IN THE ARBITRATION UNDER
CHAPTER 11 OF THE NORTH AMERICAN FREE TRADE AGREEMENT
AND UNDER THE UNCITRAL ARBITRATION RULES BETWEEN

METHANEX CORPORATION,

Claimant/Investor,

and

UNITED STATES OF AMERICA,

Respondent.

REPLY OF CLAIMANT METHANEX CORPORATION TO U.S. AMENDED STATEMENT OF DEFENSE

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I. INTRODUCTION

A. U.S. Defense

1. The U.S. Defense is characterized by five striking aspects. First, the U.S. Defense simply ignores the most important aspects of Methanex' claim. For example, the U.S. ignores Methanex' argument that "like circumstances" does not mean "identical circumstances." In fact, the U.S., Canada, and Mexico all refuse to offer any cogent definition of "like circumstances," or explain why anything more than a competitive relationship is needed to establish "like circumstances." Similarly, the U.S. ignores the fact that as a direct result of the MTBE ban, California companies such as BP, ChevronTexaco, and Shell have stopped buying methanol from Methanex and now must buy ethanol from the U.S. ethanol industry to oxygenate their gasoline. The U.S. ignores Methanex' evidence that the U.S. ethanol industry is one of the most heavily protected industries in the world, an industry that can only exist through huge subsidies and massive and corrupting political contributions. Nor does the U.S. address the secrecy surrounding, or ADM's evasions after, the Davis/ADM meeting in Decatur, Illinois.

2. This Reply will itemize the most important evidence and assertions that the U.S. ignores, (and which it should not be allowed to answer in its upcoming Rejoinder). The Tribunal should not hesitate to find that where the U.S. has not responded, it has conceded Methanex' claims.

3. Second, the State Department considers the Tribunal so naïve that it will refuse to believe that even after Davis **solicited** ADM's money, ADM received nothing in return. In contrast to the State Department's blinkered view of political reality, the U.S. Solicitor General – the highest ranking litigating attorney in the U.S. government – readily acknowledged the sordid

reality of some aspects of U.S. politics. In arguing the *McConnell* case at the Supreme Court, he referred to:

> [A] treasure trove of testimony from Members of Congress, individual and corporate donors, and lobbyists, as well as documentary evidence, establishing that contributions, especially large nonfederal donations, are given with the expectation they will provide the donor with access to influence . . . and that this expectation is often realized. . . **Former Senator Warren Rudman testified that: make no mistake about it – this money affects outcomes as well.**[1]

4. Indeed, California itself believes that the U.S. ethanol industry improperly used its political influence to subvert EPA's scientific procedures. In 1999, in return for ADM's massive contributions, Davis gave ethanol a substantial segment of the California market, and asked for an oxygenate waiver from the U.S. Environmental Protection Agency for the rest of the market. But the U.S. ethanol industry is nothing if not greedy, and it demanded the **entire** California market. And so, in California's own words, "following a national election and a change in administration, and [after] intense lobbying by the ethanol industry, the US EPA reversed course and denied California's waiver request," purportedly on scientific grounds.[2]

5. Methanex fully agrees with the State of California concerning the ethanol industry's improper influence, and it was precisely that type of improper influence – bought by ADM's contributions[3] – that triggered Davis' MTBE ban in the first place. That is how the

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[1] Brief for the Federal Election Commission et al., *McConnell v. FEC*, 2002 U.S. Briefs 1674, at 37-38 (No. 02-1674) (internal citations omitted). (21 JS tab 1 at 37-38).

[2] Petitioners' Opening Brief, *Gray Davis, et al. v. United States E.P.A. et al.*, Case No. 01-71356 (9th Cir. 2002) at 23. (21 JS at tab 2 at 23).

[3] *United States v. Andreas*, 216 F.3d 645, 650 (7th Cir. 2000) ("Top executives at ADM and its Asian co-conspirators throughout the early 1990s spied on each other, fabricated aliases and front organizations to

(continued...)

"coin-operated"[4] governor did business, and that perception of his corruption fueled one of the most humiliating recalls in American political history.

6. Third, why are there so many "empty chairs" here? Where are the witness statements of Gray Davis, John Burton, and the Andreas family? If this is a frivolous claim, and Davis' actions so routine and democratic, why won't he testify? The answer is obvious: the disgraced governor will not subject his record of pervasive corruption and influence-peddling to the crucible of cross-examination.[5] And where are Dwayne and Marty Andreas' witness statements? While it might be difficult for Michael Andreas to give credible testimony – he was only recently released from jail for price fixing – the other Andreases should be available.

7. Instead of hearing from the big fish, the key actors who surely discussed ethanol at the secret meeting, the State Department sends in only the small fry, such as Richard Vind, the ADM intermediary whom Davis approached for ADM's money, and Daniel Weinstein, a labor specialist who was at the secret meeting only by accident.

(...continued)

hide their activities, hired prostitutes to gather information from competitors, lied, cheated, embezzled, extorted and obstructed justice."). (21 JS tab 3 at 650).

[4] Republican gubernatorial candidate Bill Simon called Governor Davis the "coin-operated governor" during Davis' reelection campaign, and Californians widely adopted the telling description. *See, e.g.*, *Recall Dropouts: Will Democrats Deny Voters an Alternative?*, Sacramento Bee, July 13, 2003, at E4 ("No one in California thinks less of Gray Davis as governor than the top Democrats who know him best. They know he can't lead. They know he stands for little more than his own survival. They know the description of Davis at "the coin-operated governor" is right on the mark.") (21 JS tab 4 at E4).

[5] Moreover, the State Department cannot credibly argue it has no control over Davis. The U.S. could have agreed to evidence gathering pursuant to 28 U.S.C. § 1782, and could thus have compelled his testimony. Having resolutely blocked all evidence gathering, the U.S. bears the risk of adverse evidentiary inferences from all these missing witnesses. (*See supra* at n. 94) (detailing State Dept. Opposition to 28 U.S.C. § 1782 procedures).

8. The evidentiary inference to be drawn from the empty chairs is not debatable: Davis and ADM executives talked about MTBE, ethanol, and methanol at the secret meeting, and they do not want to be cross-examined. And that inference amply sustains Methanex' discrimination claims.

9. Fourth, it is striking that the U.S. finds it necessary to repeatedly make statements that are, to put it charitably, economical with the truth. Thus, the U.S. characterizes the 1999 ban as a "health" measure.[6] That is false. Davis himself characterized the ban as an "environmental" measure, not a health measure. The difference is important, for falsely characterizing the ban as a health measure implies an urgency and a justification that simply did not exist. The fact that Davis and California allowed MTBE to continue to be used during the phase-out period of almost five years demonstrates conclusively MTBE was not a "health" issue, but was a decision taken for political and protectionist reasons alone.

10. Similarly, the U.S. labels MTBE as "toxic."[7] That is also false. Under relevant U.S. law, "toxic" means "any substance (other than a radioactive substance) which has the capacity to produce personal injury or illness to man through ingestion, inhalation, or absorption

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[6] *See e.g.*, Executive Order D-5-99 (1999) at 1 ("Now, Therefore, I , Gray Davis, Governor of the State of California, do hereby find that 'on balance, **there is significant risk to the environment** from using MTBE in gasoline in California'") (emphasis added) at http://www.arb.ca.gov/fuels/gasoline/oxy/eod599.pdf (last accessed Feb. 16, 2004) (21 JS tab 5 at 1). *See also, e.g.,* Amended Statement of Defense at ¶ 412 ("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.")

[7] *See id* ¶ 39, n.53. ("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.")

through any body surface."[8] The U.S. EPA has the power and the duty to ban or control toxic substances. It began an examination of MTBE in 2000, but even after four years it has not and cannot conclude that MTBE is toxic. Canada's Minister of the Environment has also concluded, since the California ban, that MTBE is not toxic:

> [T]he federal Minister of the Environment and the federal Minister of Health and Welfare have concluded that the predicted concentrations of MTBE in the environment in Canada do not constitute a danger to the environment or to the environment on which human life depends, or to human life or health. **Therefore, MTBE is not considered to be "toxic"** as defined under Section 11 of the *Canadian Environmental Protection Act*.[9]

Finally, the European Union, in its refusal to ban MTBE, concluded that "the risk of severe toxic effects is…insignificant" for oral and dermal exposures; "it is not foreseen that toxic effects occur" even with repeated exposure to MTBE; and "MTBE is not considered to cause adverse health or ecotoxic effects [the] taste and odor threshold level."[10] Thus, there is no persuasive evidence MTBE is toxic.

11. Finally, the State Department's strident and shrill terminology is part of a pattern of inflammatory remarks unbecoming any litigant and inconsistent with the substantive nature of

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[8] 15 U.S.C. § 1261(g) (2003), at 2. (U.S. law definition of toxic.) (21 JS tab 6 at 2).

[9] *See* Canadian Environmental Protection Act 1992 at v (21 JS tab 7 at v); *see also*, 1999 CEPA, which requires that the Ministers of Environment and Health prepare a list of substances that should be given priority for assessment to determine whether they are "toxic" as defined under Section 64 of the Act. (21 JS tab 8 at 28). This list is known as the Priority Substances List (PSL) (Priority Substances Assessment Program, Priority Substance List at << http://www.ec.gc.ca/substances/ese/eng/psap/psl1-1.cfm.>> (Last accessed Feb. 15, 2004) (21 JS tab 9 at 1-2).

[10] European Chemicals Bureau, *European Union Risk Assessment Report: Tert-Butyl Methyl Ether* (2002), at 179, 183, 233, 237, 238, & 244. << http://ecb.jrc.it/documents/existing-chemicals/risk_assessment/report/mtbereport313.pdf >> (21 JS tab 10 at 179, 183, 233, 237, 238 & 244). *See also* Council of the European Communities, Council directive 76/769EEC, July 27, 1976, at 1 (European Union does not define MTBE as "toxic.") (21 JS tab 11 at Annex I).

the issues before the Tribunal. This stridency suggests that the State Department, in order to defend this case, has adopted the tactics of the U.S. ethanol industry – deliberately misstating and distorting the facts in order to protect ethanol.[11] Such bluster usually signifies an absence of evidence.

12. As will be amply demonstrated below, Methanex is not "inventing from whole cloth," "stretching the facts" or positing "farfetched theory." Notwithstanding the extreme and unfounded rhetoric from the State Department. Methanex is seeking the Tribunal's fair and objective rulings on questions of great significance to its interests, to the interpretation of international law, and to the concept of illegal economic protectionism in particular.

B. Summary of Expert Reports and Witness Statements

1. The Third Affidavit Of Michael Macdonald

13. Attached at Volume 19 tab A to this Reply is the Third Affidavit of Michael Macdonald, a Senior Officer of Methanex Corporation who has worked with either Methanex or its predecessor companies since 1983. The affidavit details the extent of Methanex' United States investments; its United States and California sales; and the significant economic damages

[11] It bears noting that the Bush Administration is and always has been a strong supporter of massive subsidies and protection for the U.S. ethanol industry. For example, the Bush Administration strongly supports a provision in pending agency legislation that mandates a massive increase in ethanol consumption. *See Rural America Would Greatly Benefit from Energy Bill*, USDA News Release, Nov. 24, 2003 at<< http://www.usda.gov/newsroom/0395.03.html.>> (22 JS tab 12 at 1). Agriculture Secretary Ann Venemen stated in a USDA news release that "President Bush's comprehensive energy plan places significant emphasis on the use of alternative energy sources, such as ethanol and biodiesel, as part of the nation's overall energy strategy." *See Bush Administration Continues Increased Investments For Ethanol And Bioenergy Projects,* USDA News Release, Oct. 10, 2002 at<< http://usda.gov/news/releases/2002/10/0458.htm .>> (22 JS tab 13 at 1).

sustained by Methanex as a direct result of California's MTBE ban. Specifically, the Third Affidavit:

- Establishes **again** the investments that Methanex has made in the United States.
- Describes the damages incurred by Methanex Fortier as a result of the California MTBE ban, which caused first the continued idling and eventually the permanent closing of Methanex Fortier.
- Shows that the U.S. assertion that Methanex is a "small operation" with "no significant assets," is utterly false:
    - Methanex U.S.' value exceeds $100 million;
    - Methanex U.S. 1998-2002 sales exceeded $1.6 billion;
    - Methanex U.S.' inventory in 2002 alone was $54.5 million;
    - Methanex U.S. had more than $80 million in income from 1994 to 2002;
    - Methanex U.S. has paid tens of millions of dollars for customer lists and similar items of goodwill.
- Defeats the U.S.' assertion that the January 1999 drop in Methanex' share price was unrelated to the MTBE ban, by showing that independent investment analysts unanimously attributed pre-MTBE ban share price declines to the threatened California ban.
- Shows that the MTBE ban directly damaged Methanex because it was the direct cause of a downgrade in Methanex' credit rating.
- The remainder of the Third Macdonald Affidavit corrects mistakes, inaccuracies, and omissions in the testimony of the U.S. expert, Bruce F. Burke, such as the following mistakes.
    - Burke's definition of oxygenate, if adopted, would result in ethanol's exclusion from that category.
    - Burke fails to note that MTBE is used to safely and successfully treat gallstones in humans, without reported side effects.
    - California's statutorily mandated list of known human carcinogens lists ethanol, and not MTBE, as a carcinogen.

- Burke's failure to note that, while methanol is not currently used as a vehicle fuel in Brazil, it was a significant component of Brazil's vehicle fuel pool in the mid 1990's.

- Burke seems unaware of the fact that the EPA has concluded that on balance, methanol is safer than gasoline.

- Burke's report contains numerous, minor scientific and factual errors which should be recognized and considered when reflecting upon the weight his testimony warrants in these proceeding.

2. The Ward Rebuttal Report

14. Attached at Volume 20 tab B, is the Rebuttal Report of Dr. Herb Ward, which establishes that:

- Dr. Fogg is simply wrong about MTBE biodegradation: it is, in fact, generally biodegradable in aquifers by naturally occurring microorganisms in the presence of oxygen.[12]

- Dr. Happel, in fact, confirmed this result when she demonstrated that subsurface microorganisms can and do degrade MTBE under appropriate environmental conditions.[13]

- Dr. Fogg does not understand BioRemedy, otherwise he would have recognized that addition of microorganisms to help breakdown MTBE is unnecessary.[14]

- The UC-Study authors lacked the technical understanding of microbiology to assess the potential role of biodegration to limit MTBE plume migration.[15]

- There are commercially available systems designed to control the risks of small MTBE releases from underground storage tanks.[16]

- The decision to ban MTBE and mandate ethanol as a replacement cannot be justified on a scientific or technical basis.[17]

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[12] *See* Rebuttal Expert Report of Herb Ward, February 19, 2004 at 2, 6 (20 JS tab B at 2, 6).

[13] *See id.* at 14.

[14] *See id*. at 20, 22, 27 (20 JS tab B at 20, 22, 27).

[15] *See id.* at 28 (20 JS tab B at 28).

[16] *See id.* at 27 (20 JS tab B at 27).

3. The Rausser Rebuttal Report

15. Attached at Volume 20 Tab A, is the Rebuttal Report of Professor Gordon Rausser, which establishes the fundamental flaws in Whitelaw's after-the-fact justification for the California MTBE ban. Specifically:

- Whitelaw's own estimates of the net costs of an MTBE ban – $270 million annually – continue to show that ethanol as a fuel additive is far more costly to society than MTBE as a fuel additive.
- Whitelaw's justification for the MTBE ban is seriously and self-evidently flawed because he begins with the conclusion that California must have considered benefits not found in the record. Whitelaw then presents new cost categories and other reasons, such as alleged risk aversion, that California never considered and that provide only "after-the-fact" justifications.
- Whitelaw's report ignores the overwhelming weight of the evidence that MTBE is not a health risk, and ignores all the evidence that ethanol's adverse health impacts outweigh any posed by MTBE.
- The best information available at the time of the ban did not justify it; information available since the ban was introduced further repudiates it: MTBE mitigation is less costly, gasoline prices are higher, and other costs of the ban are higher.
- Ethanol is a health risk.

4. The Williams Rebuttal Report

16. Attached at Volume 20 Tab C , is the Rebuttal Report of Dr. Pamela Williams, which rebuts the erroneous claims made by the U.S. and by its experts, Drs. Fogg, Happel, and Simeroth. Dr. Williams establishes that:

- Dr. Fogg's "cumulative detections" analysis of MTBE groundwater detections is statistically flawed, because it will **always** show an increase in MTBE detections over time, even if detections have dropped to near zero.

(...continued)

[17] *See id*. at 2 (20 JS tab B at 2).

- Dr. Fogg's annual estimate of MTBE groundwater detections is grossly misleading because it does not take into account the growing number of groundwater sources sampled in recent years.

- Dr. Fogg incorrectly claims that Methanex' groundwater analysis included uncontaminated sources.

- Dr. Fogg erroneously concludes that MTBE does not biodegrade, and thus incorrectly concludes that MTBE plumes are lengthening.

- Dr. Happel's estimate of potential MTBE impacts from leaking underground storage tanks is biased and ignores the typical pattern of underground plume development.

- The U.S. and its experts assume that MTBE, but not ethanol, is a human carcinogen; the overwhelming weight of the evidence shows that the opposite is true.

- Contrary to the U.S. expert conclusions, actual data shows that ethanol has increased air pollution in California.

II. THE UNITED STATES' RESPONSE IGNORES OR MISSTATES KEY FACTS AND ALLEGATIONS IN METHANEX' STATEMENT OF CLAIM

A. The Reality of the Oxygenate Market

17. In its Second Claim, Methanex established that methanol competes directly with ethanol, especially in the integrated refiner market segment, and that the MTBE ban ended these sales in California and in – other states that have imitated the California precedent.[18] This key evidence of a direct competitive relationship compels three legal conclusions (discussed in detail in the legal section below):

(1) methanol producers are "in like circumstances" with ethanol producers;

(2) an intent to favor ethanol producers implies an intent to harm methanol producers; and

[18] The following States have introduced measures to phase-out the use of MTBE: Arizona, California, Colorado, Connecticut, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Michigan, Minnesota, Missouri, Nebraska, New Hampshire, New York, Ohio, South Dakota and Washington.

