and WTO dispute resolution panels – neither their properties, end-uses, consumer tastes and habits, nor their tariff classifications – would support a finding that methanol and ethanol were "like products" under GATT Article III:4 for purposes of these measures. Methanex's "like products" assertion fails on its own terms.

3. Methanex's Assertion That MTBE And Ethanol Are "Like Products" Is Similarly Without Support

326. Not only does it attempt unsuccessfully to compare itself and its investments to U.S. investors and investments that produce and market ethanol, but Methanex also asks this Tribunal to disregard the fact that it and its investments produce and market *methanol* and, instead, assume that it and its investments produce and market

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[531] World Customs Organization, Harmonized Commodity Description and Coding System ("HS") ch. 29, §2905.11 (3d ed. 2002) 18 JS tab 151 at 2760); *see also* Harmonized Tariff Schedule of the United States § 2905.11 ("methanol") (16 JS tab 54 at 1463). Methanol's subheadings in the Harmonized Tariff Schedule of the United States include 2905.11.10 ("imported only for use in producing synthetic gas") and 2905.11.20 ("other"). *Id.*

[532] HS ch. 22, §§ 2207.20 ("Ethyl alcohol and other spirits, denatured, of any strength") (18 JS tab 151 at 2750); *see also* Harmonized Tariff Schedule of the United States § 2207.20.00 ("ethyl alcohol and other spirits, denatured, of any strength") (16 JS tab 54 at 1459). Ethanol has a supplemental tariff classification for ethanol used as a fuel in the Harmonized Tariff Schedule of the United States at § 9901.00.50 (16 JS tab 54 at 1467).

MTBE. This assertion is untenable on its face. Methanex produces methanol, not MTBE, and, as it is careful to explain to its own shareholders, the two are not at all the same thing.[533] Nevertheless, for the sake of completeness, even assuming that Methanex and its investments produced and marketed MTBE – which they do not – we briefly demonstrate below that there is in any event no merit to Methanex's contention that MTBE and ethanol are "like products" within the meaning of GATT jurisprudence.

327. Applying the factors set forth above, it is evident that MTBE and ethanol are not like products. Although the products share a common end-use, that is, they both are used as oxygenates in gasoline, the remaining three factors considered by the WTO support a finding that MTBE and ethanol would not be considered to be like products under the GATT regime.[534]

(a) MTBE And Ethanol Are Not Like Products Because Their Nature, Properties And Qualities Are Different

328. To begin, MTBE and ethanol are dissimilar chemically. As described above, ethanol is an alcohol. MTBE is an ether, a different class of organic compounds from alcohols like ethanol and methanol. Ethanol, as stated above, consists of two carbon atoms, one oxygen atom and three hydrogen atoms. MTBE contains five carbon atoms, twelve hydrogen atoms and one oxygen atom.[535] The chemical composition of these two compounds is unmistakably different.

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[533] *See* Methanex Corp.: MTBE, 17 JS tab 84 (Methanex "manufacture[s] and market[s] methanol, not MTBE. And the derivatives of methanol are much more diversified than MTBE's single use in gasoline") (emphasis removed).

[534] *See generally Asbestos* A/B (finding cement-based products containing chrysotile asbestos and cement-based products containing PCG fibres not like despite serving same end use and finding chrysotile asbestos fibres and chrysotile fibres not like despite having overlapping end uses).

[535] Burke Report ¶ 23, Exh. 1 (13 JS tab B).

329. As with ethanol and methanol, the production processes for ethanol and MTBE are also very different from one another. The ethanol production process has been described above, and essentially involves the fermentation and distillation of corn mash. The MTBE production process is highly complex, but essentially involves the chemical reaction of isobutylene and methanol, assisted by catalysts and under specific conditions of temperature and pressure.[536] There can be no doubt that the production processes for ethanol and MTBE bear no resemblance to one another.

330. Furthermore, of central importance in this case, the properties of ethanol and MTBE are also significantly different in terms of their impact on groundwater. As outlined above, gasoline containing MTBE is responsible for having contaminated numerous drinking water sources in California. MTBE's chemical properties cause it to bind to water, travel swiftly and resist biodegration. These properties explain why MTBE has been shown to be a significant cause of groundwater contamination in California.[537] Ethanol, which very rapidly biodegrades, has not been proven to be the cause, and is not expected to become a cause, of significant contamination in California groundwater.[538] This critical fact confirms that MTBE and ethanol are not like products.

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[536] The need for the feedstock isobutylene to produce MTBE poses unique challenges to the MTBE production industry, not faced by producers of ethanol. MTBE producers generally obtain isobutylene from one of three sources. Producers may choose to take isobutylene, which is commonly produced as a byproduct of refinery operations, and react it with methanol to produce MTBE. Other producers first convert butane to isobutylene by a process known as isomerization. After hydrogen is removed from the compound, the isobutylene is reacted with methanol in a primary reactor system to produce MTBE. This stage is in itself quite complex, using patented technology. Finally, producers may convert tertiary butyl alcohol (TBA) to isobutylene through dehydration and then react the isobutylene with methanol in a primary reactor system as mentioned above. *See* Burke Report ¶¶ 24-30, Exhs. 1-3 (13 JS tab B).

[537] *See generally* Fogg Report (13 JS tab D), Happel Report (13 JS tab E).

[538] *See, e.g.*, Happel Report at 57-58 (13 JS tab E).

331. The adverse public health effects of a product are an important consideration that may require a conclusion that the product is not "like" another product that lacks such adverse attributes. In the *Asbestos* case, for example, the WTO Appellate Body reversed the panel's findings that chrysotile asbestos fibres and PVC fibres were "like products," and that cement-based products containing chrysotile asbestos fibres and cement-based products containing PVC fibres were "like products."[539] The Appellate Body explicitly rejected the panel's rationale that it was improper to take adverse health risks into effect when determining whether products were like:

> We are very much of the view that evidence relating to the health risks associated with a product may be pertinent in an examination of "likeness" under Article III:4 of the GATT 1994. . . . This carcinogenity, or toxicity, constitutes, as we see it, a defining aspect of the physical properties of chrysotile asbestos fibres. . . . We do not see how this highly significant physical difference *cannot* be a consideration in examining the physical properties of a product as part of a determination of "likeness" under Article III:4 of the GATT 1994.[540]

332. The reasoning of the Appellate Body is apt in this case as well. Because of its very potent odor and taste at low levels, widespread MTBE contamination has rendered water sources throughout California undrinkable.[541] MTBE has thus been deemed a threat to public health and the environment. By contrast, ethanol has not been proven to cause, and is not expected to cause, such drinking water contamination.[542]

333. As the WTO Appellate Body found in *Asbestos*, a WTO panel *cannot* make a determination of whether products are "like" without taking into account a

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[539] *See Asbestos* A/B ¶ 192.

[540] *Id.* ¶¶ 113-14 (emphasis in original).

[541] *See* Fogg Report ¶ 40 (13 JS tab D) ("just one tablespoon of MTBE can render more than 586,000 gallons US (2,220,000 liters) of water undrinkable").

[542] *See* Happel Report at 57-58 (13 JS tab E).

product's adverse effects on public health. In an analysis of whether MTBE and ethanol are "like" products, the chemical properties of MTBE that have resulted in water contamination must be taken into account. Considering this evidence, it is apparent that MTBE and ethanol cannot be considered "like" products.

(b) Consumer Tastes And Preferences Demonstrate That MTBE And Ethanol Are Not Like Products

334. The third factor considered by the WTO – consumer tastes and preferences – also strongly indicates that MTBE and ethanol are not like products.[543] When consumers draw a distinction between two competing products and express a preference for one product over the other, this is evidence that the products are not substitutable and, therefore, not "like."

335. Historically, consumers of oxygenates for gasoline, including commercial consumers, have long differentiated between ethanol and MTBE. MTBE has been significantly less costly than ethanol.[544] In addition, because of ethanol's affinity for water, it requires a different transportation and blending infrastructure than MTBE – making it commercially impractical for refiners to use ethanol.[545]

336. Moreover, after MTBE groundwater contamination became widespread and well known, both gasoline refiners and the gasoline-consuming public have evidenced a preference for gasoline that does not contain MTBE. As the Appellate Body

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[543] *See Asbestos* A/B ¶ 121 ("where the [products] are physically very different, a panel *cannot* conclude that they are 'like products' if it *does not examine* evidence relating to consumers' tastes and habits. In such a situation, if there is *no* inquiry into this aspect of the nature and extent of the competitive relationship between the products, there is no basis for overcoming the inference, drawn from the different physical properties of the products, that the products are not 'like.'") (emphasis in original).

[544] *See* Second Amended Statement of Claim ¶ 93.

in the *Asbestos* case recognized, consumers, including commercial parties, will likely be influenced by the risks associated with a particular product, and it is thus "highly likely that manufacturers' decisions will be influenced by . . . potential civil liability . . . ."[546]

337. Publicly-available information demonstrates that many gasoline refiners and retail stations prefer to produce and sell gasoline with ethanol rather than gasoline with MTBE because of justifiable concerns over liability for MTBE groundwater contamination.

338. Recent judicial developments highlight the reasonableness of these concerns.[547] For example, in *South Tahoe Public Utility Dist. v. Arco*, the jury returned a special verdict on manufacturer/refiner liability in April 2002 that found that MTBE and gasoline containing MTBE were defective products, and that the MTBE manufacturer defendant as well as the gasoline refiner defendants had failed to warn of MTBE's known threats to the environment.[548] In August 2002, the *South Tahoe* action settled for approximately $70 million.[549]

339. In *Santa Monica v. Shell Oil Co.*, the City of Santa Monica recently reached a partial settlement with defendants Shell, Exxon Mobil and ChevronTexaco.[550]

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[545] Burke Report ¶¶ 115, 118 (13 JS tab B); *Methyl Tertiary-Butyl Ether (MTBE): Conditions Affecting the Domestic Industry*, U.S. International Trade Commission at 3-38 (Sept. 1999) (5 JS tab 42).

[546] *Asbestos* A/B ¶ 122.

[547] *See* Whitelaw Report at 48-49 (13A JS tab K) (citing data and declaration submitted to the Superior Court of the State of California indicating that MTBE remediation will take decades, and estimating costs of a treatment facility for five of Santa Monica's wells at $240-$527 million).

[548] See *South Tahoe Public Utility District v. Atlantic Richfield Co*., Case No. 999128, Special Verdict [Phase I] (Cal. San Francisco Cnty. Sup. Ct. Apr. 15, 2002) (18 JS tab 137 at 2623-24).

[549] *See* Sidney Bernstein, *Gasoline With MTBE Defective: Additive Leached Into Groundwater, Causing Contamination*, 34 CA. JURY VERDICT WKLY. 1 (Aug. 26, 2002) (14 JS tab 8 at 64).

[550] *See* Press Release, City of Santa Monica, Santa Monica Reaches Agreement With Oil Companies To Clean Up MTBE-Tainted Water Wells (Nov. 21, 2003) (17 JS tab 103 at 2262).

Under the settlement (which is still awaiting court approval), these companies agreed to pay $92.5 million to the city, in addition to paying for the full costs of designing, building, operating and maintaining a treatment facility to remove MTBE from affected wells[551] – a cost that experts estimate could exceed $500 million.[552]

340. These are just two of dozens of lawsuits against oil companies and gasoline retailers for damages stemming from MTBE groundwater contamination.[553] So expansive is the litigation in this area that several years ago the publication house Mealey's created a separate reporter devoted exclusively to MTBE litigation.[554] It is no

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[551] *See id.* Other companies have reached separate settlements with the city, while others have not settled and are still in litigation. *See* Press Release, City of Santa Monica MTBE Settlement Q & A (17 JS tab 102 at 2260).

[552] *See* Whitelaw Report at 48-49 (13A JS tab K).

[553] *See, e.g.*, Press Release, New Hampshire Department of Justice, *New Hampshire Sues Major Oil Companies Over MTBE Pollution* (Oct. 6, 2003) (17 JS tab 114 at 2275) (containing web-link to complaint); *New Lawsuit Filed Over Gasoline Additive*, SAC. BUS. J. (Oct. 6, 2003) (17 JS tab 96 at 2252) (reporting that Sacramento County and a group of water utilities recently filed suit against several gasoline companies for MTBE water contamination); Press Release, Orange County Water District, Orange County Water District Initiates Lawsuit Against Gasoline Companies and Manufacturers of MTBE and other Gasoline Oxygenates (May 7, 2003) (17 JS tab 118 at 2281) (announcing lawsuit against oil companies, MTBE manufacturers and other parties for damages to investigate, monitor and remove MTBE from groundwater and drinking water supplies in Orange County); *State of New Hampshire v. Amerada Hess Corp.*, Case No. 03-C-550, Notice of Removal (D.N.H. Nov. 10, 2003) at Exh. 2 (18 JS tab 138 at 2647-48) (listing 31 lawsuits concerning MTBE water contamination filed since September 30, 2003 in California, Connecticut, Florida, Illinois, Indiana, Iowa, Massachusetts, New Hampshire, New Jersey, and New York); *see also* 3:10 MEALEY'S LITIGATION REPORT: MTBE (LexisNexis, June 2003) (16 JS tab 74) (summarizing developments, including: *Roman Catholic Church of Christ the King v. ExxonMobil Corp. et al.*, No. 12115/03, N.Y. Sup., Queens Co. (complaint claiming $500 million in compensatory damages and $2.2 billion in punitive damages in connection with MTBE groundwater contamination)); 3:6 MEALEY'S LITIGATION REPORT: MTBE (LexisNexis, Feb. 2003) (16 JS tab 73) (summarizing developments, including: *County of Suffolk, et al. v. Amerada Hess Corp.*, No. 02-22305, N.Y. Sup., Suffolk Co.) (complaint by county government and county water authority claiming $2 billion in damages in connection with MTBE contamination of its aquifers and surface streams); *City of Dallas v. Explorer Pipeline Co.*, No. 02-1465 (N.D. Texas) (complaint filed by city against oil company for damages relating to spill of gasoline containing MTBE into tributary of lake); *City of Dinuba v. Unocal Corp.*, No. 305450, Calif. Super., San Francisco Co. (complaint filed by city for damages based on the theory that MTBE is a defective product)); 3:1 MEALEY'S LITIGATION REPORT: MTBE (LexisNexis, Sept. 2002) (16 JS tab 72) (summarizing developments, including: *County of Suffolk, et al. v. Atlantic Richfield Co.*, No. 09-2742 (E.D.N.Y.) (complaint filed by county government and county water authority against multiple defendant oil companies for conspiracy to withhold information about the risks of MTBE from regulators and consumers and contamination of the county's aquifers)).