(3) because the MTBE ban directly caused the end of Methanex' methanol sales to integrated refiners, Methanex has been directly and severely damaged by the ban.

Rather than confronting this evidence with some degree of intellectual honesty, the U.S. response has been to either ignore it or misstate it, evidently hoping to deflect its force. But when viewed closely, the evidence persuasively and conclusively supports Methanex' claims.

1. Integrated Refiners Have A Binary Choice: Methanol or Ethanol

18. In its Second Claim, Methanex demonstrates that integrated refiners[19] have a binary choice.[20] They can buy methanol to oxygenate their gasoline by combining it with isobutylene, or they can buy ethanol and splash blend it at their distribution terminals.[21] These integrated refiners do not buy MTBE to oxygenate their gasoline so, for these buyers, ethanol competes with methanol, not MTBE.

19. In response, the U.S. argues that Methanex' binary choice argument is "without support"[22] because integrated refiners cannot choose to splash-blend ethanol. That is false.

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[19] Integrated refiners that buy methanol to oxygenate their gasoline are the largest group of MTBE producers in the U.S., larger than merchant or TBA producers. *See* MTBE, Oxygenates, and Motor Gasoline, Energy Information Administration, U.S. Department of Energy at << http://www.eia.doe.gov/emeu/steo/pub/special/mtbe.html >> (last accessed Feb. 15, 2004) (22 JS tab 14 at 6-7) (reporting MTBE plant capacity for integrated refiners of 102,000 barrels per day versus 87,000 for merchant producers and 43,000 for TBA producers).

[20] *See* Second Amended Claim at ¶¶ 78-80 (integrated refiners have a binary choice of oxygenates); *see also* Second Macdonald Aff. at ¶ 9 (Nov. 5, 2002) (noting refiners may choose to splash blend ethanol instead of producing MTBE) (Second Amended Claim Ex. A).

[21] *See, e.g.*, Second Amended Claim at ¶ 304 ("methanol and ethanol … both compete directly for customers in the oxygenate market."). *See* Witness Statement of James W. Caldwell at ¶ 27. (13 JS tab C at 7) (permitting the sale of four oxygenates in the U.S. other than MTBE and ethanol: TAME, ETBE, DIPE, and TBA); *see also* Amended Statement of Defense at ¶ 24 (conceding that TAME, ETBE, DIPE, and TBA are used "infrequently" or "little, if at all.").

[22] Amended Statement of Defense at ¶ 164.

Evidence submitted and relied upon by the U.S. itself establishes that integrated refiners such as ChevronTexaco and ExxonMobil commenced ethanol splash blending beginning in 2003:[23]

> [E]thanol has been successfully introduced into CaRFG by most California refiners. Conoco proceeded in advance of the original MTBE phaseout date in 2002 … In early 2003, ExxonMobil, ChevronTexaco in Southern California, BP and Shell commenced ethanol blending. With ChevronTexaco in Northern California, Valero and Tesoro completing their transition to ethanol by December 31, 2003[.][24]

This U.S. evidence alone is sufficient to support Methanex' claims of a binary choice and a directly competitive relationship.

20. Moreover, a close examination of the U.S. Defense reveals how the U.S. has distorted Methanex' evidence while failing to rebut it. The U.S. pretends that integrated refiners, such as Chevron, Exxon, Tesoro, Valero, and ARCO are actually not integrated as part of a corporate group, but instead that the refineries and distribution divisions are totally separate and independent companies.[25] Consequently, the U.S. implies that even if ChevronTexaco's refineries used to buy methanol from Methanex U.S., and ChevronTexaco's distribution terminals now buy ethanol, that is not enough to show a competitive relationship between ethanol and methanol.[26]

21. The U.S. ignores the economic reality that the concept of "integrated" represents, but lacks the courage to make this argument clearly, for doing so would make its sophistry

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[23] Amended Statement of Defense at ¶ 237 n.425, *citing* California Energy Commission, *Staff Report: Ethanol Supply Outlook for California* 3 (Oct. 2003) (14 JS tab 15 at 385).

[24] *Id*.

[25] *See* Amended Statement of Defense at ¶ 164.

[26] *Id.*

obvious. The essential fact – which the U.S. evidence concedes – is that ChevronTexaco, ExxonMobil, and other **integrated** refiners – many of which were Methanex U.S. customers – were compelled to switch their purchases from methanol to ethanol because of the ban.[27] The fact that ethanol is combined with gasoline at a different point in the production/distribution stream than methanol does not alter nor eliminate this competitive relationship.

22. California itself acknowledges that it is refiners that buy ethanol to blend with their gasoline.

> Keep in mind that if refiners were to blend ethanol at 10 percent by volume, they would perform this step at the storage terminal, not the refinery. That means the refiner would ship a base gasoline with a 5.5 Rvp through the pipeline system to their terminal, then mix in the ethanol at the same time the gasoline is loaded into the tanker truck.[28]

23. Similarly, the U.S. simply ignores Methanex' testimony and documentary evidence concerning its relationship with Valero. As Mr. Macdonald stated, Valero used to buy methanol from Methanex U.S., but included in its purchase contract an opt-out clause allowing termination if the MTBE ban were implemented.[29] When the ban was finally implemented, that clause was invoked, and Methanex' sales to Valero stopped.[30] As is shown in the U.S.' own evidence cited above, Valero has switched to ethanol to oxygenate its gasoline.[31]

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[27] *See* Second Macdonald Aff. at ¶ 26 (Nov. 5, 2002). (Second Amended Claim Ex. A).

[28] Email from G. Schremp to B. Vance, dated Mar. 4, 1999 (22 JS tab 15 at 1).

[29] *See* Second Macdonald Aff. at ¶ 27 (Nov. 5, 2002). (Second Amended Claim Ex. A.)

[30] *See*, *e.g.*, *id.* (noting that, "Undoubtedly, sales of methanol for gasoline oxygenates will decrease progressively as the California MTBE ban draws nearer, as exemplified by our buyers' requirement that sales contracts include a clause that allows them to reduce or cancel methanol purchases as MTBE use is restricted.").

24. The refiners also think of themselves as integrated.

> [M]y name is Steve Smith. I'm with Phillips Petroleum. . . . Phillips, as was discussed earlier, is blending a significant amount of ethanol in California today. And, in fact, we did issue a press release – I hope you had a chance to look at it – saying that all 1,500 **of our Union 76 sites** in the State today are converted to a non-MTBE gasoline. So that means we're using a lot of ethanol today. So we're proud of going non-MTBE already.[32]

Moreover, there is no doubt that integrated refiners own the terminals.[33]

25. Thus, the evidence unrebutted by the U.S. conclusively proves the competitive relationship between ethanol and methanol and the direct damage caused by the ban.

2. Methanol Is An Oxygenate Used In The Manufacture of RFG and Oxygenated Gasoline

26. Methanex showed in the Second Amended Claim that the relevant economic sector in this case is the market for oxygenates used in the manufacture of RFG and oxygenated

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(...continued)

[31] California Energy Commission, *Staff Report: Ethanol Supply Outlook for California* 3 (Oct. 2003) (14 JS tab 15 at 385).

[32] *See Non-MTBE Gasoline Now Available at all California 76 Stations*, *Phillips Petroleum Company Press Release*, July 22, 2002. << http://www.phillips66.com/newsroom/mainpages/rel399.htm>> (22 JS tab 16 at 1). *CARB Board Meeting,* Meeting Minutes, dated (July 25, 2002) at 103 (22 JS tab 17 at 103) (emphasis added) at << http://www.arb.ca.gov/board/mt/mt072502.txt >> (last accessed Feb. 17, 2004); *see also*, *e.g.*, *MTBE: BP to Complete Calif. Ethanol Switch by 2003* Greenwire (May 3, 2002) (noting BP will make the transition to ethanol "at **its** 1,200 Arco gas stations statewide") (emphasis added) (7 JS tab 112 at 1).

[33] *See Use of Ethanol in California Clean Burning Gasoline: Ethanol Supply/Demand and Logistics*, Report Prepared for the Renewable Fuels Association by Downstream Alternatives, Inc., dated Feb. 5, 1999, at Table 9 (22 JS tab 18 at 333-335) (listing terminals by geographic areas owned by integrated refiners and projecting time required to offer ethanol). *See also* Phillips Petroleum Company 2001 Annual Report, at 20. ("Phillips also plans to make capital improvements to enhance its refining capabilities. As an example, a project at the company's San Francisco area refinery will allow the facility to broaden its crude slate and process more California") (22 JS tab 19 at 20).

gasoline.[34] It further showed that methanol is the essential oxygenating component in RFG and oxygenated gasoline using MTBE. Without methanol, MTBE is not an oxygenate.[35]

27. In response, the U.S. did not attempt to define the relevant economic sector or market. Instead, it made two responses designed more to confuse than clarify. First, it pretends at great length that methanol is not an oxygenate at all, despite the fact that the U.S. EPA has long considered it one:[36]

[34] *See, e.g.*, Second Amended Claim at ¶¶ 77-83 (noting that oxygenate consumers have a binary choice between methanol and ethanol).

[35] *See* Second Macdonald Aff. at ¶ 10 (Nov. 5, 2002) (explaining that the alcohol methanol adds the oxygen component to the final product) (Second Amended Claim Ex. A).

[36] Oxygenate Identification, Underground Storage Tanks, U.S. Environmental Protection Agency at << http://www.epa.gov/swerust1/oxygenat/oxytable.htm >> (last accessed Feb. 12, 2004) (22 JS tab 20 at 1) (identifying methanol as an oxygenate).

U.S. Environmental Protection Agency

Underground Storage Tanks

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Oxygenate Identification

Oxygenate	Names	CAS #	Chemical Formula	Molecular Weight
Methanol	Methyl alcohol Carbinol Methylol Methyl Hydroxide Monohydroxy methane Wood alcohol	67-56-1	CH_4O CH_3-OH	32.042
Ethanol	Ethyl alcohol Anhydrol Alcohol Methyl carbinol Ethyl hydrate Ethyl hydroxide Denatured alcohol Grain alcohol	64-17-5	C_2H_6O CH_3CH_2-OH	46.069
TBA	tertiary-butyl alcohol tert-butyl alcohol t-butyl alcohol 2-Methyl-2-propanol 1,1-Dimethyl ethanol Trimethyl carbinol 2-methylpropan-2-ol tert-Butanol t-butyl hydroxide Trimethyl methanol Dimethyl ethanol Methyl-2-propanol	75-65-0	$C_4H_{10}O$ $(CH_3)_3C$-OH	74.122

28. Finally, in paragraph 153, the U.S. grudgingly concedes that "methanol belongs to a class of chemicals known as oxygenates."[37] That belated concession, of course, conclusively proves Methanex' point – that methanol provides the *essential* oxygenating element of RFG and

[37] Amended Statement of Defense at ¶ 153. ("Methanex' evidence shows only as a technical matter, methanol belongs to a class of chemicals known as oxygenates.")

oxygenated gasoline,[38] and, as described above, integrated refiners in the past could choose between two oxygenates: methanol and ethanol, in order to oxygenate RFG and oxygenated gasoline. That these oxygenates compete directly in the same market is illustrated by the fact that the specialized media covering this sector routinely track both Methanex and ADM,[39] and the prices of both MTBE and methanol.[40] Before the ban, integrated refiners chose methanol to oxygenate their gasoline; now they are compelled to buy ethanol.

29. The second distorting response of the U.S. is to pretend that Methanex' case hinges on the premise that methanol can now be used as an oxygenate by **directly** splash blending it with gasoline. That is not Methanex' primary case. Methanex' primary argument is that methanol is, through MTBE, already used as an oxygenate in the manufacture of RFG and oxygenated gasoline, and, as described above, in the eyes of refiners methanol competes directly with ethanol.

30. Methanex' secondary argument is that California's ban on direct use of methanol is **further evidence** of its intent to discriminate against and harm all non-ethanol producers, including methanol producers.

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[38] *See* Second Amended Claim at ¶ 12 (describing methanol as "the essential oxygenating element of MTBE").

[39] *ADM, Methanex Face Drop in Quarterly Earnings*, Oxy-Fuel News (Feb. 3, 2003) (14 JS tab 1 at 1).

[40] *Experts Say Methanol Prices to Start Retreat in Early 2001*, Gas-to-Liquid News (Nov. 10, 2000) (16 JS tab 47 at 7); *See, e.g., Market Dynamics*, DeWitt "MTBE & Oxygenates" Report, Issue 906, Jan. 8, 2004, at 5 (reporting prices for methanol and ethanol) (22 JS tab 21 at 5); *Market Dynamics*, DeWitt "MTBE & Oxygenates" Report, Issue 905, Dec. 31, 2003, at 3-4 (reporting prices for methanol and ethanol) (22 JS tab 22 at 3-4); *Market Dynamics*, DeWitt "MTBE & Oxygenates" Report, Issue 904, Dec. 18, 2003, at 4-5 (reporting prices for methanol and ethanol) (22 JS tab 23 at 4-5).

31. There is no doubt that methanol can be used as automotive fuel, as has often and successfully been done:

> Methanol has for some time been considered to be a prime candidate to replace petroleum as our primary transportation fuel. Its excellent combustion properties have made it the alternative fuel of choice of the automotive industry, its power and safety benefits have prompted its use in the racing industry, its low emissions characteristics have generated considerable interest from EPA and state and local air quality agencies, and its potential for production from natural gas, coal, and renewable sources has brought it consideration from the Department of Energy as a national energy security measure. During the last few years, this widespread interest has generated various demonstration projects using pure methanol (M100) in transit buses, and M85 (15 percent of a high aromatic, high volatility gasoline blended with 85 percent methanol) in passenger cars; all with good success.[41]

The EPA has long authorized methanol's use as an automotive fuel:

> Summarizing, EPA will consider as "substantially similar" any fuel which contains up to 2.75 percent methanol [sic] with an equal volume of butanol, or higher molecular weight alcohol, and which complies with the remaining criteria of this interpretation.[42]

Indeed, California itself acknowledges that methanol can successfully be used as automotive fuel:

> Methanol is a viable substitute for both gasoline and diesel fuels in California's motor vehicles . . ., [and] the evidence is clear that methanol works as a fuel for passenger cars and light-duty trucks, as well as for buses and other heavy-duty equipment. While light-duty, methanol-fueled technology currently is more advanced than

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[41] Paul A. Machiele, "Flammability and Toxicity Tradeoffs with Methanol Fuels" U.S. Environmental Protection Agency (internal citations omitted) (emphasis original) (22 JS tab 24 at 51).

[42] *Fuels and Fuel Additives*; *Revised Definition of "Substantially Similar,"* 46 Fed. Reg. 38,582 (July 28, 1981); Caldwell Statement (13 JS tab C7 at 1).

> heavy-duty, **technically there is no question that methanol is a viable substitute for both gasoline and diesel fuel**.[43]
>
> The California Methanol Program has demonstrated methanol's potential as a strategy for lowering pollution from motor vehicles. Nearly all light-duty vehicles tested easily met stringent California standards for emissions of hydrocarbons (HC), carbon monoxide (CO), and oxides of nitrogen (NO_x).[44]
>
> Because methanol is more corrosive than gasoline to some metals and plastics used in engines and fuel systems, gathering accurate data on long-term engine durability has been a major objective of CEC's demonstration programs. While engine wear was, in fact, a problem in the early stages of the program, **fleets of 1981 and 1983 methanol-fueled Ford Escorts have shown little or no evidence of abnormal engine wear, even in a few vehicles that have logged over 100,000 miles**.[45]

32. Moreover, while the corrosive problems of methanol are greatly exaggerated by the U.S. – as the California evidence cited above shows – ethanol has precisely the same corrosive problems:

> Ethanol is corrosive. Neither neat ethanol nor gasoline blended with ethanol is allowed into interstate petroleum pipelines. One of the reasons given by the owners of petroleum pipelines for the ban is the corrosive nature of ethanol. At one time some vehicles manufacturers warned an owner's power-train warranty would be invalidated if they used gasoline blends with greater than 5 percent ethanol . . . Ethanol may be compromising advanced pollution control systems designed to eliminate evaporative emissions from new vehicles in California – calling into question the use of ethanol in the state and/or the efficacy of automotive industry

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[43] *California Methanol Program*, Evaluation Report, Vol. 1 Exec. Summary (Nov. 1986) (22 JS tab 25 at 1).

[44] *Id.* (22 JS tab 25 at 2).

[45] *Id.* (22 JS tab 25 at 6).

> efforts to meet California partial zero-emission vehicle (PZEVs) requirements which now have been adopted by five other states[.][46]

Use of methanol as a direct-blended oxygenate might well require minor adjustments by regulatory agencies, gasoline manufacturers, and automotive producers. But that is **precisely** what California allowed for ethanol but prohibited for methanol.

33. For example, California raised the oxygen content from 3.5 percent to 3.7 percent specifically to accommodate ethanol (so that the full federal tax subsidy would be available).[47] Similarly, CARB extended the winter Reid vapor pressure gasoline season by a month to assist ethanol producers:

> CARB has decided to extend the winter Reid vapor pressure gasoline season from Feb. 1 to March 1, 2003. The move will make for a smoother transition for refiners switching from MTBE to ethanol because ethanol has higher VOCs. The problem with that, MTBE proponents say, is CARB is breaking air quality rules to accommodate the "technical inferiority" of ethanol. The state has banned use of MTBE as of January 1, 2004, and virtually all refiners in the state have already launched plans to blend ethanol into gasoline.[48]

34. In contrast, California made no such allowances for competing alcohol oxygenates, such as methanol or TBA, another alcohol-based oxygenate that competes with ethanol. For example, it refused to consider methanol because:

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[46] *Ethanol Blends May Corrode Zero-Emission Vehicle Systems*, *InsideEnergyPolicy.com* (Feb. 9, 2004) at 12. (22 JS tab 26 at 1-2) (attributing information to government and industry sources). <<http://fuelsandvehicles.com/secure/fuels/fuels_docnum.asp >>

[47] *See* CEC, *Biomass-to-Ethanol Report 1999*, at II-7 (2 JS tab 8 at II-7) (describing the volume limit – the oxygen requirement – as one "of the more important aspects … affecting the use of ethanol").