[554] MEALEY'S LITIGATION REPORT: MTBE (LexisNexis).

surprise, in light of these developments, that the outgoing president and CEO of Sunoco stated on nationwide television that he "wish[ed] [he had] never heard of MTBE."[555]

341. Moreover, the record demonstrates that California consumers of retail gasoline differentiate between ethanol-oxygenated gasoline and MTBE-oxygenated gasoline. MTBE groundwater contamination in California received widespread attention by various media sources.[556] In response, consumers lobbied for gasoline to be sold without MTBE, a campaign to which refiners responded favorably. Chevron, for example, began selling gasoline without MTBE soon after one of its competitors, TOSCO Corp., did the same in the South Lake Tahoe area:

> We don't want a competitor to have [MTBE-free gasoline] without being able to offer it. . . . In a town like Tahoe, people are really concerned about MTBE and will drive extra miles to fill up at a station that has gas without MTBE.[557]

Other gasoline retailers similarly announced plans to discontinue the sale of gasoline with MTBE in California in response to customer concerns.[558] Even the American Petroleum

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[555] Transcript of CBS News, 60 Minutes, *MTBE: Gasoline Additive Used By Oil Companies to Meet Requirements of Clean Air Act is Now Polluting Groundwater* at 5 (Jan. 16, 2000) (18 JS tab 139 at 2653).

[556] *See, e.g., id.*

[557] *Oil Supplier To Curb Blended Gasoline*, LAS VEGAS REVIEW-JOURNAL, Apr. 9, 1999 (17 JS tab 100 at 2257).

[558] *See, e.g.*, Press Release, Phillips Petroleum Company, Non-MTBE Gasoline Now Available at All California 76 Stations (July 22, 2002) (17 JS tab 119 at 2283) (announcing voluntary discontinuance of the sale of gasoline with MTBE in all of its 1,500 locations throughout California a year-and-a-half ahead of the ban's effective date); Press Release, Equillon Enterprises LLC, Martinez Refining Company Producing Two Grades of Shell Gasoline without MTBE for Bay Area Motorists, PR NEWSWIRE (May 18, 1999) (17 JS tab 104 at 2264) (announcing that it will sell MTBE-free gasoline throughout California by the end of 2002, if not sooner, because it is "sensitive to the growing public debate about MTBE in gasoline . . . ."); Seema Mehta, *ExxonMobil Plans Early MTBE Halt*, L.A. TIMES, July 11, 2002, (16 JS tab 75 at 1652) (reporting that ExxonMobil announced that it would phase out MTBE from its gasoline one year before California's ban to go into effect); Jondi Gumz, *Soquel Water Asks Company For MTBE-Free Gasoline*, SANTA CRUZ SENTINEL (Sept. 8, 2002) (16 JS tab 52 at 1454) (reporting that Soquel Creek Water District requested that Chevron Texaco supply MTBE-free gasoline to Santa Cruz County because "[m]ost of our wells are within close proximity to gasoline stations so continued use of MTBE is of major concern for

Institute, along with other organizations, has recommended to the U.S. Congress that MTBE be phased out in U.S. gasoline.[559] All of this evidence demonstrates that both refiners and the gasoline-consuming public draw a distinction between ethanol and MTBE, further demonstrating that ethanol and MTBE are not "like" products.

(c) MTBE And Ethanol Have Different Tariff Classifications

342. As indicated above, ethanol's tariff classification under the Harmonized System is 22.07, appearing in Chapter 22 covering "Beverages, Spirits, and Vinegar."[560] MTBE's classification is heading 29.09, HS Code number 2909.19 ("Other"), under Chapter 29, Subchapter IV of the Harmonized System: "Ethers, Alcohol Peroxides, Ether Peroxides, Ketone Peroxides, Epoxides with a Three-Membered Ring, Acetals and Hemiacetals, and their Halogenated, Sulfonated, Nitrated or Nitrosated Derivatives."[561] Thus, these two chemicals are assigned different tariff classifications, and this factor consequently favors a finding that ethanol and MTBE are not like products.

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343. In sum, the record establishes that the measures accorded the same treatment to U.S. investors and investments in the methanol industry in precisely the same circumstances as Methanex and its investments. Methanex's contention that it is in like

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us."). Some gasoline refiners in Canada similarly have voluntarily discontinued the use of MTBE in gasoline. *See* Fogg Report ¶¶ 20, 25 (13 JS tab D).

[559] *See* Joint Letter from American Petroleum Institute, *et al.*, to U.S. Senate on S. 571 (Mar. 5, 2002) (16 JS tab 62 at 1564) (expressing approval for Senate Bill 517 which would phase-out the use of MTBE in U.S. gasoline over four years).

[560] HS ch. 22, § 22.07 (18 JS tab 151 at 2750).

[561] HS ch. 29, sub-ch. IV, § 2909.19 ("Other") (18 JS tab 151 at 2764). Under the Harmonized Tariff Schedule of the United States (16 JS tab 54 at 1464), which corresponds to the headings found in the international Harmonized System, MTBE has a tariff classification of 2909.19.14 in Chapter 29 under "(Organic Chemicals), Section IV: Ethers, Alcohol Peroxides, Ether Peroxides, Ketone Peroxides,

circumstances with ADM lacks any evidentiary support. And Methanex's arguments based on a GATT "like products" analysis is both legally inapposite and factually unsustainable. Methanex's national treatment claims under Article 1102 should be dismissed in their entirety.

IV. THE MEASURES DO NOT VIOLATE ARTICLE 1105(1)'S MINIMUM STANDARD

344. Methanex's latest iteration of its claim under Article 1105(1) is no more meritorious than any of its varied, earlier attempts to plead a claim under that article. Notably, in its First Amended Statement of Claim, Methanex had argued that Article 1105(1) creates a "heightened standard of 'fair and equitable treatment,'" and that the measures at issue violate a variety of supposed principles of international law, including general requirements of good faith, reasonableness, and compliance with provisions of WTO agreements, among others.[562]

345. In its fresh pleading, Methanex abandons all of its manifold assertions concerning Article 1105(1) except for the following: it alleges that "the California measures were intended to discriminate against foreign investors and their investments, and intentional discrimination is, *by definition*, unfair and inequitable."[563] Methanex also maintains its previous assertion (in reliance on the partial award in *S.D. Myers*) that a violation of Article 1102's national treatment provision establishes a breach of Article 1105(1) as well.[564]

Epoxides with a Three-Membered Ring, Acetals and Hemiacetals, and their Halogenated, Sulfonated, Nitrated or Nitrosated Derivatives."

[562] *See* Counter-Memorial at 8-16; Draft Amended Claim at 48-65.

[563] Second Amended Statement of Claim ¶ 313 (emphasis added).

[564] *Id*. ¶¶ 314-15.

346. Methanex's restated Article 1105(1) claim is without merit. *First*, Methanex's assertion that a violation of Article 1102 necessarily establishes a breach of Article 1105(1) fails on two grounds. It fails because, as demonstrated in the preceding section, Methanex has not established, and cannot establish, any breach of Article 1102. It also fails as a matter of law. The NAFTA Free Trade Commission has decided, in a binding interpretation, that "a determination that there has been a breach of another provision of the NAFTA . . . does not establish that there has been a breach of Article 1105(1)."

347. *Second*, the specific provisions of Chapter Eleven of the NAFTA comprehensively regulate discrimination against investors and investments of other NAFTA Parties. Interpreted in accordance with Article 31 of the Vienna Convention on the Law of Treaties, Article 1105(1) clearly does not impose any general obligation of non-discrimination such as that posited by Methanex here.

348. *Finally*, Methanex has failed to carry its burden of proving either the existence of the rule of customary international law it asserts or that there has been any violation of such a supposed rule as a matter of fact. Contrary to Methanex's theory, customary international law does not contain a general prohibition of economic discrimination against aliens and foreign goods. State practice condones many types of economic discrimination. And as a factual matter, even if Methanex's asserted principle of non-discrimination were recognized under international law, there is no evidence that Methanex or its investments received less favorable treatment than its U.S. counterparts (as established in the discussion of Article 1102 above).

349. As demonstrated below in more detail, Methanex's claim of liability under Article 1105(1) is unsupported. It should be dismissed in its entirety and with prejudice.

A. The FTC Interpretation Precludes Any Claim That An Alleged Breach Of Article 1102 Gives Rise To An Additional Breach Of Article 1105(1)

350. Methanex's contention that a breach of Article 1102 breaches Article 1105(1) has been foreclosed by the Free Trade Commission (the "FTC") established under Article 2001 of the NAFTA.

351. The July 31, 2001 FTC interpretation clarifies that "[t]he concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."[565] The FTC also authoritatively stated that "[a] determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)."[566] This clarification repudiates the view stated by two members of the tribunal in the *S.D. Myers* case, and precludes Methanex's current argument relying on that opinion.[567]

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[565] Free Trade Commission Clarifications Related to NAFTA Chapter 11, ¶ B(2) (July 31, 2001) ("FTC Interpretation").

[566] *Id.* ¶ B(3).

[567] *See* Second Amended Statement of Claim ¶¶ 314-15 (relying on *S.D. Myers* Partial Award); *see also Loewen Group, Inc. v. United States of America*, ICSID Case No. ARB(AF)/98/3, 4 J. WORLD INVESTMENT 675 ¶ 128 (2003) (Award of June 26) ("*Loewen* Award") (noting FTC interpretation that "a breach of Article 1105(1) is not established by a breach of another provision of NAFTA. To the extent, if at all, that NAFTA Tribunals in *Metalclad . . . , S.D. Myers*. . . and *Pope & Talbot* . . . may have expressed contrary views, those views must be disregarded.").

352. In its post-hearing submissions (which we incorporate here by reference),[568] the United States demonstrated that, under the plain terms of Article 1131(2), the FTC's interpretation is binding on this Tribunal and may not be disregarded as a supposed "amendment" to the treaty.[569] We do not propose to repeat those arguments here. Instead, we briefly note that four intervening decisions by NAFTA tribunals have repudiated Methanex's contention that this Tribunal may disregard this binding interpretation of the treaty by its Parties through the FTC.[570]

353. As these tribunals recognized, a claimant must do more than assert that it received treatment that was "unfair and inequitable" in a colloquial sense, as Methanex's current Article 1105(1) claim appears to do. The *Mondev* tribunal explained as follows:

> [A]n arbitral tribunal may not apply its own idiosyncratic standard in lieu of the standard laid down in Article 1105(1). . . . [T]he FTC's interpretation . . . makes it clear that the standard of treatment, including fair and equitable treatment . . . , is to be found by reference to international law . . . .[571]

The tribunal in *ADF* explicitly agreed with the *Mondev* tribunal that "any general requirement to accord 'fair and equitable treatment'. . . must be disciplined by being based upon State practice and judicial or arbitral caselaw or other sources of customary or

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[568] Response of Respondent United States of America to Methanex's Submission Concerning the NAFTA Free Trade Commission's July 31, 2001 Interpretation (Oct. 26, 2001); Rejoinder of Respondent United States of America to Methanex's Reply Submission Concerning the NAFTA Free Trade Commission's July 31, 2001 Interpretation (Dec. 17, 2001).

[569] Article 1131(2) provides as follows: "An interpretation by the [FTC] of a provision of this Agreement shall be binding on a Tribunal established under this Section."

[570] *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2 ("*Mondev* Award"), 42 I.L.M. 85 ¶¶ 120-22 (January 2003) (Award of Oct. 11, 2002); *United Parcel Service of Am. v. Canada* ("*UPS* Award") ¶ 96 (Nov. 22, 2002) (Award on Jurisdiction)' *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1 ("*ADF* Award"), 15:3 WORLD TRADE & ARB. MATERIALS 55 ¶ 176 (June 2003) (Award of Jan. 9, 2003); *Loewen* Award ¶ 126. Notably, each of these decisions was issued after, and implicitly or explicitly rejected, the *dicta* in the *Pope & Talbot* damages award suggesting that the FTC's interpretation was not binding.

general international law."[572] The tribunal in *UPS v. Canada* "agree[d] in any event with [the FTC's] conclusion that the obligation to accord fair and equitable treatment is not in addition to or beyond the minimum standard."[573] The *Loewen* tribunal stated the same idea: "The effect of the Commission's interpretation is that 'fair and equitable treatment' and 'full protection and security' are not free-standing obligations. They constitute obligations only to the extent that they are recognized by customary international law."[574]

354. In light of the FTC interpretation and the decisions of four other Chapter Eleven tribunals that have rendered awards since the interpretation was issued, Methanex's asserted Article 1105(1) claim fails as a matter of law to the extent that it is based on a supposed breach of Article 1102's national treatment provisions or by virtue of conduct that is supposedly "unfair and inequitable" without contravening established principles of customary international law.

B. Chapter Eleven's Specific Provisions Comprehensively Address Discrimination And Supersede Any General Prohibition Of Discrimination In Article 1105(1)

355. As stated in its Second Amended Statement of Claim, Methanex's assertion of a breach of Article 1105(1) is no different than its assertion of a breach of Article 1102. Methanex contends that "the California measures were intended to discriminate against foreign investors and their investments," and that such "intentional discrimination" violates Article 1105(1) as well as Article 1102.[575]

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[571] *Mondev* Award ¶ 120.

[572] *ADF* Award ¶ 184.

[573] *UPS* Award ¶ 97.

[574] *Loewen* Award ¶ 128.

[575] Second Amended Statement of Claim ¶¶ 313-15.

356. Such a claim of nationality-based discrimination is properly brought under provisions of Chapter Eleven other than Article 1105(1). Chapter Eleven includes a comprehensive and specific legal regime governing nationality-based discrimination, permitting discrimination under certain circumstances, and proscribing it under others. Article 1102, under which Methanex has brought a separate claim, is just one part of this comprehensive regulation of nationality-based distinctions.[576]

357. Interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose,"[577] Article 1105(1) cannot be read to incorporate the general obligation of non-discrimination that Methanex posits.

358. *First*, the ordinary meaning of the title of the article ("Minimum Standard of Treatment") and the phrases used in the text ("treatment in accordance with international law," "fair and equitable treatment" and "full protection and security") signals an *absolute*, minimum standard of treatment. Indeed, the international minimum

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[576] *See also, e.g.*, NAFTA art. 1103 (most-favored-nation treatment obligation); *id*. art. 1104 (prioritizing national and most-favored-nation treatment obligations); *id*. art. 1107 (prohibiting requirements for the nationality of senior management but permitting requirements regarding the nationality of a majority of the board of directors); *id*. art. 1105(2) (requiring that compensation for losses resulting from armed conflict or civil strife be paid on a non-discriminatory basis); *id*. art 1108 & annexes I-IV (providing comprehensive set of exceptions to specified prohibitions against discrimination); *id*. art. 1109(4) (providing that "a Party may prevent a transfer through the equitable, non-discriminatory and good faith application" of certain laws); *id.* art. 1109(5) (same with respect to required transfers); *id*. art. 1110(1)(b) (permitting expropriations "on a non-discriminatory basis" and under certain other conditions); *id*. art. 1111 (permitting different treatment on basis of nationality for certain special formalities and information-gathering requirements); *id.* art. 1410(2) (setting forth general exception to obligations in Part (including investment chapter) for certain non-discriminatory measures in pursuit of monetary and related credit policies or exchange rate policies); *id.* art. 2103(4)(b) (providing for limited application of national and most-favored-nation treatment obligations to taxation measures); *id*. art. 2104(3)(e) (permitting certain measures where a Party experiences or is threatened with balance of payment difficulties provided such measures, among other things, are applied on a national or most-favored-nation treatment basis).

[577] Vienna Convention on the Law of Treaties, May 23, 1969, art. 31(1), 1155 U.N.T.S. 331 ("Vienna Convention").

standard has historically been characterized as absolute in the sense that its content does not depend on how a State treats its own nationals.[578] By contrast, Articles 1102 and 1103 set forth standards of treatment that are *relative* in the sense that the obligation is based on a Party's treatment of its own investments and investors and those of non-Parties.[579]

359. In its *Statement of Implementation*, issued on the day the NAFTA went into force, the Government of Canada noted its understanding of the distinction between Article 1105(1)'s absolute standard and Article 1102's relative standard:

> Article 1105, which provides for treatment in accordance with international law, is intended to assure a minimum standard of treatment of investments of NAFTA investors. National treatment provides a *relative* standard of treatment while this article provides for a minimum *absolute* standard of treatment, based on long-standing principles of customary international law.[580]

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[578] IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 527 (1998); Detlev Vagts, *Minimum Standard*, *in* 3 ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 408 (Bernhardt ed. 1997); ALWYN V. FREEMAN, INTERNATIONAL RESPONSIBILITY OF STATES FOR DENIAL OF JUSTICE 502 (1970) ("For by the generally accepted law of nations, members of the international community are under the mutual obligation of assuring to each other's nationals a determinate *minimum* of legal protection."); J.C. Thomas, *Reflections on Article 1105 of NAFTA: History, State Practice and the Influence of Commentators*, 17 ICSID REV-F.I.L.J. 21, 26 (2002) ("This [referring to the international standard of treatment in treaties] was to ensure that, to use the words of a former U.S. negotiator, there would be 'a residual, but absolute minimum, degree of treaty protection to investments, regardless of possible vagaries in the host Party's national laws and their administration, or of a host party's lapses with respect to treatment of its own nationals and companies."); Louis B. Sohn and R.R. Baxter, *Convention on the International Responsibility of States for Injuries to Aliens, Final Draft with Explanatory Notes*, Explanatory Note to Article 2(1), *reprinted in* F.V. GARCÍA-AMADOR ET AL., RECENT CODIFICATION OF THE LAW OF STATE RESPONSIBILITY FOR INJURIES TO ALIENS 135, 157 (1974) ("Sohn & Baxter") ("This paragraph provides that the treatment of aliens is to be governed by an international minimum standard. This standard is to be distinguished from the 'national treatment' standard, not infrequently relied upon by respondent States. . . .").

[579] *See* NAFTA art. 1102(1)-(2) (providing for "treatment no less favorable than [a Party] accords, in like circumstances, to its own investors" or investments of such investors); *id.* art. 1103(1)-(2) (similar provision with respect to treatment of investors and investments of investors of non-Parties).

[580] Department of External Affairs, *North American Free Trade Agreement: Canadian Statement on Implementation, in* CANADA GAZETTE 68, 149 (1994) (emphasis added); *see also United Mexican States v. Metalclad Corp.*, 2001 BCSC 664 ¶ 96 (the "absolute" standard in Article 1105 "is intended to establish a minimum standard so that a Party may not treat investments of an investor of another Party worse than this standard irrespective of the manner in which the Party treats other investors and their investments.").

360. Methanex's attempt to read a general standard of non-discrimination – necessarily a *relative* standard – into Article 1105(1) thus cannot be squared with the ordinary meaning of its terms. Those terms clearly contemplate an absolute standard. Methanex's argument thus conflates the content of Article 1105(1) with that of Article 1102, when the two were clearly intended to be different.

361. *Second*, the context confirms that Article 1105(1) does not incorporate the general obligation of non-discrimination posited by Methanex. Notably, Article 1108, entitled "Reservations and Exceptions," sets forth numerous exceptions to the general obligations of non-discrimination provided in Articles 1102 and 1103. The exceptions apply to a range of measures, sectors of the economy, and economic activities, some of which are specified in the text of Article 1108, and some of which are set forth in Annexes I through IV of the treaty – which together span well over a hundred pages of text. It is clear, from Article 1108 and these annexes, that the NAFTA Parties agreed that it was *permissible* to discriminate with respect to the measures, sectors and activities specified.

362. But Article 1108 lacks any exception from the application of Article 1105(1) for these otherwise acceptable types of discrimination. Thus, if Article 1105(1) incorporated a general obligation of non-discrimination, measures and activities permissible under the provisions of the NAFTA specifically addressing discrimination (notably Articles 1102 and 1103) would be rendered violations of the NAFTA under Article 1105(1). This would render ineffective the exceptions set forth in Article 1108

and scores of pages of annexes, contrary to the principle that treaties should be construed to render their provisions effective.[581]

363. Put another way, if the NAFTA Parties had contemplated that Article 1105(1) incorporated a general obligation of non-discrimination, they would have included exceptions in Article 1108 to exempt from Article 1105(1)'s ambit the discriminatory activities they considered permissible. The fact that the Parties did not address Article 1105(1) in Article 1108's exceptions shows that the Parties did not consider Article 1105(1) to encompass any general obligation of non-discrimination.

364. Supplementary means of interpretation confirm this interpretation of Article 1105(1) as lacking any general obligation of non-discrimination.[582] Where both a general provision and a more specific one could potentially apply to a given circumstance, the more specific provision will govern rather than the general one.[583] This

[581] *See Territorial Dispute (Libya v. Chad)*, 1994 I.C.J. 6 ¶ 51 (Feb. 3) (collecting authorities supporting "one of the fundamental principles of interpretation of treaties, consistently upheld by international jurisprudence, namely that of effectiveness"); *accord Anglo-Iranian Oil Co. (U.K. v. Iran)*, 1952 I.C.J. 93, 105 (July 22) (the principle "that a legal text should be interpreted in such a way that a reason and a meaning can be attributed to every word in the text . . . should in general be applied when interpreting the text of a treaty"); *Corfu Channel (U.K. v. Alb.)*, 1949 I.C.J. 4, 24 (Apr. 9) ("It would indeed be incompatible with the generally accepted rules of interpretation to admit that a provision of this sort occurring in a special agreement should be devoid of purport or effect.").

[582] *See* Vienna Convention art. 32 ("[r]ecourse may be had to supplementary means of interpretation . . . in order to confirm the application of article 31 . . . .").

[583] *See Conditions of Admission of a State to Membership in the United Nations*, 1948 I.C.J. 57, 64 (May 28) (considering the argument that the general provision of the U.N. Charter regarding powers of the Security Council (Article 24) allowed Security Council members to create conditions for membership in the U.N. beyond those enumerated in the specific provision of the Charter (Article 4) regarding conditions for membership: "But Article 24, owing to the very general nature of its terms, cannot, in the absence of any provision, affect the special rules for admission which emerge from Article 4."); *Payment of Various Serbian Loans Issued in France*, P.C.I.J. ser. A., No. 20/21 at 30 (1929) ("The special words, according to elementary principles of interpretation, control the general expressions."); *see also Ambatielos (Greece v. U.K.)*, 1952 I.C.J. 28, 44 (July 1) ("It may be contended that because a special provision overrides a general provision, the Declaration should override Article 29 of the Treaty of 1926 . . .").

well-established principle of *generalia specialbus non derogant*,[584] also stated as *lex specialis derogat generali*,[585] avoids the potential conflict between application of general and specific provisions. Construing Chapter Eleven's more specific provisions governing nationality-based discrimination to apply to the exclusion of Article 1105(1) is thus fully consonant with these principles of interpretation as well as the text and context of the article.

365. Accordingly, general claims of nationality-based discrimination are governed exclusively by the provisions of Chapter Eleven that specifically address that subject, not Article 1105(1). Methanex's claim under Article 1105(1) therefore fails for this reason alone – as well as on the ground that, as already demonstrated above in the discussion of Article 1102, Methanex has established and can establish no discrimination here in any event.

C. Methanex Has No Claim Of Non-Discrimination Under International Law's Minimum Standard of Treatment In Any Event

366. Even if the Tribunal were to find it necessary to analyze Methanex's discrimination claim under Article 1105(1), that claim fails because Methanex has not shown, and cannot show, any violation of NAFTA's "Minimum Standard of Treatment."

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[584] Sir Gerald Fitzmaurice, *The Law and Procedure of the International Court of Justice 1951-4: Treaty Interpretation and Other Treaty Points*, 33 BRITISH Y.B. INT'L. L. 203, 236 (1957) ("The '*generalia*' principle can have a number of applications. It does not merely involve that general provisions do not *derogate* from specific ones, but also, or perhaps as an alternative method of statement, that a matter governed by a specific provision, dealing with it as such, is thereby taken out of the scope of a general provision dealing with the *category* of subject to which that matter belongs, and which therefore might otherwise govern it as part of that category.") (emphasis in original).

[585] Michael Akehurst, *The Hierarchy of the Sources of International Law*, 47 BRITISH Y.B. INT'L L. 273 (1977) (referring to the techniques for resolving conflicts between different legal rules as including *lex specialis derogat generali*, "to make a particular rule prevail over a general rule;"); *id*. 273, 279 ("However, owing to their generality, [general principles of international law] are often ousted by rules of a more specific character (including rules derived from hierarchically lower sources), in application of the maxim *lex specialis derogat generali*.").

To establish a claim under Article 1105(1), Methanex bears the burden of demonstrating the existence of the rule of customary international law that has allegedly been violated.[586] The purported "rule" Methanex asserts is that "intentional discrimination is, by definition, unfair and inequitable."[587] But Methanex supplies no legal support for its suggestion that discrimination is *per se* violative of customary international law's minimum standard.

367. As demonstrated below, and contrary to Methanex's contention, customary international law contains no general prohibition on economic discrimination against aliens. In contrast to the treaty-based obligation of national treatment, the customary international law minimum standard does not mandate equivalent treatment between nationals and foreigners. State practice condones many forms of economic discrimination, prohibiting discrimination only in certain limited contexts that are irrelevant here. Methanex thus has not shown, and cannot show, that the measures at issue violate any principle of customary international law.

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[586] *See ADF* Award ¶ 185 ("The Investor, of course, in the end has the burden of sustaining its charge of inconsistency with Article 1105(1). That burden has not been discharged here and hence, as a strict technical matter, the Respondent does not have to prove that current customary international law concerning standards of treatment consists only of discrete, specific rules applicable to limited contexts."); *Rights of Nationals of the United States of America in Morocco (Fr. v. U.S.)*, 1952 I.C.J. 176, 200 (Aug. 27) (quoting *Asylum (Colom. v. Peru)*, 1950 I.C.J. 266, 276 (Nov. 20)) ("'The Party which relies on a custom of this kind must prove that this custom is established in such a manner that it has become binding on the other Party.'"); NGUYEN QUOC DINH, PATRICK DAILLIER & ALAIN PELLET, DROIT INTERNATIONAL PUBLIC 330 § 214 (6th ed. 1999) (burden on party "who relies on a custom to establish its existence and exact content") ("c'est à [la partie] qui s'appuie sur une coutume d'en établir l'existence et la portée exacte") (translation by counsel); BROWNLIE at 11 ("In practice the proponent of a custom has a burden of proof the nature of which will vary according to the subject-matter and the form of the pleadings.").

[587] Second Amended Statement of Claim ¶ 313.

1. International Law Does Not Prohibit Discrimination Against Aliens

368. As Methanex's own legal expert has explained, "a degree of discrimination in the treatment of aliens as compared with nationals is, generally, permissible as a matter of customary international law."[588] It has been called an "oftneglected truism that discrimination is not per se unlawful or bad; indeed no unqualified doctrine of nondiscrimination could be constituted part of customary international law without sacrificing important community values."[589] As a general proposition, a State may treat foreigners and nationals differently, and it may also treat foreigners from different states differently.[590]

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[588] SIR ROBERT JENNINGS & SIR ARTHUR WATTS, 1 OPPENHEIM'S INTERNATIONAL LAW 932 (9th ed. 1992) ("1 OPPENHEIM'S").

[589] Burns H. Weston, *The Charter of Economic Rights & Duties of States & the Deprivation of Foreign-Owned Wealth*, 75 AM. J. INT'L L. 437, 445 (1981); *see also North American Dredging Co. of Texas (U.S.) v. Mexico*, OPINIONS OF COMMISSIONERS UNDER THE CONVENTION CONCLUDED SEPT. 8, 1923 BETWEEN THE UNITED STATES AND MEXICO 21, 28 (1926) ("equality of legal status between citizens and foreigners is by no means a requisite of international law – in some respects the citizen has greater rights and larger duties, in other respects the foreigner has.").