[48] *CARB Extends Higher Emission Winter Blend To Prepare For Ethanol*, InsideEnergyPolicy.com, (Jan. 22, 2003) <<http://fuelsandvehicles.com/secure/fuels/fuels_docnum.asp>> (22 JS tab 27 at 1).

> Methanol, as an additive, has an additional problem in terms of its solubility in water. If the blend of gasoline with methanol comes in contact with water, methanol separates from the gasoline, rendering the gasoline out of compliance.[49]

But ethanol has precisely the same problem.

35. Although there was no evidence comparing ethanol to methanol and TBA and finding ethanol superior, California refused to even consider accommodating methanol and TBA for a simple reason: in order to satisfy the U.S. ethanol industry, it was determined to create, by regulatory fiat, a market in which only ethanol could compete. Consequently, its ban of methanol and other competing alcohols underscores its discriminatory and protectionist intent.

3. California And The U.S. Knew That An MTBE Ban Would Damage Methanex

36. There is no dispute that both California and the U.S. foresaw that the MTBE ban would severely damage Methanex. Methanex has provided in the Supplemental Wright Affidavit direct evidence that California was fully aware that the measures would harm the U.S. ethanol industry's foreign competitors.[50] In particular, Methanex showed that Senator John Burton, the President *Pro Tempore* of the California Senate knew well in advance of the announcement of the ban that Methanex was going to be severely damaged. In his colorful,

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[49] CEC, *Supply and Cost of Alternatives to MTBE in Gasoline* (Feb. 1999) (emphasis added) (3 JS tab 16 at 424).

[50] *See* Supplemental Affidavit of Robert T. Wright, Jan. 29, 2003 ("Wright Suppl. Aff.") at ¶ 3 ("Senator Burton stated that if one wanted to benefit from the direction in which MTBE was headed, they could sell Methanex stock short.") (12 JS tab A at 2).

candid words: "You're _____ ed."[51] He also advised those with this inside information to short Methanex stock.[52]

37. The U.S. does nothing to effectively rebut this evidence, asserting that Methanex' evidence is unreliable and that Burton's comments lack "context."[53] Attached to the Third Macdonald Affidavit are contemporaneous documents that fully corroborate Burton's statements. For example, "I arranged a meeting for all of the lobbyists (Lebman, Brokaw, Van Austen) and Ned Giffith with Burton. He was very blunt about the negative atmosphere surrounding MTBE. He said that we'd better work with Byron Sher as the most realistic hope for salvaging any use for MTBE."[54] "I think John Burton's comments accurately reflected the general belief in the legislature that MTBE will be phased out within a fairly quick time frame."[55] A second contemporaneous memorandum stated "[h]owever, for the most part, the members told us they believe the phase-out is inevitable. . . . Burton was perhaps the most candid legislator to date, suggesting in only two words that a phase-out is inevitable."[56]

38. The "context" could not be more clear: Burton's statements are corroborated and unrebutted direct evidence that one of the key California actors knew that Methanex, a foreign

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[51] *Id.*

[52] *Id*.

[53] *See* Amended Statement of Defense at ¶¶ 127-28.

[54] *See* Third Macdonald Aff. at ¶ 33; (Memorandum from Susan McCabe of Brady & Berliner, to John Lynn, Jan. 31, 1999) (19 JS tab A13 at 1).

[55] *Id.* at 2.

[56] Third Macdonald Aff. at ¶ 33; (Memorandum from Rose & Kindel to MTBE Team) (Jan. 29, 1999) at 1. (19 JS tab A14a at 1).

methanol producer, was going to be immediately damaged by the ban. The only reasonable inference to draw from this evidence is an intent to harm Methanex.

39. The U.S. also does not dispute the EPA acknowledgment that "the use of domestic, renewable ethanol would clearly reduce high value energy imports relative to imported methanol or MTBE."[57] Nor does it deny that the EPA recognized that assisting ethanol producers meant harming methanol producers: "Revenues and net incomes of domestic methanol producers and overseas producers of both methanol and MTBE would likely decrease due to reduced demand and prices."[58]

40. In short, the harm to foreign methanol producers – and Methanex in particular – from an MTBE ban was not only probable but foreseeable and actually foreseen.

B. Gray Davis and the U.S. Ethanol Lobby

41. The U.S. response to Methanex' argument that the MTBE ban was the result of ADM's undue influence on Davis is both disingenuously naïve and utterly inconsistent with the findings of the U.S. Department of Justice and the U.S. Supreme Court concerning the corrosive influence of large campaign contributions. Those findings, when combined with the undisputed facts of this case, allows only one reasonable inference: Davis reached out and solicited money from the U.S. ethanol industry, and in return, he put into place measures designed to eliminate

[57] Regulation of Fuels & Fuel Additives: Renewable Oxygenate Requirement for Reformulated Gasoline, 58 Fed. Reg. 68,343 (Dec. 27, 1993) (codified at 40 C.F.R. § 80) (emphasis added) (22 JS tab 28 at 68,343).

[58] *Id.* at 68,350 (emphasis added).

foreign oxygenate competition and hand the U.S. ethanol industry the California oxygenate market.

1. The U.S. Government Findings on Political Corruption

42. Before turning to the specific facts of this case, it is important to understand what the U.S. government actually believes about the effect of large political donations – not what it professes to believe when its ox is in danger of being gored. In Methanex' Motion for Reconsideration, filed with the Tribunal on January 31, 2004, Methanex set out the factual findings of the U.S. Supreme Court in *McConnell v. FEC* concerning political corruption, and it will not repeat those factual findings here.

43. As the Tribunal is surely aware, the Supreme Court made those factual findings because the Solicitor General of the United States – the highest-ranking litigating officer in the U.S. – argued that, as a matter of fact, undue influence and political corruption inexorably follow large contributions. Specifically, the Solicitor General relied upon:

> [A] treasure trove of testimony from Members of Congress, individual and corporate donors, and lobbyists, as well as documentary evidence, establishing that contributions, especially large nonfederal donations, are given with the expectation they will provide the donor with access to influence federal officials, that this expectation is fostered by the national parties, and that this expectation is often realized." **Former Senator Warren Rudman testified that** "large soft money contributions in fact distort the legislative process" because "they affect whom Senators and House members see, whom they spend their time with, what input they get, and **make no mistake about it—this money affects outcomes as well**." One lobbyist testified that "the amount of influence that a lobbyist has is often directly correlated to the

> amount of money that he or she and his or her clients infuse into the political system.[59]

The Solicitor General also indicated that "an elected official might be tempted to favor the interests of persons who have given (or might be expected to give) large sums to his own campaign."[60]

44. Thus, in a more truthful arena, the U.S. conceded that large political contributions can and do buy undue influence. Those are the undeniable facts concerning the American political system, not the State Department's implausible characterization of the rights of citizens to petition their government.

2. The U.S. Ethanol Industry Is One of the Most Heavily Protected and Subsidized in the World

45. The U.S. does not deny two of the critical facts in this case: that the U.S. ethanol industry is one of the most heavily protected and subsidized industries in the U.S. and the world, and that it obtains this protection and support through political contributions and influence.

46. The U.S. does not deny the existence of a truly astonishing range of subsidies and protective measures designed to benefit U.S. ethanol.[61] As is set forth in detail below, this pervasive regime of subsidies and protection breaks numerous WTO obligations and could well subject the U.S. to retaliation if countries damaged by this protection, bring WTO challenges.

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[59] Brief for the Federal Election Commission, *et al*., *McConnell v. FEC*, 2002 U.S. Briefs 1674, at 37-38 (No. 02-1674) (internal citations omitted) (21 JS tab 1 at 37-38).

[60] *Id.* at 31-32.

[61] *See* Second Amended Claim at ¶ 206, *citing Ethanol Not Doing Job*, Chicago Daily Herald, June 25, 2000, at 16 (7 JS tab 93 at 16); *id*., *citing* J. Bovard, *Corporate Welfare Fueled by Political Contributions*, Business & Soc'y Rev., No. 94, June 22, 1995, at 22 (7 JS 81 at 22); *id., citing* J. Lieber, *Rats in the Grain: The Dirty Tricks and Trials of Archer Daniels Midland* 99 (2000) (6 JS tab 70 at 99).

47. The U.S. does not deny that ADM is not only "the largest beneficiary" of federal tax subsidies for ethanol,[62] but also "the most prominent recipient of corporate welfare in recent U.S. history."[63] Nor does it deny that ADM is "the number one recipient of corporate welfare" or that "about 43 percent of ADM's profits come from subsidized products" in the 1990s.[64] The U.S. industry's dominance of the U.S. ethanol market is not due to economic superiority or advantage, for it is generally acknowledged that Brazil produces ethanol much more efficiently.[65]

48. Indeed, the U.S. does not deny the U.S. ethanol industry would not even exist without protectionist measures by the U.S. federal and state governments. In 1997, the U.S. GAO, an investigative arm of the U.S. Congress, reported that, "[a]ccording to the analysts we contacted or whose work we read, the tax incentives allow ethanol to be priced to compete with substitute fuels, such as gasoline and MTBE; thus, *without the incentives, ethanol fuel production would largely discontinue.*"[66]

49. The U.S. does not deny that the purpose of these subsidies is, plainly and simply, to protect the U.S. ethanol industry from competition and to subsidize the farming sectors: "[E]thanol has historically been a heavily subsidized and protected industry not for its dubious

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[62] *See id., citing Ethanol Not Doing Job*, Chicago Daily Herald, June 25, 2000, at 16 (7 JS tab 93 at 16).

[63] *See id.*, *citing* J. Bovard, *Corporate Welfare Fueled by Political* Contributions, Business & Soc'y Rev., No. 94, June 22, 1995, at 22 (7 JS tab 81 at 22).

[64] *See id.*, *citing* J. Lieber, *Rats in the Grain: The Dirty Tricks and Trials of Archer Daniels Midland* 99 (2000) (6 JS tab 70 at 99).

[65] *California…Again*, DeWitt "MTBE & Oxygenates" Report, Issue 788, Aug. 16, 2001, at 1 (discussing U.S. ethanol producers' "frenzied" reaction to potential competition with cheaper Brazilian ethanol in California) (22 JS tab 29 at 1).

[66] GAO Report 97-41, *Tax Policy — Effects of the Alcohol Fuels Tax Incentives*, at *4 (Mar. 1997) (emphasis added) (3 JS tab 23 at *4).

environmental benefits, but because it increases farm income and reduces U.S. dependence on imported oil."[67]

50. And the U.S. does not deny that beyond subsidies, the U.S. ethanol industry is also heavily protected by tariffs and other political pressures aimed at neutralizing competition from foreign methanol. Ethanol imports are generally subject to an *ad valorem* tariff rate of 2.5 percent per liter and to a further tariff of 14.27 cents per liter (approximately 54 cents per gallon).[68] As a consequence, imports are very low:

Ethanol Production and Imports in the United States[69]
(Calendar Year 2002)

Production	2,300 million gallons
Imports	141 million gallons

51. Finally, the U.S. does not deny that "the ethanol industry is trying to win through political muscle what it hasn't been able to prove through clean air studies."[70] Others have clearly seen that "[b]y giving huge contributions to Democrats and Republicans, ADM makes clear that these contributions are not about ideology, beliefs or who wins the election. ADM

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[67] J. Soloway, *Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy*, 8 Minn. J. Global Trade 55, 71 (1999) (22 JS tab 30 at 71).

[68] *See* Harmonized Tariff Schedule of the United States, Revision 4, §§ 2207.10.60, 9901.00.50 (16 JS tab 54 at IV); *see also GAO Letter to Feinstein, Feb. 2002*, at 13 ("The U.S. generally has a 54 cents/gallon tariff, *which discourages ethanol imports*.") (emphasis added) (6 JS tab 67 at 13).

[69] *See* Central American Free Trade Agreement, Ethanol Provisions, Apr. 9, 2004, at 1. <<http://www.ustr.gov/new/fta/cafta/2004-04-09-agriculture-ethanol.pdf>> last accessed Feb. 19, 2004 (22 JS tab 31 at 1).

[70] T. Landis & J.B. Austin, *Commercial News*, Gannett News Service, Sept. 23, 1993 (7 JS tab 111).

contributions are given to guarantee that no matter who wins, ADM will have a place at the table—and access and influence in Washington."[71]

3. ADM and the Ethanol Lobby Instigated the California Ban

52. The U.S. does not deny that ADM and the rest of the U.S. ethanol industry instigated the MTBE ban in California. As part of its eternal campaign to create through political influence what it cannot obtain in the marketplace, the ethanol lobby actively sponsored California measures against methanol-based MTBE.[72] For instance, in January 1997, at about the time Senate Bill 521 was being drafted, Lynn Suter, ethanol's lobbyist in California, reported:[73]

> The hearing was something of a lovefest and received very good play in the legislature, the press, and in the larger community. **Every single speaker invited by the Committee to describe options to MTBE or to tout the benefits of ethanol as a market alternative was generated by the efforts of our team last year.** In addition a long list of environmental groups, business and agricultural interests attended the hearing and made comments during the 'public address' portion of the hearing. Nearly all of these speakers were also generated through our coalition building last year.

Suter went on to advise that the ethanol industry

> [w]ill probably have to become players in the campaign donation game… My intention would be to keep this participation to a

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[71] A. McBride, *Where Soft Money Hits Taxpayers Hard*, Palm Beach Post, July 26, 1998, at 1E (7 JS tab 114 at 1E).

[72] *See*, *e.g.*, Wright Suppl. Aff. (12A JS tab A22) (listing ethanol's lobbyist as the source/proponent of the bill). *See also* Second Amended Claim at ¶ 5.

[73] *See* Wright Suppl. Aff. (12A JS tab A20 at 1).

> minimum, **but I can see a $20,000 effort looming if we are to take advantage of the influence that might bring."**[74]

In fact, the industry ended up contributing more than $200,000 to obtain this "influence."[75]

53. U.S. does not deny that ADM played a central role in creating the hysteria leading up to proposal of the measures in the first place. It does not deny that:

> 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 the resulting hysteria created by ADM and conservative radio talk show hosts.
>
> Over time (1996 to March of 1999), this "created hysteria" (and the inability to promptly solve the Santa Monica [gasoline] tank and pipeline leak problem) wore out all of California's rational thinking.[76]

Two Los Angeles Times reporters investigating the ethanol industry's "shadowy world of influence peddling" described the undercover campaign as one that "serves as a cautionary tale for California consumers, who are being bombarded through radio talk shows and news outlets with information challenging the safety of the petroleum additive, which is called MTBE."[77] The U.S. disputes none of this.

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[74] *See id.*, 12A JS tab A20 at 3).

[75] *See* Second Amended Claim at ¶ 229 (detailing ADM contributions to Gray Davis from June 2, 1998 to September 24, 1999).

[76] F. Potter, *Good Politics in Iowa Won't Make Good Policy in Washington*, World Refining, Vol. 8, Issue 5, July 1, 1999 (7 JS tab 130 at 1).

[77] S. Fritz & D. Morain, *Stealth Lobby Drives Fuel Additive War*, L.A. Times, June 16, 1997, at A1 (7 JS tab 101 at A1).

4. U.S. Does Not Deny that MTBE and Methanol Are Depicted as Foreign Products by ADM and the Ethanol Lobby

54. The United States does not dispute that, as a matter of public discourse, MTBE and methanol are portrayed as foreign products.[78] ADM and the ethanol lobby have spared no effort to depict MTBE and methanol as foreign products that should be rejected in favor of ethanol. While ethanol is depicted as a domestic product of American family farms that are the "backbone of the [U.S.] economy," MTBE and methanol are portrayed as foreign products whose use only benefits foreign oil giants.[79]

55. The U.S. does not dispute that representatives of ADM have long stressed the "foreign" origins of methanol. In an interview with Lou Dobbs on CNN's *Moneyline*, Dwayne Andreas, then-Chairman and CEO of ADM, stated:

> Now, that methanol with an 'm' is a foreign product. If it's mandated in the reformulated gas, 70 percent of it, in future years, will come from Saudi Arabia, OPEC states, same places we get our oil from, and will cost billions of dollars in foreign exchange . . . .Well, ethanol means a billion dollars to American farmers, so it's Middle East versus Middle West.[80]

Elsewhere, Dwayne Andreas has similarly declared: "This is the Midwest versus the Middle East."[81]

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[78] The U.S. nitpicks one statement by U.S. Senator Mountjoy, but does not dispute the fact that MTBE and methanol are generally portrayed as foreign products. *See* Second Statement of Defense at ¶ 188.

[79] *MTBE–Losing Another Important Public Relations Battle?*, DeWitt "MTBE & Oxygenates" Report, Issue 902, Dec. 4, 2003, at 1-2. (22 JS tab 32 at 1-2).

[80] *Moneyline*: *Inflation Figures Look Promising Says Economists*, (CNN Television Broadcast Transcript #644, May 12, 1992. (7 JS tab 117 at 340).

[81] J. Bovard, *Corporate Welfare Fueled by Political Contributions*, Business & Society Review, No. 94, June 22, 1995. (7 JS tab 81 at 23).

56. The U.S. does not dispute other ethanol producers also have repeatedly referred to methanol and methanol-based MTBE as foreign products, describing MTBE as the "oil companies' oxygenate," which is made from methanol, a "mostly imported" product.[82] [83]

57. The importance of maintaining ethanol's image as a **domestic** product is reflected in the U.S. ethanol lobby's "frenzied reply" to Brazil's proposal to ship sugar-based ethanol to California. According to the U.S. ethanol lobby, "what the world needs is what their [U.S.] employers produce, not somebody else's."[84]

5. Gray Davis Meets the U.S. Ethanol Industry

58. The relationship between Davis, the U.S. ethanol industry and the California ban can only be evaluated in light of the facts described above: in U.S. politics, money buys influence; the ethanol industry exists only because of its political contributions and political influence; and in 1998, the U.S. ethanol industry was trying to increase its influence in California. The U.S. description of the relationship between Davis and the ethanol industry ignores these key realities, and disregards the overwhelming record evidence linking ADM to legislative efforts to ban its competitor, methanol-based MTBE.

59. The first key fact that emerges from the U.S. Defense is that it was then-Lt. Gov. Davis who actively solicited funds from ADM and the U.S. ethanol industry during his election

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[82] R.G. Friend, *Politics and Ethanol*, Oil & Gas J., Nov. 13, 1995, at 12 (7 JS tab 100 at 12).