[590] *See Eastern Extension, Australasia and China Telegraph Co., Ltd. (Gr. Brit.) v. United States*, 6 R.I.A.A. 112, 117 (1923) ("It is perfectly legitimate for a Government, in the absence of any special agreement to the contrary, to afford to subjects of any particular Government treatment which is refused to the subjects of other Governments, or to reserve to its own subjects treatment which is not afforded to foreigners."); *see also, e.g.*, Hans W. Baade, *Permanent Sovereignty over Natural Wealth and Resources*, *in* ESSAYS ON EXPROPRIATIONS 3, 23-24 (Richard S. Miller and Roland J. Stanger, eds., 1967) ("Non-discrimination is not a rule of customary international law. Otherwise, most-favored-nation provisions in commercial and other treaties would be superfluous or, by sheer volume, merely declaratory by now. Nobody claims that this is the case. Since states are free to decide with whom to trade, they must also be free to decide with whom to stop dealing – subject, of course, to as yet unexpired treaty obligations."); Edwin Borchard, *The "Minimum Standard" of the Treatment of Aliens*, 1939 A.S.I.L. PROCEEDINGS 51, 56 ("The doctrine of absolute equality – more theoretical than actual – is therefore incompatible with the supremacy of international law. The fact is that no state grants absolute equality or is bound to grant it. It may even discriminate between aliens, nationals of different states, e.g., as the United States does through treaty in the matter of the ownership of real property in this country"); ANDREAS ROTH, MINIMUM STANDARD OF INTERNATIONAL LAW APPLIED TO ALIENS 83 (1949) ("[T]he principle of equality has not yet become a rule of positive international law, i.e., there is no obligation for a State to treat the aliens like the nationals. A discrimination of treatment between aliens and nationals alone does not yet constitute a violation of international law.").

369. As Sir Robert Jennings has recognized, lawful discrimination by the State may extend to foreign investors as well:

> Where the alien is a commercial undertaking, the acquisition of property is likely to assume the character of economic investment. The question of the terms and conditions on which such investment should be allowed is primarily for the recipient state to determine and, subject to its treaty obligations, it is not obliged to accord national treatment to foreign investors. . . . A degree of differential treatment as between national and foreign investment may be called for, and is not necessarily contrary to the state's international obligations.[591]

370. By contrast, it is widely recognized that national treatment, like other common provisions in the realm of economic relations with foreigners, is a treaty-law obligation, not a rule of customary international law. As Professor Jackson observes:

> [T]he prevailing view of scholars is that such an obligation [of economic nondiscrimination] exists only when a treaty clause creates it. Lacking a treaty, nations presumably have the sovereign right to discriminate against foreign nations in economic affairs as much as they wish.[592]

In short, a State may voluntarily extend national treatment to aliens, but customary international law does not require it to do so.

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[591] 1 OPPENHEIM'S at 933.

[592] JOHN H. JACKSON, WORLD TRADING SYSTEM 134 (1989); Borchard, 1939 A.S.I.L. PROCEEDINGS at 56 ("in the absence of a treaty there is no rule prohibiting certain discriminations against aliens"); Thomas, 17 ICSID REV-F.I.L.J. at 69 ("National treatment is far from achieving the status of customary international law."); *id*. at 69 n.128 (noting that treaties with national treatment often include exceptions); *see also* Stephen Zamora, *Is There Customary International Economic Law?*, 32 GERM. Y.B. INT'L L. 9, 10-11 and 11 n.7 (1989) (quoting numerous treatises on international law finding a dearth of customary norms of international law relating to the economic sphere, with the exception of the norms regarding expropriation); EDWIN M. BORCHARD, DIPLOMATIC PROTECTION OF CITIZENS ABROAD 77-8 (1915) ("The liberty of commerce is usually provided for in treaties. . . . It includes the incidental rights . . . to carry on domestic trade, etc.); *id*. at 78 n.1 ("In the absence of treaty or law, there is no inherent right to carry on domestic trade."); ROBERT RENBERT WILSON, INTERNATIONAL LAW STANDARD IN TREATIES OF THE UNITED STATES 87 (1953) ("Traditionally . . . states have claimed the right, without infringing international law, to withhold commercial advantages to foreign nationals, vessels, and goods. The granting of trading privileges and advantages has, in general, come through treaties, principally bilateral ones.").

2. State Practice Condones Economic Discrimination Against Foreigners

371. State practice, moreover, confirms that non-discrimination is not a "categorical rule" under customary international law.[593] States typically grant political rights (such as voting) and economic rights (such as the right to work) to nationals while severely limiting or denying altogether such rights for aliens.[594] The United States has consistently advocated the view that such discrimination does not violate international law.[595]

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[593] *See* OSCAR SCHACHTER, INTERNATIONAL LAW IN THEORY AND PRACTICE 315 (1991); FREEMAN at 506-07 ("Finally, the equality argument is utterly erroneous in so far as it pretends that aliens are entitled to be put on the same footing as nationals in every respect, for this reason: in the present state of international law, a State has not only the right to impose differences in treatment between its *ressortissants* and foreigners; but it has also the right to create, within certain limits, distinctions between the *ressortissants* of different foreign nations. It may, for example, prevent aliens from acquiring title to land, from engaging in certain professions . . . These and many other permissible restrictions combine to demonstrate that the concept of equality is incompatible with State practice and will swiftly lead to error in the handling of concrete cases.").

[594] *See, e.g.*, BROWNLIE at 526 ("[I]t is agreed on all hands that certain sources of inequality are admissible. Thus it is not contended that the alien should have political rights in the host state as of right. Moreover, the alien must take the local law as he finds it in regard to regulation of the economy and restriction on employment of aliens . . . ."); Sohn & Baxter, Explanatory Note to Article 2(1) at 159 ("this Convention . . . makes no reference to political rights, such as voting, or to certain economic rights, such as the right to work. These human rights are by their very nature ones more appropriately reserved to nationals of a State and rights commonly not accorded to aliens."); Borchard, 1939 ASIL PROCEEDINGS at 54 ("The disability of the alien to claim political rights and his immunity from military service and other political obligations have now a stronger source than the statutes or treaties in which these disabilities and privileges were originally recorded. They now rest on common law."); Thomas, 17 ICSID REV-F.I.L.J. at 24 ("At customary international law, a state has considerable freedom to discriminate in the treatment that it accords to other states, to restrict aliens' entry into its territory, and to prohibit them from working or conducting business there."); J. L. BRIERLY, LAW OF NATIONS 278 (1963) ("In general a person who voluntarily enters the territory of a state not his own must accept the institutions of that state as he finds them. He is not entitled to demand equality of treatment in all respects with the citizens of the state; for example, he is almost always debarred from the political rights of a citizen . . .").

[595] 1 CHARLES CHENEY HYDE, INTERNATIONAL LAW CHIEFLY AS INTERPRETED AND APPLIED BY THE UNITED STATES 656 (1945) ("A State may exercise a large control over the pursuits, occupations and modes of living of the inhabitants of its domain. In so doing it may doubtless subject resident aliens to discrimination without necessarily violating any principles of international law."); 8 MARJORIE M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 379 (1967) (quoting Statement of U.S. Representative Patricia R. Harris on the text of art. 2(3) of the Covenant on Economic, Social and Cultural Rights) ("'International law and specific treaties recognize the right of States to make appropriate distinctions with regard to non-nationals in certain respects. This right is clearly recognized for all States, regardless of their stage of

372. As to economic rights in particular, States practice numerous forms of discrimination against aliens that, as is widely recognized, do not violate customary international law. For example, aliens may be excluded from certain occupations or sectors of the economy or certain geographical areas of the country without infringing any principle of international law.[596] And "onerous restrictions may be imposed on 'the property rights of aliens in certain national resources, *e.g.*, national vessels, national mines, and other kinds of property.' Aliens may be forbidden to engage in enumerated business enterprises."[597] International law upholds the right of governments to limit – or forbid altogether – foreign ownership of real property within their territory.[598] Aliens

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economic development, and finds expression in numerous constitutions and laws in both developing and developed countries.'").

[596] SCHACHTER at 315; *see also* ROTH at 156-57 ("A State may exercise a large control over the pursuits, occupations and modes of living of the inhabitants of its domain. In so doing, it may doubtless subject resident aliens to discrimination without necessarily violating any principle of international law. According to general international law, the States . . . may . . . reserve the exercise of economically gainful occupations to their own nationals and exclude aliens completely."); BRIERLY at 278 ("In general a person who voluntarily enters the territory of a state not his own . . . is commonly not allowed to engage in the coasting trade, or to fish in territorial waters; he is sometimes not allowed to hold land. These and many other discriminations against him are not forbidden by international law."); 1 OPPENHEIM'S at 905 ("The local state has a broad measure of discretion in its treatment of aliens – subject to its treaty obligations, which are now extensive. Thus it can, unless prevented by treaty from doing so, exclude aliens from certain professions and trades . . .").

[597] MYRES MCDOUGAL, *et al.*, HUMAN RIGHTS AND WORLD PUBLIC ORDER 740 (1980) (quoting Borchard).

[598] *See Rio Grande Irrigation & Land Co., Ltd. (U.K.) v. United States*, 6 R.I.A.A. 131, 136 (1923) (applying the United States Alien Law of 1887); *Responsibility of States for Damage Done in Their Territory to the Person or Property of Foreigners*, 23 AM. J. INT'L L. 133, 147 (Comment to Article 5) (Special Supp. 1929) (Harvard Draft Conventions and Comments on Nationality, Responsibility of States for Injuries to Aliens and Territorial Waters) ("Harvard Draft") ("The local law does not, of course, have to be uniform as to nationals and aliens. For example, it is quite possible for aliens to be denied the privilege of owning real estate . . . . "); Borchard, 1939 ASIL PROCEEDINGS at 54 ("It is well known that aliens may be denied numerous privileges, such as the ownership of real property . . . "); ROTH at 165 ("According to general international law, the alien's privilege of participation in the economic life of his State of residence does not go so far as to allow him to acquire private property. The State of residence is free to bar him from ownership of all or certain property, whether movables or realty."); 1 OPPENHEIM'S at 911-12 ("Thus a state may restrict the rights of aliens to hold property; and far-reaching interference with private property, including that of aliens, is common in connection with such matters as taxation, measures of police, public health, the administration of public utilities and the planning of urban and rural development.").

thus enjoy no general right under international law to freely engage in economic activity.[599]

3. Those Few Rules Of Non-Discrimination Recognized By International Law Apply In Limited Contexts Not Present Here

373. Customary international law does recognize certain rules of non-discrimination, but their application is limited to contexts that have no bearing on Methanex's claim. While some scholars may state the rule more broadly,[600] the more accurate expression of the state of customary international law is that discrimination constitutes an international wrong only under certain circumstances.

374. One of these circumstances is expropriation, where it is well-established that international law prohibits discriminatory takings.[601] Prohibitions on discrimination often appear in the context of describing what constitutes an illegal expropriation.[602]

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[599] FREEMAN at 513-14 ("[W]ith respect to the alien's right to engage in economic activity . . . in the absence of treaty, the extent of the alien's right to carry on business within a State is difficult to define. One of the reasons for this may be that general international law does not require States to base their economic legislation upon such principles as the unrestricted activity of private individuals and the free disposition of their property. . . . [O]ne [can] hardly speak of an alien's 'right' to engage in business. . . . In any event, it is well recognized that the State may exclude aliens from certain classes of occupations and professions, reserving these solely to its own nationals.").

[600] *See, e.g.*, A.F.M. Maniruzzaman, *Expropriation of Alien Property and the Principle of Non-Discrimination in International Law of Foreign Investment: An Overview*, 8 J. TRANSNAT'L. L. & POL'Y. 57, 57 n.2 (1988) (asserting a principle of non-discrimination "recognized in international customary practice," but citing exclusively to judicial decisions made in the context of nationalization or expropriation).

[601] *See, e.g., BP Exploration Co. (Libya) Ltd. v. Libyan Arab Republic*, 53 I.L.R. 297, 329 (1979) (Award of Aug. 1, 1974) ("the taking…clearly violates public international law as it was made for purely extraneous political reasons and was arbitrary and discriminatory in character."); *Libya v. Libyan Am. Oil Co*., 20 I.L.M. 1, 114-15 (1981) (Award of April 12, 1977) ("It is clear and undisputed that non-discrimination is a requisite for the validity of a lawful nationalization. This is a rule well established in international legal theory and practice."); *American Independent Oil Co. (AMINOIL) v. Kuwait*, 21 I.L.M. 976 ¶ 87 (1982) (considering the question "whether the nationalization of Aminoil was not thereby tainted with discrimination", but finding that there were legitimate reasons for nationalizing one company and not the other.); *see also* RESTATEMENT (THIRD) OF THE LAW OF FOREIGN RELATIONS § 712 (1987) ("A state is responsible under international law for injury resulting from . . . a taking by the state of the property of a national of another state that . . . is discriminatory . . ."); *id*. §712 Comment f ("Formulations of the rules on

375. A second circumstance where non-discrimination is a recognized principle under international law's minimum standard for the treatment of aliens is denial of justice. The principle of denial of justice includes the notion that aliens should not be discriminated against in terms of access to judicial remedies or treatment by the courts. The international minimum standard guarantees to aliens the right of free access to the courts on a non-discriminatory basis.[603]

376. A third circumstance where non-discrimination is a recognized principle of international law is in times of mob violence or unrest, armed conflict or civil strife. The international minimum standard obliges the State to compensate aliens and nationals

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expropriation generally include a prohibition of discrimination . . ."); BROWNLIE at 541 n. 96 (there is "much authority for" the proposition that the "category of types of expropriation which are illegal apart from a failure to provide compensation" includes seizures which "are discriminatory, being aimed at persons of particular racial groups or nationals of particular states.") (collecting authority).

[602] *See, e.g.*, Sohn & Baxter, art. 10(5) (Taking and Deprivation of Use or Enjoyment of Property) ("An uncompensated taking of property of an alien . . . shall not be considered wrongful, provided: . . . (a) it is not a clear and discriminatory violation of the law of the State concerned; . . .); *Responsibility of the State for injuries caused in its territory to the person or property of others*, art. 9(2) (Measures of expropriation and nationalization), *reprinted in* F.V. GARCÍA-AMADOR ET AL., RECENT CODIFICATION OF THE LAW OF STATE RESPONSIBILITY FOR INJURIES TO ALIENS 129, 130 (1974) ("In the case of nationalization or expropriation measures . . . the State is responsible if the measures . . . involve discrimination between nationals and aliens to the detriment of the latter . . . .").