[83] *Trade Patterns in MTBE*, DeWitt "MTBE & Oxygenates" Report, Issue 810, Jan. 24, 2002, at 1. (22 JS tab 31 at 1) (indicating that most MTBE imports come from the Mideast, Canada, and Latin America).

[84] *California…Again*, DeWitt "MTBE & Oxygenates" Report, Issue 788, Aug. 16, 2001, at 1. (22 JS tab 29 at 1).

campaign in 1998. Richard Vind[85] admits in his affidavit that he acted "[i]n response to Gray Davis' request for a meeting with ADM."[86] Davis undoubtedly knew that ADM could be counted upon to pay generously, and Vind and ADM were predictably responsive to Davis' solicitation: ADM made an initial contribution to Davis' gubernatorial campaign and quickly scheduled a secret meeting between Davis and ADM's top ethanol executives.[87]

60. There can be no serious doubt about what prompted this initial encounter: Davis wanted money and ADM wanted to influence Davis' future decisions. As noted above, in the words of its lead lobbyist in California: "we will probably have to become players in the campaign donation game. My intention would be to keep this participation to a minimum, but I can see a $20,000 effort looming **if we are to take advantage of the influence that might bring."**[88] This language demonstrates beyond doubt that ADM and the ethanol lobby intended to make huge political contributions precisely to influence Davis' decisions and obtain favorable treatment.

61. Second, the U.S. does not deny that Davis, Senator Burton, ADM, and Vind all kept the existence of this meeting secret. In fact, in his campaign finance filings, Davis reported

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[85] Vind has a notorious history of making cash donations to politicians to obtain help for his ethanol companies. As reported by A. Piore, *Donor with Big Needs Turns to Torricelli*, The Record, August 2, 1998, at 1. Vind made numerous contributions to former Senator Robert Torricelli, who, like Davis, was exiled from politics because of allegations of corruption. (22 JS tab 34 at 1).

[86] *See* Statement of Richard Vind ("Vind Statement"), at ¶ 7 (attested Nov. 21, 2003) (13A JS tab I at 2) (stating that he contacted Marty Andreas).

[87] *See id.*; *see also* Second Amended Claim at ¶ 229, *citing* ADM's Independent Expenditure Committee & Major Donor Committee Campaign Statements (Jan.1, 1998 - Sept. 30, 1998) (7 JS tab 158 at 1).

[88] *See* Wright Suppl. Aff. (12A JS tab A20 at 3).

the August 1998 trip to Illinois as only a meeting in Chicago with "labor representatives."[89] The U.S. concedes that the only disclosure relevant to the secret meeting was the disclosure of ADM's in-kind contribution of a chartered plane flight for Davis from Chicago to Decatur, Illinois, the location of an ADM ethanol plant and senior ethanol executives. That did not, of course, disclose the meeting itself, or its purpose. Not surprisingly, Davis' official campaign documents conspicuously fail to disclose the secret, yet lucrative 180-mile side-trip to ADM headquarters in Decatur. The omission of the secret ADM meeting was material, and intended to deceive. The only reasonable inference to draw from this secrecy is that participants had something to hide – namely influence peddling to protect the U.S. ethanol industry.

62. The U.S. does not deny that because Davis, Burton, and ADM concealed the secret meeting, it did not become public knowledge until early 2001, and once the secret meeting was revealed, ADM tried to evade the truth. ADM first claimed, "We don't hold secret meetings,"[90] an obviously untrue statement from a convicted price fixer. Only five days later, ADM conceded that it had met with Davis, but claimed that the meeting was only a "get acquainted session" and that the topic discussed was ADM's "extensive food business in California," not ethanol.[91]

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[89] *See* Form 490 Schedule E (7 JS tab 157).

[90] *See* Second Amended Claim at ¶ 231, *citing Canadian Methanol Producer Alleges Deal between California Governor and Ethanol Giant ADM*, InsideEPA.com, Mar. 7, 2001, *available at* << http://www.insideepa.com/secure/features/today_feature.asp >> (7 JS tab 86 at 1); *see also* Second Amended Claim at ¶ 232, *citing* J. Carlton, *Methanex Questions Davis-ADM Meeting in Gas-Additive Case*, Wall Street Journal, Mar. 30, 2001, at B5 (7 JS tab 86 at B5).

[91] *See* Second Amended Claim at ¶ 232, *citing ADM Denies Methanex Charge on California Campaign Cash*, Reuters English News Service, Mar. 12, 2001 (7 JS tab 77 at 1).

63. Third, the U.S., persisting in its role as Pollyanna, claims this was just a "get acquainted" session. That is preposterous – Davis asked for a secret meeting for one reason only: he wanted money, as Vind himself makes clear.[92] There is no evidence that Davis had any interest whatever in ADM's meager operations in California. Furthermore, the U.S. does not deny that the documents[93] show that the ADM delegation consisted entirely of officials in the ethanol business and their superiors.[94] If ADM's food business was such an important topic of conversation, why weren't there any executives at the meeting who actually worked in that line of business?[95] The answer is obvious: this was not a "get acquainted" meeting, or a meeting to talk about food additives.

64. Fourth, it is now clear, in contrast to ADM's previous statements, that the secret meeting was about ethanol and MTBE. The U.S. does not deny that most of the participants had some specific connection to ethanol, and that no one had any line responsibility for any other sector of ADM's business. There was no vice president or marketing manager in charge of transportation, of grain merchandising, or any of ADM's extensive food businesses scheduled to attend. None of the testimony the U.S. has proffered denies that ethanol was the main topic.

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[92] *See* Vind Statement at ¶ 7 (attested Nov. 21, 2003); (13A JS tab I at 2); *see also* Second Amended Claim at ¶ 229 *citing* ADM's Independent Expenditure Committee & Major Donor Committee Campaign Statements (Jan. 1, 1998 - Sept. 30, 1998) (7 JS tab 158).

[93] Contrary to Vind's assertions, documents were never illegally taken from his office, as is attested to by the investigator who worked on this case. *See* Vind Statement at ¶ 12; s*ee also* Declaration of Robert Puglisi ("Puglisi Decl."), ¶ 4 (22 JS tab 35 at 1) ("At no time during the investigation [of the Activities of ADM and Regent International] did anyone . . . to my knowledge unlawfully obtain documents from the premises of Regent International, Richard Vind or elsewhere. In particular, at no time were documents secretly copied from Regent's office without permission.").

[94] *See id.* ¶¶ 232-33; *see also* Amended Statement of Defense at ¶ 126 (noting only that the dinner was attended by "several ADM officers").

[95] *See* Second Amended Claim at ¶¶ 232-33.

Indeed, Roger Listenberger, who was responsible for ADM's sales of ethanol in California, admitted that he spoke to Davis about MTBE as an issue in the gubernatorial campaign.[96]

65. And if ADM, Listenberger, and Vind discussed ethanol and MTBE, it is overwhelmingly likely that they talked about it in the same terms they had used previously. When Dwayne Andreas talked about ethanol, he talked about methanol and inevitably described it as a foreign product.[97] Similarly, Vind was already on record complaining about methanol as a foreign product.[98]

66. Fifth, the U.S. has refused to offer testimony from any of the key actors at the secret meeting. Neither Gray Davis, Dwayne Andreas, Allen Andreas, Marty Andreas, Rick Reising, or Bob Dineen have testified as to what was discussed.[99] The U.S. cannot argue that those witnesses are beyond its control, for the U.S. could have agreed to the use of 28 U.S.C. § 1782 to secure compulsory process for the witness. It has repeatedly and vehemently blocked the use of that procedure,[100] and by doing so subjected itself to the normal adverse inferences that are drawn from the refusal of key witnesses to testify.

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[96] *See* Statement of Roger Listenberger at ¶ 7 (Oct. 24, 2003) (13 JB tab F at 1); *see also* Vind Statement at ¶ 10 (13A JS tab I at 3) (indicating that "[t]he conversation at dinner was about Gray Davis' election campaign, and ADM's business"); *see also* Amended Statement of Defense at 13A JS Tab J, Statement of Daniel Weinstein at ¶ 6 (Nov. 18, 2003) (affirming that "ADM representatives talked about ADM's business" at the secret meeting).

[97] *See* Second Amended Claim at ¶¶ 228, 273.

[98] *See id.* at ¶ 228.

[99] The only witness statements come from minor players: Richard Vind, Roger Listenberger, and Daniel Weinstein.

[100] *See, e.g.*, Jan. 28, 2003 letter from B. Legum (arguing that Methanex must await a decision by the Tribunal before taking affirmative steps with United States domestic courts); *see also*, January 28, 2004 (continued...)

67. The adverse inferences to be drawn from these witnesses' failure to appear are unmistakable. None of the key actors testified because their statements – if truthful – would have confirmed Methanex' claims. Furthermore, their cross-examination would have established on both sides a pattern of influence-buying. ADM is notorious for buying influence, and so is Vind.[101]

68. And Davis is notorious for selling influence. ("[A] certain pattern developed. Farmers, timber company executives, leaders of the managed health care industry or other interest groups would stage fund-raising events for Davis in conjunction with their discussions of pending issues, and by some coincidence, he would soon adopt policies that found favor with the interest groups involved.")[102] Obviously, both ADM and Davis have good reason to avoid these topics: neither wants to admit that California's clean air and its oxygenate market were for sale.

69. To be clear, there was very likely no express *quid pro quo* agreement: Davis and ADM were far too sophisticated players in this sordid game to engage in such overtly criminal

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(...continued)

letter from C. Dugan (requesting that the Tribunal grant Methanex' long-standing requests to obtain additional evidence).

[101] *See* Second Amended Claim at ¶ 209 n.8, *citing* F. Greve, Knight-Ridder News Service, *Power of Political Giving: Grain magnate reaps favors*, The Denver Post, Jan. 22, 1995, at A-16 (7 JS 107 at A-16) (listing large contributions to politicians by ADM and the results obtained thereby); *see also* Wright Supp. Aff. (12A JS tab A16) (describing Vind's relationship with Senator Robert Torricelli, who responded to Vind's political contributions by acting on behalf of Vind on numerous occasions).

[102] *See* Vind Statement at ¶ 7; (13A JS tab I at 2); *see also* Second Amended Claim at ¶ 229, *citing* ADM's Independent Expenditure Committee & Major Donor Committee Campaign Statements (Jan. 1, 1998 - Sept. 30, 1998) (7 JS tab 158); Contrary to Vind's Statement at ¶ 12, documents were never illegally taken from his office, as is attested to by the investigator who worked on this case. *See* Puglisi Decl. at ¶ 4 (22 JS tab 35 at 1) ("At no time during the investigation [of the Activities of ADM and Regent International] did anyone . . . to my knowledge unlawfully obtain documents from the premises of Regent International, Richard Vind or elsewhere. In particular, at no time were documents secretly copied from Regent's office without permission.").

behavior. Such behavior is usually implicit, involving no more than a wink and a nod, but as the U.S. Supreme Court has concluded, such implicit arrangements are no less unfair and corrosive.[103] In fact, it was that type of persistent influence peddling that earned Davis the title of the "coin-operated" governor.[104] As a result of that type of money-soliciting and influence-peddling "Davis became, in the public's mind, the personification of the state's corrupted, money-driven political culture." Consequently, the people of California rejected such corruption and sentenced Davis to one of the most humiliating recalls in American political history.[105]

70. The only reasonable inference from this record is that Davis wanted large political contributions, and in exchange for them, the U.S. ethanol industry became the sole supplier for the California oxygenate market, shutting out its oxygenate competitors. Other evidentiary inferences may be possible, but none are credible, and only someone extraordinarily credulous would believe them.

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[103] *McConnell v. FEC*, No. 02-1674, slip op. at 34 (U.S. Dec. 10, 2003) (*quoting Nixon v. Shrink Mo. Gov't PAC*, 528 U.S. 377, 389 (2000)) (23 JS tab 36 at 34); *see also FEC v. Colorado Republican Fed. Campaign Comm.*, 533 U.S. 431, 441 (2001) (acknowledging that corruption extends beyond explicit cash-for-votes agreements to "undue influence on an officeholder's judgment."). (23 JS tab 37 at 441).

[104] *See, e.g.*, Second Amended Claim at ¶ 218, *citing* C. Wade, *Gray Davis: The After 5 Governor*, American Partisan, Aug. 30, 2002, *available at* http://www.american-partisan.com/cols/wade.htm (last accessed Nov. 3, 2002) (7 JS tab 142 at 2).

[105] Harold Meyerson, *Did Arnold Matter? In the end, the recall was all about Gray*, LA Weekly, Oct. 10, 2003, *available at* http://www.laweekly.com/ink/03/47/powerlines-meyerson.php (last accessed Feb. 10, 2004). (23 JS tab 38 at 1).

6. ADM Has Benefited Enormously from the MTBE Ban

71. Not surprisingly, ADM has benefited enormously from the surge in ethanol demand triggered by the California ban.[106] ADM stated that ethanol profits were up 68 percent as the company met the demand created by the MTBE ban in California.[107] According to ADM's CEO, "We [ADM] have reason to believe there is a very strong demand for ethanol across this country. We're in a strong position in the ethanol business."[108] One of the oldest legal maxims for finding truth and identifying wrongdoing is "cui bono." There is no doubt here.

C. The MTBE Ban

1. The U.S. Does Not Deny that MTBE Was Singled Out

72. Neither the United States nor California deny that MTBE was singled out for a total ban, and that MTBE did not even appear on California's list of the twenty-three contaminants found most frequently in the state's ground water.[109] In fact, as the table below demonstrates, many chemical contaminants — including known carcinogens such as benzene (which is found in every gallon of gasoline) as well as arsenic and chloride — were and continue to be "found more often and at greater concentrations in drinking water than MTBE."[110]

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[106] *See* Second Amended Claim at ¶ 205 (noting that ADM's share of the domestic ethanol market is thirty percent larger than the next seven producers *combined*, and growing); GAO Letter to Feinstein, Feb. 2002 at 22 (6 JS tab 67 at 22); *see also* P.H. Sim & S. McElligot, *Ethanol Demand to Surge on Switch from MTBE*, Chemical Week, Sept. 18, 2002, at 39 (7 JS 137 at 39).

[107] *See Archer Daniels Midland Profits Up 68 Percent*, Associated Press, Jan. 30, 2004 (23 JS tab 39 at 1).

[108] *Id.*

[109] *See* NRDC *California's Contaminated Groundwater*, Table 4, at 18 (Apr. 2001) (citing data collected by the California Department of Health Services for October 1999 to October 2000) (3 JS tab 30 at 18).

[110] *Evaluation of UST/LUST Status in California and MTBE in Drinking Water* (November 2002) ("*Exponent Report*"), Executive Summary, at xv (Second Amended Claim Ex. E at XV).

TABLE 4 [105]

Contaminants Detected Above Maximum Contaminant Levels

The Department of Health Services compiles water quality data from drinking water sources across the state. It also sets drinking water standards (MCLs) for many contaminants. This table shows those contaminants in groundwater wells that were most often detected exceeding their MCLs between October 1999 to October 2000.

Source: Department of Health Services Drinking Water database (October 1999-October 2000) as compiled by LFR Levine-Pricke.

Contaminant	Number of samples that exceeded the MCL for this contaminant
Nitrate (as No3)	1812
Manganese	989
Tricholoroethylene	650
Dibromochloropropane (DBCP)	582
Tetrachloroethylene	591
Iron	394
Carbon Tetrachloride	249
Fluoride (temperature dependent)	243
Gross Alpha	197
Turbidity, Laboratory	114
Nitrate + Nitrite (as N)	108
Color	91
Uranium	89
Ethylene Dichloroethylene	55
TDS	52
1,1-Dichloroethylene	49
1,2-Dichloroethane	38
Odor Threshold	36
Chloride	35
Arsenic	32
Benzene	27
Specific Conductance	23
Sulfate	22

[111] *See* Natural Resources Defense Council ("NRDC"), *California's Contaminated Groundwater: Is the State Minding the Store?*, Table 4, at 18 (Apr. 2001) ("*California's Contaminated Groundwater*") (citing data collected by the California Department of Health Services for October 1999 to October 2000) (3 JS tab 30 at 18).

73. At a May 2002 international conference on oxygenates, foreign delegates expressed "disbelief that a product that has little or no proven health risk could be banned without regard for the commercial impact or even a fair hearing based on science and the facts." Indeed, the foreign delegates did not understand how such a prohibition could be enacted based solely on politics.[112]

74. Similarly, the DeWitt MTBE and Oxygenates Report for October 2001 commented, "It has been said many times and many ways that the situation in California has been blown out of proportion and that decisions surrounding the banning of MTBE from that State's gasoline were based on political expediency and not science."[113]

2. The UC-Davis Study Was Known To Be Inadequate Even When Davis Banned MTBE

75. The U.S. does not deny that the UC-Davis study was known at the time Davis banned MTBE to be under funded, incomplete, and simply wrong on many critical points. For instance, as Dr. Herb Ward explains his rebuttal expert report, "the UC-Study authors lacked the technical understanding of microbiology to assess the potential role of biodegration to limit MTBE plume migration."[114] "The authors of the UC-Study appear to have applied blinders in their technical approach for recommending the ban of MTBE, even though Dr. Fogg admits in

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[112] *A Lesson Learned*, DeWitt "MTBE & Oxygenates" Report, Issue 826, May 23, 2002, at 1 (23 JS tab 40 at 1).

[113] *More from the DeWitt MTBE/Methanol Conference*, DeWitt "MTBE & Oxygenates" Report, Issue 798, Oct. 25, 2001, at 1 (23 JS tab 41 at 1).

[114] Rebuttal Expert Report of Herb Ward, Feb. 19, 2004 ("Ward Rebuttal Expert Report") at 28 (20 JS tab B at 28).

his report (Fogg 2003) that, Remediation of groundwater MTBE plumes could potentially mitigate their impact [referring to the spread of MTBE in groundwater]…" But he is seriously misinformed when he states that "…the generally unfavorable success/failure ratio in groundwater remediation does not support optimism about likelihood of widespread success in removal of MTBE for groundwater systems (NRC 1994)." Despite these known deficiencies, Davis went beyond what even the deficient study recommended.

76. First, the U.S. does not deny that the UC-Davis study was incomplete. It was supposed to evaluate all competing oxygenates, but instead singled out one—MTBE. The UC-Davis study failed to perform any analysis of ethanol or other competing oxygenates, such as methanol and TBA.[115] The U.S. does not deny that this astonishing lapse was known to Davis.

77. Second, the U.S. does not deny that the UC-Davis study itself identified the severe risks to human health associated with the switch to ethanol, particularly in regard to the increased presence of carcinogens in the environment resulting from heavier ethanol usage.[116] In stark contrast, the UC-Davis study found that concerns over the impact of MTBE on human health were merely "plausible," but had not been substantiated in studies.[117]

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[115] *See* Second Amended Claim at ¶ 112, *citing* Cal. EPA, *Public Hearing to Accept Public Testimony on the University of California's Report on the Health and Environmental Assessment of Methyl Tertiary0Butyl Ether (MTBE),* at 53:23-54:4 (Tr. Feb. 19, 1999) (5 JS tab 46 at 53:23-54:4).

[116] *See* Second Amended Claim at ¶ 112, *citing* UC Report, Vol. I, *Summary & Recommendations* § 2.3, at 19 (4 JS tab 36 at 19); *see also* Cal. EPA, *Public Hearing to Accept Public Testimony on the University of California's Report on the Health and Environmental Assessment of Methyl Tertiary-Butyl Ether (MTBE),* at 31:22-32:12 (Tr. Feb. 19, 1999) (5 JS tab 46 at 31:22-32:12) (identifying some of the risks associated with ethanol).

[117] *See* Second Amended Claim at ¶ 112, *citing* UC Report, Vol. V, *MTBE: Evaluation of Management Options for Water Supply and Ecosystem Impacts*, at 8 (5 JS tab 40B at 8).

78. Third, as the U.S. now concedes, the UC-Davis study completely bungled the cost analysis. In analyzing the costs of banning MTBE, it included sunk costs that would have to be incurred whether or not MTBE was banned. The U.S. does not deny that this was the wrong approach. More important, this defect was well-known in 1999,[118] but the UC-Davis researchers refused to change their indefensible analysis, and Davis simply ignored the defect.

79. Fourth, the U.S. ignores the fact that the UC-Davis study was heavily criticized by the U.S. government itself. The U.S. does not dispute that the U.S. EPA as well as numerous independent reports and public comments submitted to California during the public hearings, pointed out the error of attributing to MTBE alone the sunk costs of California's years-long failure to enforce its UST laws.[119] The U.S. does not dispute that the U.S. Geological Survey, as well as contemporaneous input from several other sources, warned California that it had overestimated the future rate of MTBE impacts on drinking water sources, as well as the cost of remediation.[120]

80. Fifth, the U.S. does not deny that the UC-Davis study miscalculated future leakage rates and clean-up costs. The U.S. does not deny that the UC-Davis study itself

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[118] *See* Second Amended Claim at ¶ 117, *citing UC Report: An Integral Cost-Benefit Analysis, Meeting California Phase II Reformulated Gasoline Requirements,* at 45 (5 JS tab 40G at 45); *see also* Amended Statement of Defense at ¶ 199 (conceding that the flaws in the cost analysis were known in 1999).

[119] *Expert Report of Gordon C. Rausser,* at 12, 16-17.33 January 31, 2003. (12A JS at tab F at 12, 16-17.33).

[120] *See* Second Amended Claim at ¶ 115, *citing* Cal. EPA, *Public Hearing to Accept Public Testimony on the University of California's Report on the Health and Environmental Assessment of Methyl Tertiary-Butyl Ether (MTBE)*, at 31:15-32:21 (Tr. Feb. 23, 1999) (5 JS tab 47 at 31:15-32:21).

recognized that upgrading USTs would greatly reduce future leaks.[121] As a consequence of the UC-Davis study's failure to factor this ameliorization into its costs estimates, it overstated cleanup costs by 500 percent according to the State of California.[122]

81. Sixth, the U.S. does not deny that the UC-Davis study was underfunded and incapable of completing the thorough and comparative analysis that had been mandated. The U.S. also does not deny that this deficiency was also well known at the time.[123]

82. Finally, the U.S. does not deny that the UC-Davis study, perhaps recognizing its own deficiencies, did not recommend a ban on MTBE nor its immediate replacement with ethanol. Instead it recommended further study of other oxygenates, and that in the meantime, Governor Davis "consider" phasing-out MTBE.[124] The U.S. does not deny that Davis ignored these limitations and qualifications and instead rushed to a judgment on MTBE and ethanol that was not supported by even the defective science in the UC-Davis study.

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[121] The UC-Davis report calculated that upgrading underground storage tanks would reduce gasoline leaks into groundwater by up to ninety-seven percent. UC Report, Vol. IV, *Leaking Underground Storage Tanks (USTs) as Point Sources of MTBE to Groundwater and Related MTBE-UST Compatibility Issues*, at 2 (4 JS tab 39B at 2).

[122] S. Mehta, *MTBE Phaseout Cost in Billions, Analysts Says*, L.A. Times, at 1 (Apr. 20, 2002) (quoting California Energy Commission analyst Gordon Schremp, who notes that "University of California research in 1998 projected that annual water-cleanup bills could reach $1.5 billion if MTBE were kept in gasoline, but . . . that by using new assumptions gleaned from four years of MTBE experience, cleanup costs would be less than one-sixth of that figure.") (7 JS tab 115 at B12).

[123] *See* Second Amended Claim at ¶ 112, *citing* Cal. EPA, *Public Hearing to Accept Public Testimony on the University of California's Report on the Health and Environmental Assessment of Methyl Tertiary-Butyl Ether (MTBE),* at 40:13-14 (Tr. Feb. 19, 1999) (5 JS tab 46 at 40:13-14).

[124] *See* Second Amended Claim at ¶ 112, *citing* UC Report, Vol. I, *Summary & Recommendations* § 2.3, at 13 (4 JS tab 36 at 13).

83. By admitting or failing to deny all of these deficiencies – known at the time to be deficiencies – the U.S. concedes that the UC-Davis study was an inadequate scientific basis for banning MTBE. Why, then, the rush to ban MTBE and replace it with ethanol? There is only one possible answer: Davis wanted to pay his debt to ADM by creating a market for ethanol and getting rid of all its competing oxygenates – MTBE, methanol, TBA, and others. The real problem, as it turns out, was a governor who was bought and paid for by large political contributions, and who was willing to justify drastic actions on the basis of dubious and incomplete science.

3. Governor Davis Selected Ethanol Without Comparing It to Other Oxygenates

84. Davis selected ethanol as **the** oxygenate for the California market[125] without any valid risk assessment and without comparing it to other oxygenates. As noted, despite the mandate it was required to follow, the UC–Davis study focused almost entirely on MTBE to the exclusion of all other oxygenates, failing to compare and contrast the costs and benefits of MTBE to other oxygenates.[126] On the basis of this flimsy and incomplete report, Davis mandated a complete shift from MTBE to ethanol, even though California had not yet completed sufficient or meaningful studies on ethanol or the risks and costs associated with its use. Indeed, the UC–Davis study warned that "substitutes for MTBE [must] be further evaluated before they

[125] Winston Hickox, Secretary, California EPA, *The Future of Ethanol in California's Phase 3 Reformulated Gasoline Market*, Renewable Fuels Association Meeting, Mar. 22-24, 2000, at 3 (noting that "[e]thanol is the only oxygenate currently approved for use in California gasoline in 2003"). (23 JS tab 42 at 3).

[126] *See* Second Amended Claim at ¶ 112, *citing* Cal. EPA, *Public Hearing to Accept Public Testimony on the University of California's Report on the Healthy and Environmental Assessment of Methyl Tertiary-Butyl Ether (MTBE)*, at 53:23-54:4 (admitting that no other oxygenates were studied and that no comparative analysis was performed) (5 JS tab 46 at 53:23-54:4).

are widely used as substitutes for MTBE. **To replace MTBE with an untested substitute would compound the current problem."**[127] Similarly, the California Air Resources Board recommended that "[a]n environmental assessment of ethanol, as recommended by the UC study, [] be completed prior to a significant increase in ethanol use."[128] It was not until December 1999, at the earliest that California completed an assessment of the risks and consequences of giving ethanol a monopoly on the supply of oxygenates in the California energy market.[129]

85. But Davis decided to favor ethanol long before the risk assessment was complete. In October 1999, before any valid risk assessment, a CARB official – expressly speaking "on behalf of Governor Davis" – testified before Congress. He assured Congress that after "MTBE is eliminated in California, the only feasible oxygenate will be ethanol."[130] The media recognized that the shift to ethanol was a "done deal," even though no ethanol studies had been

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[127] *See* Second Amended Claim at ¶ 116, *citing* UC Report, Vol. I, *Summary & Recommendations* § 3.11, at 28 (emphasis added) (4 JS tab 36 at 28).

[128] Memorandum from Michael H. Scheible, Deputy Executive Officer, Air Resources Board, to Bill Vance, Special Assistant to the Secretary, on "CARFG and MTBE Issues," Dec. 4, 1998, at 3. (23 JS tab 43 at 3).

[129] *See* Air Resources Board, Stationary Source Division, *Summary of Public Meeting to Discuss Issues Related to California's Phase 3 Reformulated Gasoline (CaRFG3) Regulations*, Aug. 18, 2000, at 2 (23 JS tab 44 at 2). ("The [Air Resources Board] has entered into a contract with Harold Haskew & Associates, Inc. to investigate the effects of ethanol on permeation emissions."); *see also* Winston Hickox, Secretary, California EPA, *The Future of Ethanol in California's Phase 3 Reformulated Gasoline Market*, Renewable Fuels Association Meeting, Mar. 22-24, 2000, at 3 (23 JS tab 42 at 3) (indicating that Davis only ordered health, environmental, and transportation studies on ethanol and evaluated that scientific evidence *after* he had already issued the Executive Order mandating the shift from MTBE to ethanol).

[130] Testimony of Michael P. Kenny, Executive Officer, California Air Resources Board, before the U.S. Senate Committee on Environment and Public Works, Subcommittee on Clean Air, Wetlands, Private Property Nuclear Safety, Oct. 5, 1999, at 1, 6 (23 JS tab 45 at 1, 6).

completed.[131] Significantly, even once completed, the ethanol studies remained "curiously tentative, stating repeatedly that more work will be required," which clearly demonstrates Davis' willingness to take drastic actions in spite of the dearth of scientific evidence supporting the ban on MTBE or the shift to ethanol.[132]

86. Indeed, subsequent evidence has demonstrated that shifting to ethanol has reversed the benefits of MTBE and instead increased air pollution. MTBE helped California to reduce toxic air emissions by 27 percent, benzene ambient levels by 43 percent, NOx by 8 percent, ozone emissions by 50 percent, and "ozone exceedances" by 20 percent. In contrast, "ethanol-based RFG doubled exceedances in ozone levels," and the addition of ethanol caused exceedances to increase 97 percent from 2000 and 71 percent from the prior three-year average.[133] Ethanol also "has a tendency to increase NOx emissions in automobile exhaust,…degrade drivability and increase exhaust emissions," and increase emissions of "NOx, volatile organic compounds, and carcinogens."[134] Not surprisingly, the increase in ethanol usage in California coincided with a "surge in ozone and pollution problems" after "twenty years of improving ozone conditions."[135] This phenomenon was not unique to California, for Colorado

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[131] *California Approves Phase 3 Gasoline*, DeWitt "MTBE & Oxygenates" Report, Issue 705, Dec. 16, 1999, at 1 (23 JS tab 46 at 1).

[132] *Id.*

[133] *Highlights from the 12th Annual DeWitt Global Methanol & Clean Fuels Conference*, DeWitt "MTBE & Oxygenates" Report, Issue 898, Nov. 6, 2003, at 1 (23 JS tab 47 at 1).

[134] *California Ozone Problems Continue Even As Weather Moderates*, DeWitt "MTBE & Oxygenates" Report, Issue 895, Oct. 9, 2003, at 1 (23 JS tab 48 at 1).

[135] *California Dreamin*, DeWitt "MTBE & Oxygenates" Report, Issue 885, July 31, 2003, at 1 (23 JS tab 49 at 1).

also suffered an increase in "ozone problems" (e.g., Denver exceeded federal ozone standards several times) after switching to ethanol.[136]

87. U.S. Senator Dianne Feinstein of California has publicly questioned the benefits of ethanol given the environmental harm she herself witnessed. In a letter to the Secretary of the California EPA, Senator Feinstein cited worsening air quality in southern California, including the "first smog alert in five years" and "35 days above the federal ozone standard in [the first six months of] 2003 [compared to] 21 days exceeding the federal ozone standard in all of 2002."[137] Senator Feinstein had no doubt that ethanol was "one of the main culprits" in wreaking this damage to California and its environment.[138] Indeed, Senator Feinstein warned that "new information from the [California] EPA suggests that using ethanol would actually increase smog in Southern California, which already is experiencing an unusually heavy smog season."[139] According to Senator Feinstein, "the bottom line is that it is counterproductive to force California to use ethanol in its gasoline that it does not need and is potentially detrimental to its air quality."[140]

88. Increasing ethanol use will also cause increased water pollution. Ethanol RFG is more volatile than MTBE, and this could increase the level of leaks in USTs. Greater release

[136] *When Smoke Gets in Your Eyes*, DeWitt "MTBE & Oxygenates" Report, Issue 884, July 24, 2003, at 2 (23 JS tab 50 at 2).

[137] *California Revisits Air Impacts of Ethanol After Senator Cites Concern*, InsideEPA.com, July 25, 2003 (quoting a letter from Senator Feinstein to Gordon Hickox, Secretary of the California EPA) (23 JS tab 51 at 1).

[138] *Id.*; *see also* Ron Harris, *Court Orders EPA to Review California Request for Ethanol Waiver,* Associated Press, July 18, 2003 (23 JS tab 52 at 1).

[139] *Ethanol Could Cause Worse Smog*, Daily News (Los Angeles), Aug. 7, 2003 (23 JS tab 53 at 1).

[140] *Id.*

rates will increase environmental water contamination by benzene, ethanol, and other chemicals classified as carcinogens with certainty, in contrast to MTBE.[141] In addition, evidence indicates that ethanol causes benzene plumes to lengthen because, as ethanol degrades, it depletes oxygen. This interferes with the attenuation of benzene. A report by the Lawrence Livermore National Laboratory to the California Water Resources Board cautioned that ethanol could cause a four-fold decrease in the rate of BTEX degradation and increase benzene plume lengths by 250%.[142]

89. As Dr. Ward makes clear in his rebuttal expert report:

> The decision to ban MTBE as a fuel oxygenate and mandate ethanol as a replacement cannot be justified on a scientific or technical basis because the environmental consequences of widespread use of ethanol are largely unknown. Product substitution of such magnitude is counter to commonly accepted principles of pollution prevention, which require a thorough and timely analysis of potential adverse impacts to the environment.[143]

90. Davis rushed to ban MTBE, and substitute ethanol because it was a political decision, not a scientific one.

D. Even if the Oxygenate Waiver Had Been Granted, Large Amounts of Ethanol Would Still Have Been Used in California

91. Even if the U.S. EPA had granted the oxygenate waiver sought by California, the evidence leaves no doubt that ethanol's sales in California would still have increased

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[141] *See* Expert Report of Gordon Rausser at 24, (20 JS tab A).

[142] "Environmental Assessment of the Use of Ethanol as a Fuel Oxygenate: Subsurface Fate and Transport of Gasoline Containing Ethanol. Report to the California State Water Resources Control Board," Ed. David Rice and Rosanne T. Depue, October 2001; *See* expert Report of Gordon Rausser at 30.

[143] Ward Rebuttal Expert Report at 2 (20 JS tab B at 2).

dramatically.[144] In his April 12, 1999 letter to EPA Administrator Carol Browner requesting the waiver, Governor Davis noted that elimination of MTBE would result in exclusive reliance on ethanol as an oxygenate for gasoline. In the supporting documentation attached to the letter, Governor Davis stated unequivocally that: "even with a waiver of the federal RFG oxygen mandate, **a significant portion of California gasoline would still contain ethanol**."[145] While testifying before a Congressional subcommittee in 1999, a senior CARB official, again speaking on behalf of Governor Davis, stated that "California welcomes the prospect of increased ethanol use that will almost certainly occur even without a federal mandate."[146] Similarly, in March 2000, the Secretary of the California EPA informed the Renewable Fuels Association that he expected "substantial use of ethanol in the production of California gasoline even with [the] waiver."[147] If the waiver was granted, he estimated that "California [would] need about 50 to 100 million gallons of ethanol, beyond proposed California ethanol production of 50 million gallons, to meet the South Coast's winter oxygenate needs and depending on refiners voluntary use of ethanol to replace MTBE in gasoline."[148]

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[144] "With or without an oxygenate requirement for Federal reformulated gasoline in California, a very large amount of ethanol and other outside components will have to be used to meet California's quality and volume requirements." *Another Look at Reality*, DeWitt "MTBE & Oxygenates" Report, Issue 785, July 26, 2001, at 1 (23 JS tab 54 at 1).

[145] Letter from G. Davis to C. Browner, dated April 12, 1999 (emphasis original). (16 JS tab 65 at 8).

[146] Testimony of Michael P. Kenny, Executive Officer, California Air Resources Board, before the U.S. Senate Committee on Environment and Public Works, Subcommittee on Clean Air, Wetlands, Private Property, and Nuclear Safety, Oct. 5, 1999, at 6 (23 JS tab 45 at 6).

[147] Winston Hickox, Secretary, California EPA, *The Future of Ethanol in California's Phase 3 Reformulated Gasoline Market*, Renewable Fuels Association Meeting, Mar. 22-24, 2000, at 3 (23 JS tab 42 at 3).

[148] Winston Hickox, Secretary, California EPA, *The Future of Ethanol in California's Phase 3 Reformulated Gasoline Market*, Renewable Fuels Association Meeting, Mar. 22-24, 2000, *Id*. at 3-4.