[603] *See, e.g.*, *Ambatielos (Greece v. UK)*, 12 R.I.A.A. 90, 111 (1956) ("The modern concept of 'free access to the Courts' represents a reaction against the practice of obstructing and hindering the appearance of foreigners in Court, a practice which existed in former times and in certain countries, and which constituted an unjust discrimination against foreigners. Hence, the essence of 'free access' is adherence to and effectiveness of the principle of non-discrimination against foreigners who are in need of seeking justice before the courts of the land for the protection and defence of their rights."); BORCHARD, DIPLOMATIC PROTECTION OF CITIZENS ABROAD at 334 ("[an American citizen's] own government is justified in intervening in his behalf only if the laws themselves, the methods provided for administering them, and the penalties prescribed are in derogation of the principles of civilized justice as universally recognized or if, in a specific case, they have been wrongfully subverted by the courts so as to discriminate against him as an alien or perpetrate a technical denial of justice."); C.F. AMERASINGHE, STATE RESPONSIBILITY FOR INJURIES TO ALIENS 243 (1967) ("Especially in a suit between State and alien it is imperative that there should be no discrimination between nationals and aliens in the imposition of procedural requirements. The alien cannot be expected to undertake special burdens to obtain justice in the courts of the State against which he has a complaint.").

on an equal basis for damages incurred during such times of violence, insurrection, conflict or strife.[604]

377. Other than in these limited circumstances, no established rule of customary international law has emerged that prohibits economic discrimination against aliens.

378. None of these contexts where international law prohibits discrimination exists in Methanex's case. First, as to expropriation, Methanex asserts a separate Article 1110 claim that includes allegations of intentional discrimination.[605] Article 1110(1)(b) explicitly recognizes the international rule of non-discrimination in the expropriation context. As explained more fully in Section V below, Methanex's Article 1110 claim fails as a matter of law and fact. Second, Methanex's claim cannot be fit into the rubric of denial of justice as there are no allegations here that any domestic adjudicatory remedies were foreclosed to Methanex or that it was discriminated against in U.S. courts. Third, clearly, the circumstances of mob violence or other unrest do not exist in this case.

379. In sum, Methanex has failed to establish any general obligation of non-discrimination under customary international law. Although customary international law

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[604] See, e.g., *Standard Oil Co. (U.S. v. Germ.)*, 2 R.I.A.A. 781, 794-95 (1926); League of Nations, *Bases of Discussion: Responsibility of States for Damage Caused in their Territory to the Person or Property of Foreigners*, League of Nations Doc. C.75.M.69.1929.V. at 104-23 (1929), *reprinted in* 2 SHABTAI ROSENNE, LEAGUE OF NATIONS CONFERENCE FOR THE CODIFICATION OF INTERNATIONAL LAW [1930] 526-45 (1975) (Basis of Discussion No. 21 includes the provision that a State must "[a]ccord to foreigners to whom damage has been caused by its armed forces or authorities in the suppression of an insurrection, riot or other disturbance the same indemnities as it accords to its own nationals in similar circumstances." Basis of Discussion No. 22(b) states that "[a] State must accord to foreigners to whom damage has been caused by persons taking part in an insurrection or riot or by mob violence the same indemnities as it accords to its own nationals in similar circumstances.").

[605] Second Amended Statement of Claim ¶ 317.

does recognize an obligation of non-discrimination in certain limited contexts, none of those contexts has any application here.

4. Methanex Can Show No Violation Of Customary International Law On These Facts

380. Moreover, Methanex cannot establish, and has not established, any violation of customary international law on these facts. As noted below, State practice clearly excludes any customary international law bar to the only genre of discrimination alleged by Methanex – discrimination against foreign-produced goods in favor of domestically produced goods. And the record establishes no such discrimination in any event.

381. Discrimination against foreign goods is only proscribed to the extent set forth in international agreements, and is otherwise permissible under international law. For example, an essential feature of the global trading system today is that goods generally receive different levels of treatment depending on the membership of their country of origin in free trade areas. The United States, the States of the European Union, and other countries lawfully administer a complex system of classification of goods in order to assess tariffs and duties on goods based on their country of origin.[606] Likewise, the world trading system permits the imposition of tariffs based on a finding that a good is subsidized or sold at less than fair value, or for other reasons. Ethanol from Brazil, for example, is presently subject to a $0.54 per gallon tariff in the United States that does not

[606] *See, e.g.*, Harmonized Tariff Schedule of the United States (16 JS tab 53) ("The USITC (Office of Tariff Affairs and Trade Agreements) is responsible for publishing the *Harmonized Tariff Schedule of the United States Annotated* (HTSA). The HTSA provides the applicable tariff rates and statistical categories for all merchandise imported into the United States; it is based on the international *Harmonized System*, the global classification system that is used to describe most world trade in goods.").

apply to ethanol from Canada, which can be imported into the U.S. free of any duty.[607] Clearly, absent treaty-based obligations, States are permitted to discriminate against and among foreign goods.

382. Methanex charges that "protectionism," as the counterpart of discrimination, is an international wrong.[608] In reality, protecting domestic industries and goods is a common State practice. International law, for example, permits the oft-used practice of granting government contracts on a preferential basis to domestic firms.[609] In the *ADF* case, another NAFTA tribunal accepted as lawful domestic content and performance requirements in governmental procurement, acknowledging that the practices are common not only to the NAFTA Parties, but "are to be found in the internal legal systems or in the administrative practice of many States."[610]

383. Discrimination against foreign goods therefore does not constitute a violation of customary international law. But even if it did, Methanex's Article 1105(1) claim would still fail. As demonstrated by the discussion in Section III above, the California measures do not, in fact, discriminate against foreign-supplied methanol. The measures were motivated by concern for California's water supply and were not directed at methanol at all.

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[607] California Energy Commission, *Staff Report: Ethanol Supply Outlook for California* 17 (Oct. 2003) (14 JS tab 15 at 399); HTSA (2003) Ch. 22 (16 JS tab 54 at 1459) (subheading 2207.10.60 in the "Special" column notes duty rate of "Free" for "CA," which denotes Canada).

[608] *See, e.g.*, Second Amended Statement of Claim ¶ 315.

[609] SCHACHTER at 316.

[610] *ADF* Award ¶ 188. *See also*, Paul Carrier, *Domestic Price Preferences in Public Purchasing: An Overview and Proposal of the Amendment to the Agreement on Government Procurement*, 10 N.Y. INT'L L. REV. 59, 67 (1997) ("The public procurement systems of virtually every country protect domestic suppliers and contractors of goods, services and construction services from external competition.").

384. Also as a factual matter, the California measures do not discriminate between domestic and foreign methanol producers. Methanex has not received less favorable treatment than similarly-situated U.S. producers of methanol. Thus, even if Methanex's theory were accepted, and Article 1105(1) were interpreted to guarantee national treatment, its national treatment claim would fail for the reasons explained in Section III above.

V. METHANEX'S EXPROPRIATION CLAIM UNDER ARTICLE 1110 IS BASELESS

385. Methanex's expropriation claim has changed again and again over the course of this arbitration. Despite multiple rounds of pleadings in this case, the basis of the claim remains obscure. One thing is clear: Methanex's expropriation claim fails as a matter of law and fact.

386. In its Second Amended Statement of Claim, Methanex states its expropriation claim as follows: a "substantial portion of [its] investments, including its share of the California and larger U.S. oxygenate market were taken . . . ."[611] By contrast, in its original Statement of Claim, Methanex asserted that its two U.S. enterprises, Methanex US and Methanex Fortier had been expropriated.[612] Methanex then changed its position in its Draft Amended Statement of Claim, asserting that various intangibles that it described as "[m]arket share, market access and goodwill" were the

[611] Second Amended Statement of Claim ¶ 317.

[612] *See* Statement of Claim ¶ 35 ("The measure constitutes a substantial taking of Methanex US' and Fortier's business, and Methanex's investment in Methanex US and Fortier. The measure is both directly and indirectly tantamount to an expropriation, and has resulted in an impairment and deprivation of Methanex US' and Fortier's economic value.").

"investments" that were expropriated.[613] In its most recent submission, Methanex abandons some of its earlier assertions and claims that the California measures "have deprived and will continue to deprive Methanex and Methanex US of a substantial *portion* of their customer base, goodwill, and market for methanol in California."[614]

387. Methanex's new claim that a "substantial portion of [Methanex US's, Methanex Fortier's or its] customer base, goodwill and market in California" were expropriated fails for several reasons. *First*, Methanex's fresh pleading does not even attempt to identify what "portions" of which investment were expropriated. Its pleading is thus facially deficient. *Second*, Methanex's claim fails because goodwill, market share and customer base are not, by themselves, "investments" that are capable of being expropriated. *Third*, Methanex's claim, which boils down to an allegation that its investments' profitability will be negatively impacted by the measures, fails because such an allegation cannot support a finding of expropriation, and Methanex has failed to carry its burden of proof in any event. *Finally*, the type of regulatory action taken by California cannot, absent extraordinary circumstances not present in this case, be deemed expropriatory.

A. Methanex's Vague Allegation Of Expropriation Does Not Meet The UNCITRAL Rules' Pleading Standard

388. Article 18 of the UNCITRAL Arbitration Rules requires a claimant to include in its statement of claim, among other things, "a statement of facts supporting the

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[613] Draft Amended Claim at 69 ("Market share, market access, and goodwill are all property interests that can be illegally expropriated. . . . By preventing Methanex and its U.S. enterprises from maintaining their market share, and instead transferring that market share to the domestic ethanol industry, the United States 't[ook] a measure tantamount to . . . expropriation of . . . an investment.").

[614] Second Amended Statement of Claim ¶ 322 (emphasis added).

claim."[615] In its First Partial Award, the Tribunal thus instructed Methanex to "set out its *specific* factual allegations, including all specific inferences to be drawn from those facts."[616] After more than three years of pleading, however, Methanex has yet to identify with even minimal clarity what it alleges was expropriated.

389. Methanex's failure to adequately plead its expropriation claim was the subject of one of the United States' objections to admissibility. In its memorials on jurisdiction and admissibility, the United States extensively examined Methanex's failure to plead any investment capable of being expropriated.[617] In its Partial Award, the Tribunal determined to adjourn its decision on the United States' objection "in the light of the factual evidence still to be adduced in these arbitration proceedings," but expressly noted that "it may be necessary for the Tribunal to address and decide many of these submissions at a later stage of this arbitration."[618]

390. Despite having been warned of this deficiency in several rounds of briefing, and despite having received a *third* opportunity to replead its case, Methanex has nonetheless failed to plead with any measure of detail what investment it claims has been taken. Methanex's failure, on this record and at this late stage of the proceedings, in itself warrants dismissal of its expropriation claim.

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[615] *See* First Partial Award ¶ 148.

[616] *Id.* ¶ 162 (emphasis added).

[617] *See* Memorial on Jurisdiction and Admissibility at 30-38 (Nov. 13, 2000); Reply Memorial of U.S. at 39-43 (Apr. 12, 2001); Rejoinder of U.S. at 42-44 (June 27, 2001).

[618] First Partial Award ¶ 95.

B. Methanex Has Failed To Identify Any "Investment" That Has Allegedly Been Expropriated

391. Methanex's claim that a "substantial portion of [its investments'] customer base, goodwill and market in California"[619] has been expropriated also fails because goodwill, customer base and market share are not, by themselves, investments that are capable of being expropriated.

392. Article 1139 provides an exhaustive list of what may constitute an investment for purposes of Chapter Eleven.[620] Neither goodwill, customer base nor market share are among the items listed in Article 1139. In addition, customary international law has long recognized that in order for there to be an expropriation, a *property* right or interest must have been taken. [621]

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[619] Second Amended Statement of Claim ¶ 322.

[620] Under Article 1139 of the NAFTA, investment is defined as

> (a) an enterprise; (b) an equity security of an enterprise; (c) a debt security of an enterprise; . . .; (d) a loan to an enterprise . . .; (e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise; (f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution . . .; (g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and (h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, . . .

but investment is not

> (i) claims to money that arise solely from (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or (ii) the extension of credit in connection with a commercial transaction . . . ; or (j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h).

[621] *See, e.g.*, Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 3 R.C.A.D.I. 176, 272 (1983) ("[O]nly *property* deprivation will give rise to compensation.") (emphasis in original); Rudolph Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REV. F.I.L.J. 41, 41 (1986) ("Once it is established in an expropriation case that the object in question amounts to 'property,' the second logical step concerns the identification of expropriation."); *see also* Free Trade Agreement, June 6, 2003, Chile-U.S. ("Chile-U.S. FTA"), ann. 10-D ¶ 2 ("An action or series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible *property* right or *property* interest in an investment") (emphasis added); Free Trade Agreement, May 6, 2003, Sing.-U.S. ("Sing.-U.S. FTA"), exchange of letters clarifying art. 15.6.1 (Expropriation) (same).

393. Goodwill, market share and customer base, however, are not property rights or interests that, by themselves, are capable of being expropriated. International law authorities have thus drawn a distinction between property that may be expropriated by itself, and goodwill and market share which may be taken into account when valuing an enterprise that has been expropriated but are not, by themselves, capable of being expropriated. Gillian White, for example, observes as follows:

> A property right, in order to qualify for the protection of the international law rules must be an actual legal right, as distinct from a mere economic or other benefit, such as a situation created by the law of a State in favour of some person or persons who are therefore interested in its continuance. . . . [T]he notion of goodwill is too vague to be regarded as a separate property right apart from the enterprise to which it is attached. This assumption gains support from the complete absence of any reference to goodwill or business reputation in any of the post-war decrees or compensation agreements examined by the writer. The most that can be said is that goodwill constitutes an element of the value of an enterprise and as such may have been covered by some of the compensation payments.[622]

394. International tribunals have similarly rejected claims that customer base, goodwill and market share are, by themselves, property interests that can be expropriated. In the *Oscar Chinn* case, for example, the Permanent Court of International Justice denied an expropriation claim for failure to identify a property right.[623] There, a British river

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[622] GILLIAN WHITE, NATIONALISATION OF FOREIGN PROPERTY 49 (1961); *see also* AMERICAN SOCIETY OF INTERNATIONAL LAW, THE IRAN-UNITED STATES CLAIMS TRIBUNAL: ITS CONTRIBUTION TO THE LAW OF STATE RESPONSIBILITY 196-97 n.33 (Richard Lillich & Daniel Magraw eds., 1998) (although goodwill may be considered an element in the calculation of compensation, that does not mean that it can be the object of expropriation) (citing, among others, ALLAHYAR MOURI, INTERNATIONAL LAW OF EXPROPRIATION AS REFLECTED IN THE WORK OF THE IRAN-U.S. CLAIMS TRIBUNAL 58-60 (1994)); Rudolf L. Bindschedler, *La protection de la propriété privée en droit international public*, 90 R.C.A.D.I. 179, 223-24 (1956) ("La clientèle, notion intimement liée à celle de la liberté du commerce et de l'industrie, n'est pas plus que cette dernière susceptible d'appropriation.") ("Clientele, a notion intimately linked to that of liberty of commerce and industry, is no more capable of expropriation than the latter.") (emphasis omitted; translation by counsel).