92. Thus, even if the waiver had been granted, the ethanol industry would have been awarded a huge new market.

E. Davis Intended To Establish a California Ethanol Industry

93. The U.S. does not dispute that California has long intended to create an in-state ethanol industry. The latest report by the California Energy Commission describes those efforts in detail:

> California government has, during the past two decades, provided various types of support for ethanol fuel production and use. Table 1 provides a historical summary of California's ethanol-related initiatives, none of which are in place today. The remainder of this report is intended to inform decision-makers about ethanol incentives in place in other states and at the federal level, should new consideration of support for ethanol emerge in California.[149]

[149] *Ethanol Fuel Incentives Applied in the U.S.: Reviewed from California's Perspective*, California Energy Commission Staff Report (Jan. 2004) at << http://www.energy.ca.gov/reports/2004-02-03_600-04-001.PDF >> (last accessed Feb. 14, 2004) (23 JS tab 55 at 3-4).

Table 1 Past California Ethanol Initiatives[150]	
Year	**Action**
1979-1980	Ethanol/gasoline blends demonstrated in state government fleets
1980-1983	Dedicated ethanol vehicles demonstrated in state government fleets
1980-1983	Seven state-sponsored ethanol production feasibility studies conducted
1981-1983	State-sponsored ethanol production demonstration – Raven Distillery, Fresno
1983	State-sponsored California Alcohol Fuel Plant Design Competition for on-farm ethanol production; winning project, Gildred/Butterfield facility at Paso Robles built and demonstrated
1981-1984	State excise tax incentive applied to ethanol – 3 cents/gal reduction for 10 percent ethanol blends (from 7 cents/gal gasoline tax)
1986	State grant helps establish Parallel Products ethanol production facility
1988	State legislation (SB 2637) creates a liquid fuels production incentive grant program for production of ethanol and other biofuels (no funding authorized)
1990-1994	State-sponsored Energy and Chemical Feedstock Crop Demonstration Program; studies of crops suitable for ethanol production
1991-1998	State legislative exemption for ethanol/gasoline blends from gasoline volatility standard
1997	State/federal Sustainable Technology Energy Partnership study of biomass-to-ethanol production in San Joaquin County
1998-2001	State/federal sponsorship of Gridley and Collin Pine biomass-to-ethanol projects
1999	**Governor's Executive Order banning MTBE includes directive to evaluate biomass-to-ethanol production potential and identify steps to foster ethanol development**
2001-2002	State legislation (SB 87, 2001 & SB 1728, 2002, Costa) introduced to provide $25 million of funding for liquid fuels production incentive program (not enacted)

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

As shown in the above table, two years before the MTBE ban, the CEC collaborated with the National Renewable Energy Laboratory to investigate potential biomass-to-ethanol projects in California.[151] UC-Davis's California Institute of Food and Agricultural Research ("CIFAR") was a major participant in the study.[152]

94. The U.S. does not dispute that Davis ordered – at the same time that he banned MTBE – a study to foster an in-state ethanol industry:

> The California Energy Commission (CEC) shall evaluate . . . the potential for development of **a California** waste-based or other biomass ethanol industry. CEC shall evaluate what steps, if any, would be appropriate to foster waste-based or other biomass ethanol development **in California** should ethanol be found to be an acceptable substitute for MTBE.[153]

The U.S., of course, ignores this clear evidence of Davis' specific intent to establish a California ethanol industry.

95. Moreover, the U.S. does not deny that the record is replete with evidence of California's intent to create its own ethanol industry. Shortly after the ban, in correspondence to CIFAR's Executive Director, CARB's Chairman, Alan Lloyd, concedes California's interest in developing an in-state ethanol industry:

> Ethanol use in California is expected to increase dramatically in the future. Initially, this demand will be met with Midwest imports but could eventually be met with in-state production. To explore the latter, Governor Davis directed the California Energy

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[151] CEC, *Biomass-to-Ethanol Report 1999,* at II-13 (2 JS tab 8 at II-13).

[152] *Id.*

[153] Exec. Order D-5-99 at ¶ 11 (emphasis added) available at << http://www.arb.ca.gov/fuels/gasoline/oxy/eod599.pdf >> (last accessed Feb. 16, 2004) (21 JS tab 5 at 1).

> Commission to evaluate the potential for developing a California waste-based or biomass-based ethanol industry.[154]

96. Other CARB officials are equally candid:

> To the extent that [biomass-to-ethanol] technology is shown to be commercially possible, we would like to see California biomass-to-ethanol production **derive from California biomass feedstocks**.[155]
>
> [W]e believe ethanol will play an expanded and significant role in the future production of California gasoline. To the extent ethanol will be used in California gasoline, **we prefer ethanol come, as much as possible, from California biomass**.[156]

A December 1999 CEC study claimed that a prior CEC evaluation of MTBE alternatives in February 1999 "helped lay the groundwork for the Governor's Executive Order intended to phase out MTBE."[157] It also stated that there is: "a major potential role for ethanol as an MTBE replacement."[158] Moreover, the report finds that if California becomes a growing market for ethanol fuel then "potential sources of supply include new in-state production facilities."[159]

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[154] Letter from A. Lloyd to S. Shoemaker, dated May 17, 1999 (23 JS tab 56 at 2).

[155] Memorandum from M. Kenny, CARB Executive Officer, to K. Smith, CEC Chief Deputy Director, dated Nov. 30, 1999 (23 JS tab 57 at 1).

[156] Letter from M. Kenney, CARB Executive Officer, to D. Bransford, Chairman of California Rice Commission Industry Affairs Committee, dated Apr. 10, 2000 (23 JS tab 58 at 2).

[157] *Evaluation of Biomass-to-Ethanol Report December 1999,* at II-16 (2 JS tab 8 at II-16); *see* CEC, *Supply and Cost of Alternatives to MTBE in Gasoline* (Feb. 1999) (3 JS tab 16 at 424) (the prior study that CEC claims helped lay the groundwork for the ban).

[158] *Evaluation of Biomass-to-Ethanol Report December 1999,* at II-16 (2 JS tab 8 at II-16).

[159] *Id.* at II-18; *see also id.* ("The driving force for in-state ethanol production is the impending phase-out of MTBE by December 31, 2002."); Public Hearing Before the California Energy Resources Conservation and Development Commission Fuels and Transportation Committee, *Evaluation of Biomass-to-Ethanol Fuel Potential in California*, at 147:20-22 (Tr. Sept. 10, 1999) ("*Biomass-to-Ethanol Hearing, Sept. 1999*") (statement of L. Forrest, TSS Consultants) ("[T]he only reason that all of us are even here today is there's a phaseout going on of MTBE.") (5 JS tab 48 at 147:20-22).

97. In July 2000 Davis allocated $250,000 for yet another study of the costs and benefits of establishing an in-state ethanol industry.[160] A draft of this 2001 study describes new jobs and increased tax revenues among the benefits of having an in-state ethanol industry.[161] The final 2003 report, which describes the prospects for conventional ethanol projects in the state and ultimately recommends exploration of an in-state industry,[162] estimates the statewide economic benefits to be $1 billion over a 20-year period.[163] Moreover, the 2001 report found that an "in-state ethanol industry could help California supply its transportation fuel needs from indigenous sources and provide new sources of ethanol that would reduce import requirements and improve the overall ethanol supply/demand balance."[164]

98. These conclusions mirror the protectionist arguments of the ethanol lobby:

> If our crop residues are a resource in need of an industry, one option that could be a savior is a California based biomass to ethanol industry. The California Department of Food and Agriculture estimates that California could produce over 1.4 billion gallons of ethanol from existing crop and forest residues. This production would provide new jobs in our rural areas, a renewable

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[160] *See* Letter from W. Keese, CEC Chairman, to M. Kenny, CARB Chairman, dated Oct. 12, 2000, (noting FY 2000-2001 budget contained line item 3360-001-0465 to provide the CEC with $250,000 to conduct an in-state ethanol feasibility study) (23 JS tab 59 at 9); *see also Costs and Benefits of a Biomass-to-Ethanol Production Industry in California*, March 2001, at viii (2 JS tab 7 at viii).

[161] *See* Letter from W. Keese, CEC Chairman, to M. Kenny, CARB Chairman, dated Oct. 12, 2000 at attachment B (noting benefit categories as taken from a draft of the report) (23 JS tab 59 at 7).

[162] *Costs and Benefits of a Biomass-to-Ethanol Production Industry in California*, March 2001, at ix (2 JS tab 7 at ix).

[163] *Costs and Benefits of a Biomass-to-Ethanol Production Industry in California*, March 2001, at viii-x (2 JS tab 7 at viii-x); *see also* Perez, *Speech to the 23rd Symposium Biotechnology for Fuels and Chemicals*, May 8, 2001, at *5 (estimating benefits of "$1 billion over [a] 20-year period, *assuming state government incentives totaling $500 million for a 200 million gallon per year industry*") (emphasis added) (6 JS tab 74 at *5).

[164] *Id.*, at xi.

> source of energy, an alternative gasoline oxygenate, significant relief from a rural/urban controversy and other meaningful direct environmental benefits.[165]

The claim that an ethanol industry would spur rural development was also delivered to the CARB by the ethanol industry.[166] Moreover, the "California-based biomass representatives have for years hounded state energy officials to provide hefty subsidies to accelerate the ethanol-production industry in the state."[167]

99. James D. Boyd, a Commissioner of the five-member CEC and the presiding member of the Transportation Fuels Committee, which has jurisdiction over fuel additives, admits what is happening – "we like to think of our own":

> [There are] issues that need to be explored . . . such as, you know, how to increase the domestic supply of ethanol, and vis-à-vis being dependent on out of state ethanol. I mean, you do hear me refer to the nation State of California, **and we like to think of our own**, and a lot of work's gone forward on that.[168]

100. The U.S. does not deny that California continues to try to develop its ethanol industry. For instance, on February 21, 2002, California State Senator Costa introduced Senate Bill 1728, which would appropriate $25 million per year until 2010 to fund a $.40 per gallon

[165] Joint Letter from the Agricultural Council of California, Butte County Farm Bureau, California Grain & Feed Association, California Rice Industry Association, Colusa County Farm Bureau, and Glenn Country Farm Bureau to G. Davis, dated June 16, 1999 (23 JS tab 60at 1).

[166] *See* CARB Meeting, Nov. 16, 2000 (arguing that construction of ethanol plants using rice straw and other waste products would provide serious economic development benefits to rural California), available at http://www.arb.ca.gov/board/mt/mt111600.txt>> (last accessed Feb. 18, 2004) (32 JS tab 61 at 145-150).

[167] Companies Seek Permits To Build CA Ethanol Plants; Will Import Corn, *Inside Washington Publishers* (July 18, 2004) (InsideenergyPolicy.com document) (32 JS tab 62 at 2).

[168] Public Workshop Before the California Energy Resources Conservation and Development Commission, Fuels and Transportation Committee, *Possible Impacts of MTBE Phase-Out on Gasoline Supplies*, at 230:16-23 (Feb. 19, 2002) ("*Feb. 19, 2002 Workshop*") (emphasis added) (6 JS tab 50 at 230).

production incentive "to foster the development of new in-state production facilities to produce ethanol for use as an additive in California transportation fuel."[169] The bill also states that it is the "goal of the State of California to create an industry that can supply at least 50 percent of the ethanol needed for use in California transportation fuel by 2010."[170]

101. Despite all this evidence, the U.S. points out that California's attempts to create a local ethanol industry have been a dismal failure.[171] While that is likely true (the U.S.' own experts analysis concluded that the MTBE ban would cost $270 million annually[172] because ethanol is tremendously expensive and generally uneconomic even with subsidies and protection), California's failure to achieve its intended result does not mean it never **intended** to create an in-state industry. The U.S. does not, in fact, deny that California **intended** to create an in-state industry. Thus, that intent is an undisputed fact. And that protectionist game is evidence of illegal, discriminatory intent.

F. Subsequent Events Confirm That The MTBE Ban Was A Uniquely Bad Measure

102. Events subsequent to 1999 have confirmed that the UC-Davis study was indeed deficient and that the MTBE ban was the wrong solution.

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[169] California Senate Bill 1728, Feb. 21, 2002, available at << http://www.leginfo.ca.gov/pub/01-02/bill/sen/sb_1701-1750/sb_1728_bill200220221_introduced.pdf >> (23 JS tab 63 at 99).

[170] *Id.*

[171] Amended Statement of Defense at ¶¶ 207-211 (arguing ethanol is as foreign to California as methanol); *see also,* California Energy Commission, *Staff Report: Ethanol Supply Outlook for California* 10 (Oct. 2003) ("CEC 2003 Report") (14 JS tab 15 at 384) ("No new ethanol plant project are under construction in California. However, a number of projects are in planning, some of which could begin construction and be in operation in the 2004-2006 time period.").

[172] See Expert Report of Gordon Rausser at 5 (20 JS tab A at 5).

1. The EU Decision Allowing MTBE

103. The U.S. ignores the EU's decision to continue to use MTBE. But the facts are stark: the EU review, prompted by the California ban, reached a contrary decision. The EU concluded that MTBE is not a carcinogen, that it is not a human health threat, that it reduces air pollution, and that the proper measure for preventing MTBE contamination was not to ban it, but to ensure that underground fuel storage tanks do not leak.[173] In and of itself, the EU review calls into question the *bonafides* of the California ban.[174]

104. The U.S. Defense at no point addresses the EU decision directly, but does claim that little MTBE is actually used in Europe.[175] But that is both wrong and irrelevant. It is used enough to raise the possibility of contamination, and in some places used more widely than in the U.S., yet the EU saw no need to ban it.

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[173] European Comm'n, *Draft Summary Record*, Meeting of the Commission Working Group on the Classification and Labeling of Dangerous Substances, at 20 (Jan. 8, 2001) (3 JS tab 21 at 20) ("[T]he suspicion that MTBE can cause cancer was not sufficiently founded by the available data."); European Comm'n, *Recommendation of 7 November 2001*, Official Journal of the European Communities, 2001/838/EC, at L319/42-44 (Dec. 4, 2001) (3 JS tab 22 at 42-44) (finding that for consumers and for human health, there was "no need for further information and/or testing"); European Chemicals Bureau, *European Union Risk Assessment Report: Tert-Butyl Methyl Ether* (2002), at 18 (indicating that methanol and MTBE "improve air quality") (21 JS tab 10 at 18); International Fuel Quality Center, *Update on the European Union MTBE Situation*, Feb. 19, 2001, at 1 (3 JS tab 26 at 1) (indicating that a 2001 EU study concluded that "the adequate enforcement of existing tank legislation is the key to safeguarding water quality in the EU" and preventing MTBE contamination).

[174] *Some Clear Thinking in Europe*, DeWitt "MTBE & Oxygenates" Report, Issue 805, Dec. 13, 2001, at 1 (summarizing an EU report on MTBE that found "no concern" for risks to consumers, human health, and the atmosphere and ecosystem, and that recommended the EU focus on the application of the "best approaches to tank design and construction" and monitoring for early detection of groundwater contamination) (23 JS tab 64 at 1). *See Exponent Report*, Individual International Information Summaries, at 22, *citing MTBE*, EU Institutions (Brussels) Press Release, May 11, 2001 (Second Amended Claim Ex. E at 22) (noting the Commission's belief that robustly enforcing UST standards is "the best way to tackle the problem of possible groundwater contamination by MTBE").

[175] Amended Statement of Defense at ¶ 205 (arguing that some European countries use MTBE in gasoline in smaller volumes than that used in the United States).

105. Finland provides an excellent comparison: it uses MTBE at concentrations up to 15 percent (in contrast to typical U.S. concentrations of 11 percent) and its watertable is quite high, creating a significant risk of contamination. Yet the EU and Finland saw no need to ban MTBE because both effectively regulate underground gasoline storage tanks.[176]

106. Typically, the U.S. chooses to ignore the one salient difference between the U.S. and Finland – the U.S. has an ethanol industry agitating and willing to pay for an MTBE ban, but the EU does not. And that is why the EU has no ban.

2. MTBE Contamination Has Decreased "Tremendously"

107. There is no serious doubt that, in contrast to the alarmist rhetoric of the U.S. ethanol industry, MTBE contamination has substantially decreased since the ban was announced, but before it was implemented.

108. The U.S. does not deny that MTBE contamination of surface water such as reservoirs has been virtually eliminated. "The surface-water data show a much more notable downward trend in the overall detection frequency for MTBE since 1998 than do the groundwater data. The observed decrease in surface-water source detections is likely due to the discontinued use of two-stoke engines in selected water bodies in California. The surface-water data provide further evidence that MTBE is rarely found in public drinking water supplies at the

[176] European Chemicals Bureau, *European Union Risk Assessment Report: Tert-Butyl Methyl Ether* (2002), at 18 (noting that Finland and the EU do not ban methanol or MTBE, and that some European countries like Finland require the addition of oxygenates to reformulated gasoline) (21 JS tab 10 at 18); International Fuel Quality Center, *Update on the European Union MTBE Situation*, Feb. 19, 2001, at 1 (3 JS tab 26 at 1) (indicating that a 2001 EU study concluded that "the adequate enforcement of existing tank legislation is the key to safeguarding water quality in the EU" and preventing MTBE contamination).

levels of greatest concern."[177] "Evaluations based on all surface-water data indicate that the rate at which new drinking water sources have been found to contain MTBE appears to have generally decreased over the last few years. Similar, but even more dramatic, trends in decreasing source detections are observed when evaluating the subset of surface-water data that are more likely to reach consumers or those sources containing MTBE concentrations that exceed state standards."[178] Surface water supplies drinking water for 60-70 percent of Californians.[179] For them, MTBE contamination has decreased to the point of invisibility.

109. Just as important, the U.S. ignores the fact that the surface water MTBE problem was solved not by banning MTBE, but by directly addressing the source of the problem: two-stroke engines on recreational water vehicles, such as jet-skis and outboard engines.[180] By banning or reducing the use of these engines, California solved the surface water MTBE problem long before the MTBE ban went into effect. Moreover, Dr. Reuter of U.C. Davis knew this **at the time of the ban**:

> Over the water bodies tested, Lake Tahoe had the highest detection level of MTBE (20-25 ppb), and occurred in an area of Lake Tahoe with heavy boat use. There was detection of plumes in Lake Tahoe which extended over 2,000 feet. Dr. Reuter covered the different potential sources of MTBE (atmospheric fallout, runoff, groundwater flow, fuel spills, and recreational vehicles). In California, lakes and reservoirs are generally not in highly urbanized areas. Two stroke engines on boats are the biggest source of contamination of MTBE in lakes and reservoirs, which

[177] *Exponent Report*, Second Amended Claim Ex. E at 29.