[623] *(U.K. v. Belg.)* 1934 P.C.I.J. ser. A/B, No. 63, 65 (Dec. 12).

carrier operator claimed that the Belgian Congo had expropriated its property when the government increased its funding for a state-owned competitor, which resulted in that competitor being granted a *de facto* monopoly. In denying the claim, the Court held that it was "unable to see in [claimant's] original position – which was characterized by the possession of customers . . . anything in the nature of a genuine vested right."[624] The Court reasoned that "[f]avourable business conditions and goodwill are transient circumstances, subject to inevitable changes."[625]

395. Because customer base, goodwill and market share are not, by themselves, property rights capable of being expropriated, Methanex's expropriation claim fails as a matter of law.

C. Methanex's Allegation That Its Investments Have Been Negatively Impacted By The Measures Fails To Establish A Taking

396. Methanex has failed in any event to establish an expropriation in two critical respects. First, it is well-established that more than a regulation's negative impact on an investment's profitability is required to establish a taking under international law. Methanex here has shown no impact, much less an interference so substantial that it could be viewed as a *de facto* taking of anything. Second, Methanex has failed to establish any reasonable expectation that MTBE, a product whose market was born of regulation, would not be further regulated in California.

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[624] *Id.* at 88.

[625] *Id*; *see also, e.g., SA Biovilac NV v. European Economic Comm'y*, (Case 59/83), [1984] E.C.R. 4057 ¶ 22 (1984) ("Even though those measures may . . . have a detrimental effect on sales of its products, that negative effect cannot be regarded as an infringement of the substance of those rights . . ."); *Kügele (Germ. v. Pol.), reprinted in* ANN. DIG. 1931/32 69 (Upper Silesian Arbitral Tribunal 1932) ("[T]here is an essential difference between the maintenance of a certain rate of profit in an undertaking and the legal and factual possibility of continuing the undertaking. The trader may feel compelled to close his business because of the new tax. . . . But this does not mean that he has lost the right to engage in the trade.").

397. *First*, it is well-settled in international law that an allegation that an investment's profitability has been negatively impacted as a result of regulation is insufficient to support a finding of expropriation. As one commentator has noted,

> Whatever may be the remedy of foreigners caught by general changes in the law, if those changes do not in fact dispossess them but merely lessen the value of their holdings or expectations, in the general interest, then bona fide changes in the public interest will not be confiscations, since the owners are left in possession of their property . . . .[626]

398. Thus, "the general body of precedent usually does not treat regulatory action as amounting to expropriation."[627] If States were held liable for expropriation every time a regulation had a mere impact on an investment, governments could not regulate. As one NAFTA Chapter Eleven tribunal has observed, "governments must be free to act in the broader public interest through protection of the environment . . . . Reasonable government regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this."[628]

399. Accordingly, NAFTA tribunals have declined to find an expropriation where a portion of the claimant's business activity was impacted by regulation. For

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[626] B.A. WORTLEY, EXPROPRIATION IN PUBLIC INTERNATIONAL LAW 50 (1959); *see also* IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 535 (1998) ("State measures, prima facie a lawful exercise of powers of government, may affect foreign interest considerably without amounting to expropriation."); G.C. Christie, *What Constitutes a Taking of Property Under International Law*, 38 BRIT. Y.B. INT'L L. 307, 335 (1962) ("It would seem, on balance, that in cases of 'partial monopoly' or 'partial prohibition' the difficulties are so great that the only practicable solution is to resolve all doubts against the alien claimant.").

[627] *S.D. Myers, Inc. v. Canada* ¶ 281 (Nov. 13, 2000) (Partial Award).

[628] *Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1 ("*Feldman* Award) (Dec. 16, 2002) (Award); *see also id.* ¶ 112 ("[N]ot all government regulatory activity that makes it difficult for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110."); *cf. Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978), *reh'g denied*, 439 U.S. 889 (1978) ("Government

example, in *Feldman v. Mexico*, the tribunal declined to find that the Mexican government's denial of tax rebates on cigarettes exported by the claimant's investment amounted to an expropriation.[629] In reaching this determination, the tribunal considered that

> the regulatory action has not deprived the Claimant of control of his company, . . . interfered directly in the internal operations of [the company] or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of business activity . . . . Of course, he was effectively precluded from exporting cigarettes . . . . However, this does not amount to Claimant's deprivation of control of his company.[630]

400. In *Pope & Talbot Inc. v. Canada*, a NAFTA Chapter Eleven tribunal denied the claimant's expropriation claim on similar grounds. In that case, the claimant challenged Canada's export control regime that placed quotas on the amount of lumber that could be exported from Canada into the United States duty-free. The claimant alleged that "each time Canada reduced the Investment's allocation of fee free quota, a further expropriation occurred."[631] In rejecting the claimant's expropriation claim the tribunal stated:

> Even accepting (for the purpose of this analysis) the allegation of the Investor concerning diminished profits, the Tribunal concludes that the degree of interference with the Investment's operations due to the Export Control Regime does not rise to an expropriation (creeping or otherwise) within the meaning of Article 1110. While it may sometimes be uncertain whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive

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could hardly go on if to some extent values incident to property could not be diminished without paying for every such change in the general law.").

[629] *Feldman* Award ¶ 153.

[630] *Id.* ¶ 142.

[631] ¶ 81 (June 26, 2000) (Interim Award).

> to support a conclusion that the property has been "taken" from the owner.[632]

401. Thus, an allegation that an investment's profits have diminished as a result of regulatory action is insufficient to support a claim for an expropriation. At best, this is all that Methanex has alleged. In any event, Methanex has offered no evidence to support even that allegation.

402. The Tribunal ordered Methanex to adduce *all* evidence in support of its claim along with its fresh pleading.[633] Methanex, however, has produced not a shred of evidence to support its allegation that any investment has been expropriated. Methanex has not shown that Methanex Fortier or Methanex US even had any goodwill value, nor has it provided documentary evidence of their customer base. With respect to market share, Methanex has provided no documentary evidence whatsoever. Indeed, what is of record strongly suggests that neither Methanex nor its investments have suffered *any* loss or damage as a result of the California measures.[634] Methanex's complete failure of proof warrants dismisssal of its expropriation claim.

403. *Second,* Methanex has not attempted to demonstrate – nor could it demonstrate – that it had any reasonable expectation that MTBE would not be the subject of further regulation in California. This failure of proof further eviscerates its expropriation claim.

404. As the Permanent Court of International Justice in the *Oscar Chinn* case noted:

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[632] *Id.* ¶ 102; *see also S.D. Myers* Partial Award ¶¶ 279-88 (finding no expropriation where profits allegedly diminished as a result of temporary border closure to exports of PCB waste).

[633] First Partial Award ¶ 163.

> No enterprise . . . can escape from the chances and hazards resulting from general economic conditions. Some industries may be able to make large profits during a period of general prosperity, or else by taking advantage of a treaty of commerce or of an alteration in customs duties; but they are also exposed to the danger of ruin or extinction if circumstances change. Where this is the case, no vested rights are violated by the State.[635]

405. Similarly, the Iran-U.S. Claims Tribunal has taken into account the reasonable expectations of an investor when determining whether or not an expropriation has occurred:

> [I]nvestors in Iran, like investors in all other countries, have to assume a risk that the country might experience strikes, lock-outs, disturbances, changes of the economic and political system and even revolution. That any of these risks materialized does not necessarily mean that property rights affected by such events can be deemed to have been taken.[636]

406. Methanex, like all investors, assumed the risk that there could be changes in the economic and political conditions in the United States, including in the regulatory requirements concerning the sale of MTBE in gasoline. MTBE, like many chemicals and like any component in gasoline, is a highly regulated product. MTBE producers thus

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[634] *See supra* Section II.

[635] 1934 P.C.I.J. ser. A/B, No. 63 at 88.

[636] *Starrett Housing Corp. v. Iran*, 4 Iran-U.S. Cl. Trib. Rep. 122, 156 (1983); *see also* Dolzer at 62. It is also noteworthy that the recent Free Trade Agreements signed by Singapore and the United States and Chile and the United States provide in part as follows:

> The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:
>
> (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
>
> (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
>
> (iii) the character of the government action.

Chile-U.S. FTA, ann. 10-D ¶ 4(a); Sing.-U.S. FTA, exchange of letters clarifying art. 15.6.1 (Expropriation) ¶ 4(a).

necessarily operate with the knowledge that their product is regulated and may be further regulated in the future.

407. As far as Methanex's business concerns the sale of methanol to producers that manufacture MTBE, Methanex's business was born of regulation: the use of MTBE as an octane enhancer and an oxygenate arose in direct response to the adoption in 1973 of regulations limiting lead in gasoline and the 1990 amendments to the Clean Air Act. Methanex, as a producer of a feedstock for MTBE, was necessarily aware of the origins of the market for MTBE in gasoline in the United States and operated under the risk that the regulations that gave rise to that market segment could change and eliminate the market segment those regulations created. As the *Feldman* tribunal noted: "Governments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue."[637] Methanex had no reasonable expectation that the United States would not, in response to changing conditions, further regulate the composition of gasoline, as it has done repeatedly in the last few decades.

408. In sum, Methanex has produced no evidence in support of its claim that any of its investments in the United States has been expropriated. To the contrary, the evidence in the record shows that Methanex's investments have suffered no loss or damage – which in and of itself would be insufficient to support a claim for expropriation – as a result of the measures. Nor has Methanex shown that the California measures were in any way outside of the realm of what it could and should have reasonably

expected, given the fact that gasoline has been and remains highly regulated in the United States.

D. The Measures At Issue Are Not Expropriatory

409. Quite apart from the infirmities in Methanex's expropriation claim reviewed above, Methanex's claim fails because the measures Methanex challenges cannot be considered expropriatory. The 1999 Executive Order and the CaRFG3 Regulations were actions taken by California to protect the public health by safeguarding its citizens' drinking water supply. Absent extraordinary circumstances not present here, such actions are not expropriatory under customary international law.

410. It is a principle of customary international law that, where economic injury results from a *bona fide* regulation within the police powers of a State, compensation is not required.[638] As Professor Friedman notes:

> State practice contains numerous examples of the suppression of particular activities which may be carried out . . . . In the first place, the activity may be regarded as harmful at a given time although it was perfectly legal hitherto and may indeed become so again. . . . In all these cases where a particular activity was suppressed, with a resulting destruction of important corporeal and incorporeal property rights, no compensation was paid to those suffering damage in consequence of the measures taken.[639]

411. Thus, as a general matter, States are not liable to compensate aliens for economic loss incurred as a result of a nondiscriminatory action to protect the public

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[637] *Feldman* ¶ 112.

[638] *See, e.g.*, FRIEDMAN, EXPROPRIATION IN INTERNATIONAL LAW 50-51 (1953) (collecting cases where harmful activities were suppressed and no compensation was paid, including "lotteries, the manufacture of oleo-margarine and pool halls" in the United States, "prohibition on the manufacture and sale of alcoholic liquor introduced in 1926" in the United States and similar measures in France); *Lauder (U.S.) v. Czech Republic* (Sept. 3, 2002) (Final Award) ¶ 198 (The "detrimental effect on the economic value of property is not sufficient; Parties to the Treaty are not liable for economic injury that is the consequence of *bona fide* regulation within the accepted police powers of the State.").

[639] FRIEDMAN at 50-51.

health.[640] For example, in *Parsons (Gr. Brit.) v. United States*, when United States military authorities destroyed a British national's stock of liquor deemed to be poisonous (it contained methanol), an international tribunal found this action to be non-compensable.[641] Similarly, in the *Bischoff (Italy) v. Venezuela* case, an international tribunal declined to award compensation for the taking of the claimant's carriage by Venezuelan police authorities, where the authorities believed the carriage was contaminated with smallpox.[642]

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[640] *See, e.g.*, RESTATEMENT (SECOND) OF THE LAW OF FOREIGN RELATIONS § 197(1) (1965) ("Conduct attributable to a state and causing damage to an alien does not depart from the international standard of justice indicated in § 165 if it is reasonably necessary for (a) the maintenance of public order, safety, or health, . . ."); BROWNLIE at 539 (1998) ("Cases in which expropriation is allowed to be lawful in the absence of compensation are within the narrow concept of public utility prevalent in *laissez-faire* economic systems, i.e. exercise of police power, health measures, and the like."); Christie, 33 BRIT. Y.B. INT'L L. at 338 ("If, however, such prohibition can be justified as being reasonably necessary to the performance of a State of its recognized obligations to protect the public health, safety, morals or welfare, then it would normally seem that there has been no 'taking' of property."); Louis B. Sohn and R.R. Baxter, *Convention on the International Responsibility of States for Injuries to Aliens, Final Draft with Explanatory Notes*, art. 10(5) (1961), *reprinted in* F.V. GARCÍA-AMADOR ET AL., RECENT CODIFICATION OF THE LAW OF STATE RESPONSIBILITY FOR INJURIES TO ALIENS (1974) ("An uncompensated taking of property of an alien or a deprivation of the use or enjoyment of property of an alien which results . . . from the action of the competent authorities of the State in the maintenance of public order, health, or morality; . . . shall not be considered wrongful, provided . . . it is not a clear and discriminatory violation of the law of the State concerned, [and] it is not an unreasonable departure from the principles of justice recognized by the principal legal systems of the world"); United Nations Commission on Permanent Sovereignty over Natural Resources, *The Status of the Question of Permanent Sovereignty over Natural Wealth and Resources*, U.N. Doc. A/AC.97/5/Rev.2, Ch. III, ¶ 65 (Preliminary Study by the Secretariat, 1959) ("The taking of an alien's property has been held non-compensable when the state action was deemed to be within its police power or for reasons of public health or safety."); *see also* Chile-U.S. FTA, ann. 10-D ¶ 4(b); Sing.-U.S. FTA, exchange of letters clarifying art. 15.6.1 (Expropriation) ¶ 4(b) ("Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations."); RESTATEMENT (THIRD) OF THE LAW OF FOREIGN RELATIONS § 712, cmt. g (1987) ("A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory, . . . and is not designed to cause the alien to abandon the property to the state or sell it at a distress price.").

[641] 6 R.I.A.A. 165, 165-66 (1955) (Award of Nov. 30, 1925).

[642] VENEZUELAN ARBITRATIONS OF 1903, 581 (1904) ("Certainly during an epidemic of an infectious disease there can be no liability for the reasonable exercise of police power"). While denying the expropriation claim, the tribunal awarded damages for the "unreasonable length of time [of the detention] and injuries to the carriage during [the detention] period." *Id.*; *see also Booker Aquacultur Ltd. & Hydro Seafood GSP Ltd. v. Scottish Ministers*, 2003 ECJ CELEX LEXIS 287 (E.C.J. July 10, 2003) (finding no deprivation of property rights where the Scottish government ordered the destruction of contaminated fish

412. The text of the NAFTA is consistent with the view that it is a State's sovereign right to protect public health and the environment. The preamble of the NAFTA notes the Parties' resolve to "PRESERVE their flexibility to safeguard the public welfare; . . . STRENGTHEN the development and enforcement of environmental laws and regulations . . . [and] UNDERTAKE each of the preceding in a manner consistent with environmental protection and conservation."[643] Article 1101(4) requires that Chapter Eleven be construed so as not "to prevent a Party from providing a service or performing a function such as . . . social welfare . . .[or] health." And, Article 1114(2) includes the NAFTA Parties' recognition that:

> [I]t is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor.[644]

These provisions strongly suggest that the NAFTA Parties did not intend for nondiscriminatory regulatory measures to protect the public health and the environment, like the measure at issue here, to be the subject of an expropriation claim.

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stocks); *Gallagher v. Lynn*, [1937] A.C. 863 (H.L.) (finding no expropriation where the intent of a measure was to "secure the health of the inhabitants of Northern Ireland by protecting them from the dangers of an unregulated supply of milk.").

[643] *See also* North American Agreement on Environmental Cooperation, Sept. 8, 9, 12, 14, 1993, Can.-Mex.-U.S. art. 3, 32 I.L.M. 1480 (1993) ("Recognizing the right of each Party to establish its own levels of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental laws and regulations . . . .").

[644] *See also* NAFTA art. 1114(1) ("Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.").

413. As demonstrated above, the California measures are *bona fide*, non-discriminatory regulatory actions taken to protect the public drinking water supply.[645] Drinking water is a precious natural resource and is perhaps the most critical element to human survival.[646] Since the dawn of time, humankind has depended on water for drinking, cooking and washing.[647] A steady supply of potable drinking water is critical to public health in any civilization.[648] Thus, protection of drinking water supplies has become an essential function of governments worldwide.[649]

414. Methanex cannot and does not dispute that even small concentrations of MTBE make large quantities of groundwater unpotable.[650] In the mid-1990s, California experienced a crisis of MTBE contamination. Drinking water wells at dozens of sites around the state were affected by releases of MTBE into the drinking water supply.[651] Water boards across the state received complaints from their customers that the water

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[645] *See supra* at 12-22, 25-27.

[646] *See, e.g.*, 16 ENCYCLOPÆDIA BRITANNICA 672 (15th ed. 1997) (16 JS tab 43 at 1365) ("The dependence of life on water is complete; it is the major constituent of plant and animal cells."); 28 ENCYCLOPEDIA AMERICANA 432 (1999) (16 JS tab 44 at 1381) ("Water is both an essential ingredient of all living organisms and a major component of the environment in which they live.").

[647] *See, e.g.*, 16 ENCYCLOPÆDIA BRITANNICA 672 (16 JS tab 43 at 1365); 28 ENCYCLOPEDIA AMERICANA 451 (16 JS tab 44 at 1399).

[648] *See* 16 ENCYCLOPÆDIA BRITANNICA 672 (16 JS tab 43 at 1365) ("Water is required for a variety of purposes; water for drinking is still paramount, and such water must be relatively pure.").

[649] 28 ENCYCLOPEDIA AMERICANA 441a (16 JS tab 44 at 1388) ("The increase in the number and variety of uses for water throughout the world has produced a wide range of standards of water quality that must be satisfied. These demands include . . . potability of the water supply. . . . [T]here are constraints reflecting public health requirements, aesthetics, economics, and short- and long-term ecological impacts."). In the United States, federal regulations set forth drinking water standards, known as maximum contaminant levels (MCLs). *See* 42 U.S.C. 300f (2003) (18 JS tab 143 at 2691). In accordance with these regulations, California has adopted its own rules that require water systems to analyze samples taken from their water supplies for primary (health) and secondary (taste/odor) MCLs. *See* CAL. CODE REGS. tit. 22 § 64449 (2003) (14 JS tab 11 at 150).

[650] *See, e.g.*, Fogg Report ¶ 40 (13 JS tab D).

[651] *See supra* 16-17; Happel Report Table 10 (13 JS tab E).

from their taps "smelled like turpentine."[652] Dozens of concerned citizens testified before the California Environmental Protection Agency during the hearings on the U.C. Report, urging California to remove MTBE from gasoline.[653] For example, Stephen Hall of the Association of California Water Agencies testified that

> The fact that MTBE is detectable with taste and odor at very low levels presents, to us, a particularly urgent problem. It's a crisis of confidence among our customers. If they can taste and smell something that tastes and smells like turpentine in their water, they won't trust that drinking water. . . . [G]iven our state's growing need for water and its limited supply, we simply can't afford to squander the available resources that we have.[654]

415. It was the detection of MTBE contamination in California's drinking water wells that compelled the state to take regulatory action to safeguard its citizens' drinking water supply from MTBE's potent taste and odor effects.[655] Governor Davis explicitly states as much in the Executive Order. He directed California's executive agencies to act based on "the environmental threat to groundwater and drinking water" posed by MTBE.[656] Likewise, CARB indicated in its Resolution adopting the CaRFG3 standards that "the people of California will not accept drinking water in which they can taste MTBE; Accordingly, the threat posed by MTBE . . . makes it necessary to prohibit the use of MTBE in California gasoline."[657]

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[652] *See, e.g.*, Happel Report at 53-55 (13 JS tab E).

[653] *See generally* California Environmental Protection Agency, Public Hearings to Accept Public Testimony on the University of California's Report on the Health and Environmental Assessment of Methyl Teriary-Butyl Ether (MTBE) (Feb. 19, 23-24, 1998) (15 JS tab 22).

[654] Transcript of UC Report Hearing no.2 at 173 (Feb. 23, 1999) (15 JS tab 22 at 936).

[655] *See supra* at 12-22, 25-27.

[656] 1999 EXECUTIVE ORDER pmbl. (1 JS tab 1(c)).

[657] CARB Resolution 99-39 at 6-7 (Dec. 9, 1999) (16 JS tab 24 at 1215-16).

416. The measures thus establish on their face that their purpose was to regulate to protect public health. There is, in international law, a "necessary presumption that States are 'regulating' when they say they are 'regulating,' and they are especially to be honored when they are explicit in this regard.[658] Nothing in this record overcomes that presumption.

417. In sum, California's actions, which were taken to protect its citizens' drinking water and were not discriminatory, may not be deemed expropriatory. Methanex's claim under Article 1110 is without legal or factual support. It should be dismissed with prejudice.

VI. THE TRIBUNAL LACKS JURISDICTION OVER METHANEX'S NEW CLAIM, WHICH IS INADMISSIBLE IN ANY EVENT

418. For four years, the cornerstone of Methanex's claim has been its "complain[t] against US measures taken by the State of California restricting the use of MTBE in gasoline in California."[659] For the first time, in its Second Amended Statement of Claim, however, Methanex notes that the regulations "went beyond merely banning MTBE" by prohibiting the use of any oxygenate in gasoline other than ethanol unless that

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[658] Burns H. Weston, *Constructive Takings Under International Law: A Modest Foray Into the Problem of "Creeping Expropriation,"* 16 VA. J. INT'L L. 103, 121 (1975); *see also,* Christie, 38 BRIT. YB. INT'L L. at 332 ("[I]f the facts are such that the reasons actually given [for an alleged expropriatory measure] are plausible, search for the unexpressed 'real' reasons is chimerical. No such search is permitted in municipal law, and the extreme deference paid to the honour of States by international tribunals excludes the possibility of supposing that the rule is different in international law."); *id.* at 338 ("A State's declaration that a particular interference with an alien's enjoyment of his property is justified by the so-called 'police power' does not preclude an international tribunal from making its own independent determination of this issue. But, if the reasons given are valid and bear some plausible relationship to the action taken, no attempt may be made to search deeper to see whether the State was activated by some illicit motive."); *see also supra* nn.205, 206 and accompanying text. As demonstrated at length above, Methanex's attempt to inject discrimination into the intent behind the measures finds no support in the record. *See supra* Sections I & III.

oxygenate undergoes a multi-media evaluation.[660] Methanex also observes that the regulations conditionally prohibit the use of *methanol* as an oxygenate in California gasoline after December 31, 2003.[661] Methanex's new observation, which is of no consequence in any event,[662] cannot support a claim for two reasons.

419. *First*, Article 20 of the UNCITRAL Arbitration Rules requires that a tribunal deny a party permission to amend its claim where the amended claim would fall outside of the tribunal's jurisdiction. Methanex has not complied with the NAFTA's jurisdictional prerequisites for asserting a new claim such as this.

420. This Tribunal made clear in its Partial Award that "in order to establish the necessary consent to arbitration [under Chapter Eleven], it is sufficient to show . . . that all pre-conditions and formalities required under Articles 1118-1121 are satisfied . . . ."[663] Pursuant to Article 1119, a disputing party is required to specify in its notice of intent "the issues and the factual basis for the claim."[664] The factual basis for Methanex's claim in its various notices of intent was, and has been until the submission of its fresh pleading, the ban of MTBE, which it alleged to harm its business of selling methanol for use in MTBE.[665] Not until its Second Amended Statement of Claim did Methanex allege

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[659] First Partial Award ¶ 22.

[660] Second Amended Statement of Claim ¶ 22.

[661] *See id*.

[662] Methanex's new observation is of no consequence as a matter of fact. As demonstrated at length *supra* Section I(B), methanol is not, and cannot be, used as an oxygenate in gasoline.

[663] First Partial Award ¶ 120. *But cf. ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, 15:3 WORLD TRADE & ARB. MATERIALS 62 ¶ 133 (June 2003) (Award of Jan. 9, 2003) ("We see no logical necessity for interpreting the 'procedures set out in the [NAFTA]' as delimiting the detailed boundaries of the consent given by either the disputing Party or the disputing investor.").

[664] NAFTA art. 1119(c).

[665] *See* Notice of Intent at 2-3 (July 2, 1999) (no mention of measures preventing the use of methanol as an oxygenate); *see also* Notice of Arbitration at 5 (Dec. 3, 1999) (discussing the uses of methanol, but

that "the regulations banned not only MTBE, but methanol as well, from competing with ethanol in the California oxygenate market."[666] No such new claim, however, could be submitted to arbitration in accordance with the NAFTA's procedures.[667]

421. The decision of the International Court of Justice in *Certain Phosphate Lands in Nauru (Nauru v. Australia)*[668] is instructive on the question of whether a new claim is sufficiently distinct from the original claim to fall outside a party's consent to arbitration. In that case, Nauru filed an application instituting proceedings against Australia "in respect of a 'dispute . . . over the rehabilitation of certain phosphate lands [in Nauru] worked out before Nauruan independence.'"[669] Nauru later attempted to add a claim in its memorial concerning the *overseas* assets of the British commissioners who had managed the phosphate industry in Nauru during the trusteeship period. "There was no reference to the disposal of the overseas assets of the British Phosphate

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declining to include use as an oxygenate); *id.* at 8 (in discussing harm to Methanex, no mention of measures preventing the use of methanol as an oxygenate); Statement of Claim (Dec. 3, 1999) ¶ 4 (discussing the uses of methanol, but declining to include use as an oxygenate); *id.* ¶ 10 (omitting to include methanol in a list of oxygenates that refiners may blend into gasoline to comply with the CAAA requirements); *id.* ¶ 35 (in discussing harm to Methanex, no mention of measures preventing the use of methanol as an oxygenate); Claimant's Reply to the Statement of Defense ¶ 2 (Aug. 28, 2000) (discussing the uses of methanol, but declining to include use as an oxygenate); *id.* ¶ 73 ("The effect of the measure is to cause the removal of MTBE from commerce in California. The result is the indirect expropriation of Methanex U.S.' business of selling methanol to MTBE producers."); Notice of Change of Legal Counsel and Intent to File an Amended Claim (Nov. 30, 2000) (no mention of measures preventing the use of methanol as an oxygenate); Draft Amended Claim at 4 (Feb. 12, 2001) (discussing the use of methanol as a feedstock for MTBE, but declining to identify methanol as an oxygenate); *id.* at 6 (omitting to include methanol in a list of oxygenates that refiners may blend into gasoline to comply with the CAAA requirements); *id.* at 35-38 (in discussing harm to Methanex, no mention of measures preventing the use of methanol as an oxygenate); Methanex Counter-Memorial on Jurisdiction & Admissibility at 21-22 (Feb. 12, 2001) (in discussing harm to Methanex, no mention of measures preventing the use of methanol as an oxygenate); Methanex Rejoinder on Jurisdiction, Admissibility & the Proposed Amendment at 2 (May 25, 2001) ("[T]he market has winnowed the effective [oxygenate] competitors to three: MTBE, ETBE and ethanol."); *id.* at 5-7 (in discussing harm to Methanex, no mention of measures preventing the use of methanol as an oxygenate).