[178] *Id.*

[179] *Id*. at 25.

[180] *Improvement evident after MTBE ban in Tahoe*, Associated Press Newswires (May 16, 2001) (23 JS tab 65 at 1).

> has caused increased management of the water bodies in order to prevent further contamination. From a management perspective MTBE volatilizes at the air water interface. As the boating season ended, a 50 percent decline in MTBE was found on the lake. MTBE does not stay a long time in lakes, so if you could control the boat engines, number of boats, or the MTBE in the fuel there is a workable solution.[181]

110. With respect to ground water (*i.e.*, wells), the U.S. does not dispute that California's underlying problem was its failure to clean up its leaking underground storage tanks. It does not dispute that fully **half** of all such tanks were not in compliance in 1999, nor does it dispute the California State Auditor's conclusion that:

> Health Services and the state and regional boards are not making certain that public water system operators, storage tank owners or operators, and regulatory agencies responsible for detecting and cleaning up chemical contamination are doing their jobs. Not only does the State regulate underground storage tanks ineffectively, it has failed in some instances to aggressively enforce the State's Safe Drinking Water Act and the laws governing underground storage tanks.[182]

The U.S. does not dispute that today more than 95 percent of USTs are in compliance.

111. Further, the U.S. does not dispute that the 1998 UST upgrade mandate was only the beginning in resolving California's leaking UST problem. Since then, California has addressed the inadequacies of UST leak prevention and leak detection by passing additional legislation. For example, California's SB 989 requires that:

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[181] *MTBE Blue Ribbon Panel*, Draft Meeting Minutes, Sacramento Convention Center, dated Mar. 25-26, 1999, <http://www.epa.gov/otaq/consumer/fuels/oxypanel/sacdraft.pdf>> (23 JS tab 66 at 10).

[182] California State Auditor, *California's Drinking Water: State and Local Agencies Need to Provide Leadership to Address Contamination of Groundwater by Gasoline Components and Additives*, Summary of Report No. 98112 (Dec. 1998) (2 JS tab 12 at 1).

(1) all dispensers be equipped with containment sumps by December 31, 2003;

(2) all secondary containment be equipped with a "continuous monitoring system capable of detecting the entry of the hazardous substance stored in the primary containment into the secondary containment and capable of detecting water intrusion into the secondary containment; and

(3) all operators, installers, service technicians, and inspectors meet minimum training standards.[183]

In addition, the amended California Health and Safety Code requires testing of the secondary containment.[184] None of these were a requirement of the original UST upgrade mandate. These new requirements were based on studies that showed where the weaknesses of USTs lie and how to resolve them, and each requirement advances the technology of preventing leaking underground gasoline storage tanks.

112. Ignoring these changes, the U.S. pretends that this massive conversion to an underground tank regime approaching the European model has had no impact on MTBE contamination. That is false. These upgrades have worked very well, and – although the U.S. studiously ignores this evidence – California itself has admitted that MTBE detections in ground water have also decreased. Winston Hickox, Secretary of CalEPA, urged a delay in the MTBE ban because the "the pace of contamination has slowed **tremendously**."[185] Similarly, six days after Davis delayed the ban for a year, Gordon Schremp, an analyst for the California Energy Commission, admitted to the 2002 World Fuels Conference that "[t]he frequency of MTBE

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[183] *See* California Senate Bill 989, Oct. 10, 1999 available at << http://www.leginfo.ca.gov/pub/99-00/bill/sen/sb_0951-1000/sb_989_bill_19991010_chaplercd.pdf >> (23 JS tab 67 at1); Cal. Health and Safety Code, Chapter 6.7, §§ 25284.1 & 25291 (23 JS tab 68).

[184] *Id.* at § 25284.2.

[185] J Woolfolk, *California Governor Moves To Keep Gas Prices In Check By Delaying Additive Ban*, Knight-Ridder, March 16, 2002. (23 JS tab 69 at 2).

showing up in wells is a lot less than anticipated in the UC study."[186] EPA Secretary Hickox further admitted that the decrease is due to improved underground tank management when he stated that the MTBE "problem" was being corrected through the much-improved UST management programs.[187] "Our prior analysis of the LUST/UST data in California show that such policies are already having a positive impact on reducing gasoline release and subsequent MTBE detections. These findings have also been confirmed by CDHS officials, who claim that new UST-upgrade laws and strong state regulatory programs have helped to significantly reduce the amount of MTBE detected in water wells and ground water and new monitoring data show that detections of MTBE in ground water are 'decreasing significantly' in California."[188] Thus, all gasoline components leaked from underground gasoline storage tanks – not just MTBE – were being addressed. Contrary to Fogg's flawed analysis, subsequent events clearly show that MTBE detection in ground water was decreasing. "The estimates presented in the Fogg report, however, are based on a statistically flawed approach that is inappropriate for evaluating trends in MTBE groundwater detections. Specifically, Dr. Fogg's approach is incorrect because it will always show an increase in MTBE detections over time, regardless of the actual trend in the

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[186] S. Mehta, *MTBE Phaseout Cost in Billions, Analysts Says*, L.A. Times, at B12 (Apr. 20, 2002) (quoting California Energy Commission analyst Gordon Schremp, who notes that "University of California research in 1998 projected that annual water-cleanup bills could reach $1.5 billion if MTBE were kept in gasoline, but . . . that by using new assumptions gleaned from four years of MTBE experience, cleanup costs would be less than one-sixth of that figure.") (7 JS tab 115 at B12).

[187] J Woolfolk, *California Governor Moves To Keep Gas Prices In Check By Delaying Additive Ban*, Knight-Ridder, March 16, 2002. (23 JS tab 69 at 2)**;** *see also Exponent Report*, Executive Summary, at xiii, *citing* Hickox (Second Amended Claim Ex. E at xiii) (confirming that "the pace of contamination has slowed tremendously"); *see id.* (noting Hickox suggests that a delay in implementing the ban would not constitute "a great risk to groundwater.")

[188] Rebuttal Report by Dr. Pamela Williams to Amended Statement of Defense of Respondent and Selected Expert Reports in Methanex v. USA, dated February 19, 2004. (20 JS tab A at 13).

underlying data …. Thus, even if groundwater detections of MTBE were stable or decreasing over time, Dr. Fogg's approach would consistently show an increased trend in detections."[189]

113. This admitted decrease in MTBE contamination as a result of better tank management and compliance was no surprise. The UC-Davis study itself estimated in 1998 that fixing the leaking tanks would eliminate over 99 percent of the leaks.[190] Davis simply ignored this reality and the obvious solution.

3. The UC-Davis Report Grossly Overstated MTBE Cleanup Costs

114. There is no longer any doubt that the UC-Davis study badly bungled the cost issue. In addition to the enormous sunk cost miscalculation now admitted by the U.S., the UC-Davis study failed to take into account its own prediction that tank upgrades would cut gasoline leaks. As a consequence, as California now admits, the UC-Davis study overstated the cleanup cost by 500 percent. As Gordon Schremp, the CEC analyst put it: "University of California research in 1998 projected that annual water-cleanup bills could reach $1.5 billion if MTBE were kept in gasoline, but . . . that by using new assumptions gleaned from four years of MTBE experience, cleanup costs would be less than one-sixth of that figure."[191] As with so much of the material adverse to it, the U.S. simply ignores this critical evidence from responsible California officials.

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[189] *Id*.

[190] *See* UC Report, Vol. IV, *Leaking Underground Storage Tanks (USTs) As Point Sources of MTBE to Groundwater and Related MTBE-UST Compatibility Issues,* Kevin Couch & Thomas Young, Ph.D., University of California, Davis, at 20 (Nov. 12, 1998) (4 JS tab 39B).

[191] S. Mehta, *MTBE Phaseout Cost in Billions, Analysts Says*, L.A. Times, at B12 (Apr. 20, 2002) (7 JS tab 115 at B12).

115. One reason why UC-Davis overstated the costs was its failure to recognize that MTBE is, in fact, biodegradable. As Dr. Herb Ward explains in his rebuttal expert report, "MTBE is generally biodegradable in aquifers by naturally occurring microorganisms in the presence of oxygen after a period of adaptation."[192] Even without the presence of oxygen, it has been conclusively demonstrated that MTBE is biodegradable.[193] Accordingly, directly contradicting Dr. Fogg's testimony,[194] Dr. Ward explains that: "In 'slow aquifers' with long (years) MTBE travel times natural attenuation . . . should be **fully protective** of groundwater resources."[195] The bottom-line is that MTBE biodegrades and "remediation technologies **are** available to treat MTBE plumes cost-effectively."[196] There are commercially available systems designed to control the risks of small MTBE releases from underground storage tanks.[197]

116. Davis banned MTBE because of politics, not science. An independent, neutral voice has articulated this persuasively:

> In the late 1980s, isolated reports of MTBE in water wells began to appear. The cause was determined to be leaking underground gasoline tanks where MTBE and other gasoline components were seeping into water supplies. Many of these products such as

[192] Ward Rebuttal Expert Report at 1 (20 JS tab B at 1).

[193] *See* Ward Rebuttal Expert Report at 6 (20 JS tab B at 6) ("anaerobic biodegradation of MTBE has been conclusively demonstrated").

[194] *See* Expert Report of Graham Fogg, Dec. 1, 2003 ("Fogg Expert Report") ("Travel times from contaminant source locations to wells can range from days to a century or more, with ties on the order of decades quite common in many basins in California.") (13 JS tab D).

[195] *See* Ward Rebuttal Expert Report at 18 (20 JS tab B at 18) (emphasis added).

[196] Ward Rebuttal Expert Report at 2 (20 JS tab B at 2) (emphasis added). *See id.* at 27 ("systems designed to continuously or intermittently add oxygen to the geological materials underneath underground storage tanks (USTs) could cost-effectively enhance the probability that natural attenuation would suffice to control the risks of small MTBE releases.").

[197] *See id.* at 27 (20 JS tab B at 27).

> toluene are known carcinogens while MTBE is not. **The solution should have been to fix these leaking tanks, but that, by enlarge, did not happen. Here is when politics enter the picture. The main competition to MTBE as an octane/clean air component was ethanol.** Although ethanol is highly supported by huge federal and sometimes state subsidies, MTBE was the preferred product. To counter this disturbing situation the ethanol lobby greatly exaggerated the MTBE in groundwater situation in an attempt to get MTBE banned in the US gasoline pool.
>
> . . . .
>
> Summing up, MTBE is still an excellent versatile clean air blending component in gasolines. It will continue to grow in Southeast Asia and European markets. However, **due to politics in the US, MTBE use will decline along with its benefits in improving auto emission**. I personally feel that major refiners and auto makers don't want ethanol in their gasoline and that over the years we could see a phasing out of ethanol as they come up with newer improved gasoline and the auto companies improve engine designs. Corn could then revert back to what it's meant for – a food.[198]

4. Research Has Shown That MTBE Is Neither Toxic, Nor Carcinogenic, Nor An Environmental Risk

117. MTBE is neither toxic nor carcinogenic. "The [U.S.'] conclusion that MTBE poses a human cancer risk, however, is not supported by the available scientific data. Specifically, the overall weight-of-evidence suggests that MTBE is not a human carcinogen, and that the evidence for human carcinogencity is far less for MTBE than for other contaminants of concern by the State of California, such as benzene and acetaldehyde."[199] The U.S. does not

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[198] Bill Ludlow, *An MTBE Review*, MTBE/Octane Report, dated Feb. 5, 2004 (emphasis added). Mr. Ludlow served as the former head and founder of the *DeWitt MTBE/Oxygenates/Clean Fuels Newsletter* and has nearly forty-years of experience with the product (23 JS tab 70 at 1). *See id.*

[199] Rebuttal Report by Dr. Pamela Williams to Amended Statement of Defense of Respondent and Selected Expert Reports in Methanex v. USA, dated February 19, 2004. (20 JS tab C at 44).

deny that the International Agency for Research on Cancer of the World Health Organization,[200] the Federal National Toxicology Program of the National Institute for Environmental Health Sciences,[201] and the California Proposition 65 Scientific Advisory Panel Carcinogen Identification Committee[202] have **all declined to list MTBE as a carcinogen**.[203]

118. The EU has also concluded, after conducting a detailed risk assessment on MTBE, "that **risks are not** expected" to consumers or human health.[204] Finland served as the rapporteur for the EU Risk Assessment, and the scientific work on the EU report was prepared by the Finnish Environment Institute, the National Product Control Agency for Welfare and Health, and the Finnish Institute of Occupational Health.[205] This is significant because Finland's

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[200] *See* IARC, *Summary of Data Reported and Evaluation, available at* << *http://193.51.164.11/htdocs/monographs/vol73/73-13.html* >> (last visited Nov.1, 2002) (determining that MTBE is not classifiable as a human carcinogen) (3 JS tab 24 at 2).

[201] *See* NTP, *Ninth Report on Carcinogens* (Revised Jan. 2001), *available at* << http://ehp.niehs.nih.gov/roc/toc9.html >> (last visited Nov. 1, 2002) (stating that MTBE not listed as carcinogen despite having been reviewed for potential inclusion on the list) (3 JS tab 29 at 7).

[202] *See* Press Release, Cal. EPA, *Prop. 65 Scientific Review Panels Copnclude MTBE is Neither a Reproductive or Developmental Toxicant nor a Carcinogen* (Dec. 10, 1998), *available at* << *http://www.calepa.ca.gov/PressRoom/Releases/1998/C2898.htm* >> (last visited Nov. 1, 2002) (finding insufficient support for the proposition that MTBE is a carcinogen) (7 JS tab 83 at 1).

[203] J. McCarthy & M. Tiemann, *MTBE in Gasoline: Clean Air and Drinking Water Issues,* CRS Report, Order Code 98-920, at CRS-6 (updated May 3, 2002) (stating that IARC, NTP, and California's Carcinogen Identification Commission have "all determined not to list MTBE as a human carcinogen") (3 JS tab 27 at CRS-6).

[204] *Commission of the European Communities November 7, 2001 Recommendation On The Results Of The Risk Evaluation And The Risk Reduction Strategies For The Substances Acrylaldehyde; Dimethyl Sulphate; Nonylphenol Phenol, 4-Nonyl-, Branched; Tert-Butyl Methyl Ether*, Official Journal of the European Communities, December 12, 2001, L 319/30, at L319/43 (finding "that there is at present no need for further information and/or testing or for risk reduction measures beyond those which are being applied" to "protect consumers" and "human health (physico-chemical properties)") (emphasis added) (7 JS tab 22 at L319/43).

[205] *Id.* at L319/42; *see also Risk Assessment for Tert-Butyl Methyl Ether* (Final Report 2002) ("There is at present no need for further information or testing or risk reduction measures beyond those which are being applied already.") (3 JS tab 20 at VIII).

average MTBE usage (at nearly 15 percent volume) substantially **exceeded** that of California.[206] As noted earlier, both Canada and the U.S. EPA have declined to identify MTBE as toxic.

119. Moreover, the Finnish conclusions were mirrored by the German EPA, which ultimately concluded that "MTBE is an important component for the production of gasoline . . . [and that t]here was no risk established for the environment from the use of MTBE fuels in Germany, nor is such a risk expected to occur in the future."[207]

120. The truth is that MTBE is good for the environment and **significantly** reduces the release of harmful components into the air.[208] But Davis was interested in something other than scientific validity.

G. Methanex' Investment and Damages

1. Methanex' U.S. Investment

121. Contrary to the United States allegations, Methanex does have valuable investments and assets in the United States.[209] Methanex owns several companies in the United

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[206] *See* Letter from J. Kneiss, Vice President, Regulatory & Technical Affairs of the Oxygenated Fuels Association, to A. Lloyd, Chairman, CARB, dated Apr. 16, 2001 ("it is important to recognize that the E.U. assessment was carried out by a member country (Finland) with average MTBE usage (at nearly 15 volume percent of the gasoline pool) substantially exceeding that of California.") (23 JS tab 71 at 3); *see also* European Chemicals Bureau, *European Union Risk Assessment Report: Tert-Butyl Methyl Ether* (2002), at 18 (noting that Finland requires 2.0-2.7 percent-wt oxygen to be added to reformulated gasoline, which is the equivalent of 11 to 15 percent vol MTBE, and that "the legal maximum concentration of MTBE [in the EU] is 15 percent volume in automotive petrol") (21 JS tab 10 at 18); Amended Statement of Defense at ¶ 205 ("Other countries use MTBE in gasoline, if at all, in substantially smaller volumes than the United States has used it.").

[207] International Fuel Quality Center Special Report: *German EPA Position Paper on MTBE* (1999) (3 JS tab 25 at 1).

[208] Second Macdonald Aff. at ¶ 18 (Nov. 5, 2002) (Second Amended Claim Ex. A.), and Exponent Report (Second Amended Claim Ex. E).

[209] Amended Statement of Defense at ¶¶ 77, 84-85.

States; of these there are two principal operating entities: Methanex Methanol Co. ("Methanex U.S."), which is responsible for methanol sales and inventory, and Methanex Fortier, Inc., which is responsible for methanol production. Methanex U.S. is a Texas general partnership owned by two companies, Methanex, Inc. and Methanex Gulf Coast, Inc., both incorporated in the State of Delaware. Methanex indirectly owns 100 percent of the shares of both partners.[210] Methanex Fortier, Inc. is also incorporated in Delaware, and Methanex also indirectly owns 100 percent of the shares in this company.[211]

122. The United States asserts that Methanex Fortier is not a valuable asset because the plant has been idled since 1999.[212] That assertion is incorrect. Until very recently, Methanex viewed Fortier as an asset that might be reopened if conditions – including the MTBE ban – changed. Indeed, Methanex has spent approximately $5 million to maintain its ability and flexibility to reopen the plant. For example, the Fortier plant requires an oxygen supply, and Methanex has continued to make payments to ensure its oxygen supplier is willing and able to resume the oxygen supplies.[213]

123. The Unites States notes the write-off of the Fortier plant in the year 2002.[214] Methanex reached that decision when it became clear that the California ban would no longer be delayed. Methanex' annual report notes, however, that the MTBE ban was one of the factors in

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[210] For some inexplicable reason, the U.S. believes that sworn witness testimony subject to cross examination is not "evidence of record."