[666] Second Amended Statement of Claim ¶ 22.

[667] *See* NAFTA, art. 1122(1); First Partial Award ¶ 120.

[668] 1992 I.C.J. 240 (June 26).

Commissioners . . . in Nauru's Application either as an independent claim or in relation to the claim for reparation submitted . . . ."[670]

422. The Court found that it lacked competence to hear Nauru's new claim because that claim concerned a different set of operative facts from those described in the application.[671] Just as the Court, if it had entertained Nauru's new claim, would have had to "consider a number of questions that appear[ed] to it to be extraneous to the original claim,"[672] this Tribunal would be forced to consider completely new factual allegations if it were to entertain Methanex's new claim.

423. *Second*, even where jurisdiction is present, Article 20 of the UNCITRAL Arbitration Rules grants tribunals discretion to deny a new claim, having regard to delay and prejudice to the other party, as is evidently present here. In its First Partial Award, the Tribunal made clear that "[t]he fresh pleading must not exceed the limits of Methanex's existing case (pleaded and unpleaded); and [it did] not intend Methanex to make any new claim in its fresh pleading."[673] In the operative part of the award, the Tribunal ordered that Methanex "submit a fresh pleading . . . *conforming to the decisions contained in this Award; . . . .*"[674]

424. In the four years since Methanex originally filed its claim, the United States has been forced to respond to no less than three sets of pleadings, not to mention claims that have changed with each subsequent written submission and oral presentation.

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[669] *Id.* ¶ 1 (quoting Nauru's application).

[670] *Id.* ¶ 64.

[671] *Id.* ¶ 70.

[672] *Id.* ¶ 68.

[673] First Partial Award ¶ 162.

It is far too late for Methanex to introduce a new claim at this stage. In accordance with the *dispositif* of the First Partial Award, as well as the NAFTA's notice of intent requirement, the Tribunal should thus dismiss Methanex's new claim.

VII. METHANEX HAS INTRODUCED NO EVIDENCE ESTABLISHING ITS OWNERSHIP OR CONTROL OF INVESTMENTS IN THE UNITED STATES

425. Methanex has alleged cryptically that it "owns, indirectly 100 percent of the shares of both partners" comprising Methanex US (Methanex, Inc. and Methanex Gulf Coast, Inc.).[675] Likewise, Methanex alleges without explanation that it "indirectly owns 100 percent of the shares of Methanex Fortier."[676] But Methanex submits no evidence proving its ownership of these "investments." Nor does it even reveal – much less prove – the nature of its "indirect" ownership.

426. The burden of proof of ownership of an investment clearly lies with the claimant.[677] Adequate proof of ownership for purposes of recovery before an international tribunal must consist of more than affidavits from witnesses claiming familiarity with the property.[678] A claim for loss or damage to property should be dismissed if the claimant fails to substantiate or provide evidence to support its

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[674] *Id*. ¶ 172(5).

[675] Second Amended Statement of Claim ¶ 13.

[676] *Id*. ¶ 16.

[677] *See* UNCITRAL Arbitration Rules art. 24(1); *see, e.g.*, *Harris Int'l Telecomms., Inc. v. Iran*, 17 Iran-U.S. Cl. Trib. Rep. 31 ¶ 63 (1988) ("Each Party has the burden of setting out the facts upon which it wishes to base its case . . ."). *See generally*, *supra* at 40 (discussing burden of proof).

[678] *See Barbes (U.S.) v. Turkey*, AMERICAN-TURKISH CLAIMS SETTLEMENT UNDER THE AGREEMENT OF DEC. 24, 1923: OPINIONS AND REPORT 155, 156 (undated opinion) (dismissing claim where only proof offered of ownership was affidavits of witnesses familiar with the property, finding that "[p]roof with respect to the ownership and value of the property is inadequate.").

allegations – including alleged ownership of the supposedly damaged property.[679] Methanex has provided no explanation for its failure to provide documents that should, logically, be in its possession and control, and would prove its ownership of Methanex US and Methanex Fortier. This failure of proof of an essential element of Methanex's claim provides yet another ground for dismissal.

VIII. THE TRIBUNAL SHOULD AWARD THE UNITED STATES COSTS

427. In accordance with Articles 38 and 40 of the UNCITRAL Arbitration Rules, the United States respectfully requests that the Tribunal require Methanex to bear the full costs of this arbitration.

428. As recognized in the award on costs in *S.D. Myers, Inc. v. Canada*:

> Although . . . the UNCITRAL Rules confer wide discretion on an arbitral tribunal in respect of its award on costs, it can be seen that an arbitral tribunal is required to adopt a subtle difference of approach between the "arbitration costs" (the items contained in Articles 38(a),(b),(c),(d) & (f)) and the costs of "legal representation and assistance" (the term referred to in Article 38(e)). Under Article 40.1 the former are to be borne "in principle" by the "unsuccessful party"; under Article 40.2 the latter are to be apportioned by an arbitral tribunal after "taking into account the circumstances of the case." There is no reference to the "successful" or "unsuccessful" party in Article 40.2.[680]

429. On the subject of the arbitration costs, the United States believes that it has demonstrated that Methanex's claims are without merit and respectfully requests, therefore, that the Tribunal render an award that unequivocally designates Methanex as the "unsuccessful party." Moreover, there is no reason to depart here from Article 40(1)'s

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[679] *See Cyrus Petroleum Ltd. v. Iran*, 11 Iran-U.S. Cl. Trib. Rep. 70, 71 (1988) (merely listing allegedly expropriated properties and their supposed values in summary fashion did not satisfy claimant's burden to substantiate its allegations).

[680] *S.D. Myers, Inc. v. Canada* ("*S.D. Myers* Final Award") ¶ 10 (Dec. 30, 2002) (Final Award).

rule that the arbitration costs are to be borne by the unsuccessful party – particularly since Methanex had the choice of an arbitral regime that did not expressly establish a loser-pays presumption for arbitration costs, but freely chose that of the UNCITRAL rules.[681] No more need be said on the subject of arbitration costs here.

430. Because Methanex addressed the subject of costs of legal representation and assistance in its letter of June 16, 2003, the United States briefly addresses it here.

431. As the *S.D. Myers* tribunal also noted in its award on costs, "[t]he conduct of the Disputing Parties during the course of the proceedings is certainly a matter to be taken into account in assessing the apportionment to be made in respect of costs [of legal representation and assistance]."[682] The conduct of Methanex during these proceedings supports an award requiring Methanex to bear the United States' costs of legal representation and assistance.

432. Methanex submitted its claim to arbitration in December 1999 – almost a year before any measure banning MTBE in California's gasoline became law, more than three years before the ban's effective date and years before the ban could have any effect on demand for MTBE. It asserted in its claim that it had suffered a "loss" of $970 million from a ban that did not exist at the time and, even as proposed, would not go into effect until 2003.

433. One may rightly wonder why Methanex would bring such an obviously premature claim. The answer, as its senior officer has made clear, is for public relations

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[681] *See* NAFTA art. 1120(1) (disputing investor may choose between ICSID Additional Facility Rules and UNCITRAL Arbitration Rules); *compare* ICSID Arbitration (Additional Facility) Rules art. 58 ("the Tribunal shall decide how and by whom [the costs of the arbitration] . . . shall be borne.") *with* UNCITRAL Arbitration Rules art. 40(1) ("the costs of arbitration shall in principle be borne by the unsuccessful party.").

[682] *S.D. Myers* Final Award ¶ 20.

purposes. As he noted in an interview with *Oxy-Fuel News*, Methanex views these arbitral proceedings as a useful bully-pulpit for stating its views in the public debate on whether MTBE should be phased out from use as an oxygenate in gasoline:

> "A lot of the energy debate in the U.S. is on energy security and ethanol has pounced on that," said Michael Macdonald, senior vice president of technology for Methanex. While the ethanol industry has marketed its product as a renewable fuel and that can lessen the U.S.' dependence on foreign oil, "the voice of methanol has not been heard in that debate," he said. . . . . "Our strategy as a company was to get involved through an international trade dispute. That's the only forum where we even have an opportunity to even get a hearing, because the media and the rhetoric of the ethanol lobby" have made it difficult for the facts to be heard, he said.[683]

434. From the inception of this arbitration, Methanex has repeatedly gone to any length to get to a hearing where its views on MTBE could be discussed.

435. In November 2000, the United States submitted its memorial on jurisdiction which, as the Tribunal later found, clearly demonstrated that the Tribunal lacked jurisdiction over Methanex's claims.[684] Two weeks later, Methanex suddenly "discovered" supposed new evidence, changed its counsel, announced its intention to amend its claim to assert a new claim of discrimination and requested that the agreed schedule for proceedings on jurisdiction be suspended for months.[685]

436. Methanex then added a new claim under Article 1102. The claim, as stated by Methanex, was largely based on a series of irresponsible accusations concerning

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[683] *Methanex Looks for Greater Voice in Energy Debate*, 14:42 OXY-FUEL NEWS (Oct. 21, 2002) (17 JS tab 88 at 2217).

[684] *See* First Partial Award ¶ 150 ("this Tribunal decides that it would have no jurisdiction to hear [Methanex's] claim, as pleaded in the Original Statement of Claim.").

[685] *See* Notice of Change of Counsel and Intent to File an Amended Claim (Nov. 30, 2000).

the motives of Governor Davis in finding that MTBE posed a threat to the state's drinking water supplies.

437. Methanex's amended statement of claim also articulated no less than five new legal theories to support its claim under Article 1105(1).[686] The United States demonstrated at length, in response, that there was no legal support for any of the theories. Methanex later abandoned all of those legal theories save one in its Second Amended Statement of Claim.

438. At the hearing on jurisdiction, when it became apparent that the Tribunal was concerned that Methanex's new allegations did not clearly support a finding of jurisdiction, Methanex asserted that it had evidence to prove its wild accusations that Governor Davis acted with discriminatory intent. It asserted, for example, that its evidence included an "agenda" of Mr. Davis's meeting with executives of ADM that supposedly "confirms conclusively that this was an ethanol meeting" and that this was "a secret meeting that was not revealed in Governor Davis's campaign filings."[687] The evidence of record, notably, contains no agenda – only a draft itinerary, which "confirms" nothing of the kind – and conclusively demonstrates that Mr. Davis's trip to Decatur, Illinois to meet with ADM executives *was* timely disclosed in his campaign filings.[688]

439. On August 7, 2002, the Tribunal issued its First Partial Award, finding that it lacked jurisdiction over the claims stated in Methanex's original statement of claim but concluding that Methanex had so muddied the waters with allegations of fact at the

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[686] *See* Claimant Methanex Corporation's Draft Amended Claim (Feb. 12, 2001).

[687] Transcript of Hearing on Jurisdiction at 470 (July 13, 2001).

[688] *See supra* at 50. It is also noteworthy that the draft itinerary was copied without the authorization of the owner of the document. *See* Vind Statement ¶¶ 12-15 (13A JS tab I).

jurisdictional hearing that it could not conclude whether it had jurisdiction over the amended claim.

440. With timing oddly evocative of its earlier "discovery" of supposed new evidence after receipt of the U.S. memorial on jurisdiction, a few weeks after the award was issued Methanex again "discovered" supposed new evidence, this time of a supposed conflict of interest requiring disqualification of arbitrator Warren Christopher.[689] On that same day, Methanex made a "request for interpretation and clarification" of the award that, the Tribunal later determined, was no such thing.[690]

441. On March 31, 2003, the Tribunal held a procedural hearing at which the nature of the next phase of the proceedings was debated. At that hearing, Methanex, in order to induce the Tribunal to order a hearing that would include discussion of the scientific merits of MTBE, again made assertions of fact that have no support in the record. Notably, Methanex asserted that "in Brazil [methanol is] used extensively, both as a gasoline additive and an oxygenate" and that "[t]echnically, methanol can be used as an oxygenate."[691] Both statements are insupportable – there is no significant use of methanol as an oxygenate or gasoline additive in Brazil and, as Methanex itself repeatedly advised its own shareholders, methanol *cannot*, as a matter of law, be used as an oxygenate in gasoline in the United States.[692]

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[689] *See* Notice of Challenge (Aug. 28, 2002).

[690] *See* Letter to Tribunal from Methanex at 2 (Aug. 28, 2002); *see also* Letter to Disputing Parties from Tribunal (Sept. 25, 2002).

[691] Transcript of Procedural Hearing at 137-38 (Mar. 31, 2003).

[692] *See* Burke Report ¶ 102 (13 JS tab B); *supra* n.269 and accompanying text.

442. Finally, Methanex has, since at least as early as July 2002, not "expect[ed] the impact of [the loss of California MTBE demand] to have much of an impact on pricing, if at all."[693] It has felt confident enough in that expectation to repeat it again and again to its investors over the following weeks and months, leading up to Mr. Choquette's statement in mid-2003 that "I always like to say that I wish they would eliminate [MTBE from the U.S. market] tomorrow morning so we could get on with life because *it's not that big a deal*."[694]

443. Yet, despite its deepening conviction that the ban would have no impact on it, Methanex continued to press on with this arbitration in the second half of 2002 and on through 2003. The United States has therefore been forced at considerable expense to defend a claim based on a ban that, as Methanex has admitted, is of no real consequence to it.

444. Methanex's conduct in these proceedings, from the premature submission of its claim to its continued prosecution of the claim after realizing the ban was "not that big a deal," are difficult to square with the obligation to arbitrate in good faith that inheres in the arbitration agreement. As the tribunal in *S.D. Myers* noted in its decision on costs, it is appropriate for the Tribunal to take that conduct into account in apportioning the costs of legal representation and assistance under Article 40(2) of the UNCITRAL Arbitration Rules.

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[693] Transcript of Methanex 2002 Second Quarter Earnings Conference Call at 2 (18 JS tab 140 at 2659).

[694] Scotia Capital Speech at 7:25 (16 JS tab 38 at 1322) (emphasis added).

RELIEF SOUGHT

445. For the foregoing reasons, the United States respectfully requests that this Tribunal render an award: (*a*) in favor of the United States and against Methanex, dismissing Methanex's claims in their entirety and with prejudice; and (*b*) pursuant to paragraphs 1 and 2 of Article 40 of the UNCITRAL Arbitration Rules, ordering that Methanex bear the costs of this arbitration, including the United States' costs for legal representation and assistance.

Respectfully submitted,

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