[211] Third Macdonald Aff. at ¶ 5.

[212] Amended Statement of Defense at ¶ 80.

[213] Third Macdonald Aff. at ¶ 9.

[214] *See* Amended Statement of Defense at ¶ 95.

the continuing shut down of Fortier.[215] Even then, there was still a possibility Fortier could reopen, and Methanex continued to make the payments to maintain that flexibility.

124. Methanex made the decision to finally and permanently close Fortier only yesterday, February 18, 2004, in order to reduce costs. It will no longer invest discretionary funds to maintain reopening flexibility. As the 3rd Macdonald Affidavit makes clear, the MTBE ban was a substantial cause of the permanent Fortier closure.

125. The United States asserts that Methanex U.S. is a "small operation" with "no significant assets."[216] That is false. Methanex U.S. is a substantial company with numerous assets. Indeed, in 1995 Methanex paid $33 million for a one-third share of Methanex U.S., thus valuing the company at the time at approximately $100 million. That is a very significant investment.[217]

126. Methanex U.S.' operations are also substantial. Methanex U.S. takes legal custody of all methanol before it reaches the United States and is responsible for all of Methanex' methanol sales in the United States, which are considerable:[218]

1998	1999	2000	2001	2002
$252,770,280	$228,628,882	$353,540,113	$393,381,815	$304,519,170

[215] *Id.* at ¶ 10.

[216] Amended Statement of Defense at ¶ 85.

[217] Third Macdonald Aff. at ¶ 12.

[218] *Id.* at ¶ 13.

127. In order to make these sales, Methanex U.S. maintains substantial inventories of methanol, either in transit or in the United States:[219]

1998	1999	2000	2001	2002
$22,394,937	$21,416,729	$75,046,940	$27,417,319	$54,597,193

128. In order to store its inventory, Methanex U.S. leases terminals in the United States; the cost for these terminals was $10,458,715 in 2002. Methanex also maintains a significant fleet of rail-cars, at times up to approximately 1,000 cars, to serve its many customers that are remote from its terminals and widely distributed throughout the United States.[220]

129. The United States asserts that Methanex U.S. does not generate a profit.[221] That is false, for its operations are quite profitable. As the chart below demonstrates, [222] Methanex U.S. has generated more than $80 million in income in the last 9 years.[223]

Year	Income in U.S. $
1994	44,159,000
1995	16,373,000
1996	7,884,000
1997	6,320,000
1998	(833,000)
1999	4,000,000
2000	2,103,000
2001	582,000
2002	1,942,000

[219] *Id.* at ¶ 14.

[220] *Id.* at ¶ 15.

[221] Amended Statement of Defense at ¶ 85.

[222] Third Macdonald Aff. at ¶ 16. Net income was extraordinarily high in 1994 and 1995 because the price for methanol was extraordinarily high at that time.

[223] Third Macdonald Aff. at ¶ 16.

130. The Unites States asserts that Methanex U.S. has paid little tax.[224] While it is difficult to understand the relevance of Methanex U.S.' tax payments, Methanex U.S. is a highly capital-intensive business, and it routinely incurs significant depreciation expenses. In the United States, most of this related to the Fortier plant. Those accumulated non-cash deductions largely off-set income.[225]

131. Methanex U.S.' assets include a substantial amount of goodwill and marketing rights. For example, in 2002, Methanex U.S. paid $25 million for Terra Corp.'s U.S. methanol customer list and certain production rights regarding its Beaumont, Texas methanol plant. Similarly, in 2002 Methanex U.S. acquired similar assets from Lyondell for $10 million.[226] The value of Methanex U.S.' customer base, market share, and goodwill is reflected in its 1995 valuation at $100 million.

132. Thus, the evidence shows that Methanex U.S. is a very substantial investment.

2. Methanex' Damages

133. Methanex has suffered significant damages to its U.S. investments due to the MTBE ban. For example, Methanex' Annual Report – which was submitted to the U.S. Securities and Exchange Commission subject to all the normal requirements of truthful reporting

[224] Amended Statement of Defense at ¶ 85.

[225] Third Macdonald Aff. at ¶ 17.

[226] *Id.* at ¶ 18.

– states that the MTBE ban contributed to the continuing idling of the Fortier plant.[227] When Fortier was permanently abandoned on February 18, 2004, the MTBE ban was a substantial reason driving that decision.[228]

134. Similarly, the MTBE ban severely damaged Methanex by triggering simultaneous downgrades in Methanex' debt ratings. Moody's Investor Service, Fitch IBCA, and Standard & Poor's all downgraded Methanex' debt, and the evidence from these rating agencies clearly demonstrates a direct link – and a damaging one – between the MTBE ban and Methanex' finances.[229]

135. In March 1999, Moody's reviewed Methanex' ratings for a possible downgrade, stating that one of its principal reasons for the review was "Moody's heightened level of concern due to regulatory risk associated with MTBE."[230] Moody's stated that "[t]he review will also focus on the potential consequences of proposed legislation in California and elsewhere aimed at reducing the use of MTBE in the gasoline pool."[231] In July 1999, after the MTBE ban, Moody's downgraded Methanex' rating to Ba1 from Baa3.[232]

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[227] *Id.* at ¶ 8. ("Limiting or eliminating the use of MTBE in gasoline in California or more broadly in the United States will reduce the demand for MTBE and methanol in the United States and negatively impact the viability of MTBE and methanol plants (such as our Fortier facility) in the United States."). (19 JS tab A-2 at 53).

[228] Third Macdonald Aff. at ¶ 11.

[229] *Id.* at ¶ 27.

[230] *See* Macdonald Third Aff., *See* Moody's Investors Service Rating Action, (Moody's Investor Service Fundamental Credit Research 25 Mar. 1999), (19 JS tab A9).

[231] *Id.*

[232] *See* Moody's Investors Service Rating Action, (Moody's Investor Services Fundamental Credit Research, 26 Jul. 1999, (19 JS tab A10); Third Macdonald Aff. at ¶ 28.

136. Fitch IBCA took the same position as Moody's. In July 1999, after the California ban, Fitch downgraded Methanex to BBB from BBB+. Fitch stated that one of its principal reasons for the downgrade was "the growing uncertainty in the U.S. surrounding [MTBE] use in gasoline, which could potentially decrease MTBE demand over the medium term."[233] Standard & Poor's also lowered Methanex' rating to BBB- from BBB citing as a principal reason "the possible phase out of [MTBE] in California and the rest of the U.S."[234] Thus, the evidence is irrefutable that California's MTBE ban had a direct and damaging impact on Methanex' ability to obtain debt financing.

137. The impact of these downgrades was to reduce Methanex' credit rating from "investment grade" to "speculative" or non-investment grade. The practical impact of this was to increase the cost of any new debt Methanex raised, and to reinforce the downward pressure on Methanex' share price, described below. This damage was one of the immediate and direct consequences of the California ban.[235]

138. The California measures also damaged Methanex by seriously depressing its stock price. From January 29 to February 9, 1999, there was a 21.3 percent decline in the value of Methanex' shares. Although the U.S. asserts this drop was before and thus not related to the California ban, the evidence conclusively proves the contrary. Independent analysts repeatedly

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[233] *See* Press Release, Fitch IBCA, Methanex Sr. UNSEC Notes Downgraded to "BBB" by Fitch IBCA (July 27, 1999) at 1 Fitch IBCA Press Release, (19 JS tab A11 at 1); Third Macdonald Aff. at ¶ 29.

[234] Methanex Corp.'s Ratings Lowered to "BBB," Outlook Negative, Standard & Poor's Ratingdirect (Standard & Poor's, Toronto, Canada), 05-Apr-2000, *See* Standard & Poor's Creditwire, (19 JS tab A12); Third Macdonald Aff. at ¶ 30.

[235] *Id.* at ¶ 31.

and consistently made it clear that it was California's **threatened** MTBE ban that caused that particular drop:

> In addition to California, New Hampshire, Connecticut, East Texas, and Maine are considering anti-MTBE bills. California has chosen a threshold level for MTBE content in water of five parts per billion that other states are now considering.[236] A complete ban would be chaos for the industry and would have a significant negative impact on the economy as MTBE plants are closed.[237]
>
> Methanex shares continue to be under pressure as a result of MTBE concerns in the U.S.[238]
>
> Methanex is only trading at about 30 percent of replacement cost and 75 percent of book value (after plant closures), which suggests the MTBE risk is fully factored into its stock price. Therefore, Methanex' share price should be close to bottom. However, if a decision to ban or phase out MTBE is given, it still might temporarily knock the stock further.[239]

The impact of the California threat was also made clear during a conference call with analysts in February, 1999 (the same time period cited by the U.S.). During the call, MTBE was the **only** significant issue raised by the company and analysts. "It was clear that MTBE had become a political issue and that science was not winning the battle."[240]

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[236] *See* Daily Edge, (Scotia McLeod, Inc., Toronto, Canada) January 22, 1999, (19 JS tab A5 at 1); Third Macdonald Aff. at ¶ 22.

[237] *See Awaiting California's MTBE Decision*, Goepel McDermid Securities Insight (Goepel McDermid, Inc.), Mar. 9, 1999 at 1, (19 JS tab A4 at 1); Third Macdonald Aff. at ¶ 22.

[238] *See Medicine Hat 1 Plant Shut Down*, Goepel McDermid Securities, Morning Note, (Goepel McDermid, Inc.), March 17, 1999, at 1, (19 JS tab A3 at 1); Third Macdonald Aff. at ¶ 21.

[239] *See Awaiting California's MTBE Decision*, Goepel McDermid Securities, Insight, (Goepel McDermid, Inc.) March 9, 1999, at 2; (19 JS tab A4 at 2); Third Macdonald Aff. at ¶ 21.

[240] *See* Letter from Raymond James to Chris Cook, Director, Investor Relations, Methanex Corporation, (January 14, 2004), Third Macdonald Aff. (19 JS tab A6 at 2).

139. In this period before the ban was implemented, the decline and underperformance of Methanex' share price was highly company specific and not sectoral—no other similar chemical company was suffering such a decline. At that time, MTBE represented approximately 30 percent of the global methanol demand, and California's MTBE consumption alone represented approximately 6 percent of global methanol demand. The equity markets' response to the California MTBE ban, reflected in their pessimism towards Methanex' stock, was a clear demonstration of their understanding that methanol is a global commodity, and that events in one market, such as California, impacted all of Methanex' business globally.[241] For example, Raymond James Equity Research stated in an analysis of Methanol's price that one of the principal reasons for the lower demand for methanol was "[p]oor MTBE demand due to . . . California eliminating its use (as was expected)."[242]

140. Methanex' share price has never recovered from the California measures in a relative, not an absolute sense. Methanex' share price has historically tracked the price of its only product – methanol. The nature of that historical correlation was permanently altered by the California MTBE ban, for while the Methanex share pricing still tracks methanol price, it has since traded at a significant discount to the pre-1999 historical correlation. The Raymond James analysis stated that in 2000/2001 Methanex' market value did not keep pace with Methanol "due to the California MTBE overhang."[243]

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[241] *Id.*; Third Macdonald Aff. at ¶ 23.

[242] *Insight Canada*, (Raymond James Equity Research, Canada, June 25, 2003 at 1, Third Macdonald Aff. (19 JS tab A7 at 1).

[243] *Id.* at 3; Third Macdonald Aff. at ¶ 24.

141. Moreover, as shown by recent U.S. legislative initiatives, there is no doubt that the damage of transitioning from MTBE to ethanol has been severe. The U.S. recognizes as much and may pay up to $2 billion to US-domicile MTBE producers adversely impacted by the switch.[244]

142. The U.S. cannot contend that all these independent sources – Standard & Poor's, Moody's, IBA Fitch, Raymond James – are biased or wrong. The financial markets repeatedly and consistently recognized the immediate and direct link between the MTBE ban and Methanex. Methanex was severely damaged by both the threat and the subsequent implementation of the ban.

H. The Recent Market for Methanol and Mr. Choquette's Statement

143. The methanol market is a cyclical commodity market that is very sensitive to overall production capacity relative to demand. In North America, the methanol market was quite strong in 1999 due to a strong economy and tight supplies. In 2000, the methanol market went into an oversupply situation due to added capacity,[245] which depressed prices somewhat. Methanol companies, including Methanex, took various restructuring measures to mitigate their losses. Because of these proactive actions, the damage of the MTBE ban is not as severe as it would have otherwise been. In 2003-2004, the market once again turned around. The oversupply was corrected and methanol's price has recently been strong. As with all cyclical markets, the strong price will inevitably be followed by a weak one.

[244] *See* H.R. 6 (appropriating $2 billion for U.S. firms over an eight-year period to facilitate the transition from MTBE) (16 JS tab 55 at 777).

[245] Karl Greenberg, *New Capacity Hits Outlook for Methanol and Methyl Tertiary Butyl Ether*, Chemical Market Reporter, at 56 (Mar. 27, 2000) (16 JS tab 51 at 1450-51).

144. The U.S. assertions that the loss of the MTBE demand would have little impact on pricing or that the loss would be fully absorbed are gross distortions of economic reality.[246] The U.S. relies on comments made by Mr. Pierre Choquette, Methanex' Chairman and C.E.O., that are taken completely out of context. The statements made by Mr. Choquette must be seen in the backdrop in which they occurred. By mid-2003 the market for methanol had changed for the better and supply and demand, the two principal determinants of price for any commodity, were in a balanced-to-tight situation. Because of the strong price, the immediate damage of the MTBE ban was not felt.

145. If MTBE had continued in commerce in California and elsewhere and thus increased incremental demand, the tight supply situation would be accentuated, leading to even higher pricing (and profits for Methanex). Alternatively, the negative impact of a future excess supply, and consequent lower prices, would be mitigated if California methanol demand had not been permanently lost.[247]

146. One example of the United States' distortion of Mr. Choquette's comments occurs in paragraph 103 of the U.S. Defense, where the United States cites to *one* sentence from a speech that is approximately 45 minutes long implying that Methanex actually wanted to eliminate MTBE from the U.S. market. That proposition is utterly false. Looking at the text in context,[248] Mr. Choquette was discussing the short term performance of the company. His

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[246] Amended Statement of Defense at ¶ 103.

[247] Third Macdonald Aff. at ¶ 34.

[248] (16 JS 38) The paragraph the sentence is taken from reads as follows:

(continued...)

speech shows that the MTBE ban caused a drop in annual growth of methanol sales from 4 percent to 2 percent, which surely diminished Methanex' sales and profits. But Mr. Choquette's main point was that there was still growth even if it was not as good as before the ban, and because of that growth, the industry could absorb the loss of the U.S. MTBE market in the short term. This statement in no way indicates that Methanex wanted the MTBE ban implemented or that the ban would not cause damages.[249]

III. THE CALIFORNIA MEASURES VIOLATE NAFTA

A. Article 1101: The California Measures Relate To Methanex

147. The California measures "relate" to Methanex because it is clear from both the direct evidence and the inferences to be drawn from the record that Davis intended the measures to harm foreign producers of methanol. Taken as a whole the record shows that the MTBE ban was not a valid environmental measure, but a barely disguised form of economic protection intended to benefit ethanol and harm its competitors.

148. In its Second Claim, Methanex made a number of legal arguments on the issue of intent to harm, which the U.S. does not dispute. First, Methanex argued that all anti-

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(...continued)

So, looking at the demand side and then I will touch on supply, this is really the only overhead that I have on demand. Historically growth has been around 4 percent that's certainly the case over the past five years that would be consistent with looking at global GDPs and global industrial production plus a little bit. Going forward there is one end use for Methanex called MTBE the additive in gasoline that's under threat in the United States that's been a bit of a dark cloud over our company, ***I always like to say I wish they would eliminate product tomorrow morning so we could get on with life because it's not that big a deal.*** And so when we look forward here we've assumed 2 percent growth until 2008 that assumes that this additive MTBE is totally eliminated from the United States. Please you can see that if you enter a period like this with strong supply-and-demand fundamentals the industry can accommodate some reduction in demand and that's because this non-MTBE use has substantial growth.

[249] Third Macdonald Aff. at ¶ 35.

discrimination legal regimes recognize that an intent to favor one competitor demonstrates, by definition, is an intent to harm the unfavored competitors. A state-imposed benefit to one competitor, or class of competitors, functions as a burden on all competitors that are not provided with the benefit, and the natural and foreseeable consequence of benefiting one competitor is to harm the non-favored competitors. The WTO Appellate Body confirmed the point in the *Asbestos* case: "[I]f there is 'less favorable treatment' of the group of 'like' imported products, there is, conversely, 'protection' of the group of 'like' domestic products."[250]

149. The U.S. Supreme Court takes the same position. In *Bacchus Imports, Ltd. v. Dais,* 468 U.S. 263 (1984), it struck down a Hawaii tax law which exempted two locally produced liquors from a general Hawaii tax that was applied to all other alcoholic beverages originating in state and out of state. Hawaii had argued that it did not intend to discriminate against products from out of state; it merely intended to favor domestic products, urging that "there was no discriminatory intent on the part of the [state] legislature because "the exemptions in question were not enacted to discriminate against foreign products, but rather, to promote a local industry.'"[251]

150. The Supreme Court quickly rejected Hawaii's argument as a verbal distinction having no legal significance:

> If we were to accept that justification, we would have little occasion ever to find a statute unconstitutionally discriminatory. Virtually every discriminatory statute allocates benefits or burdens

[250] *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, Appellate Body Report, WT/DS135/AB/R at ¶ 100 (Mar. 12, 2001).

[251] *Id.* at ¶ 273 (citation omitted).

> unequally; *each can be viewed as conferring a benefit on one party and a detriment on the other, in either an absolute or relative sense. The determination of constitutionality does not depend upon whether one focuses upon the benefited or the burdened party*. A discrimination claim, by its nature, requires a comparison of the two classifications, and it could always be said that there was no intent to impose a burden on one party, but rather the intent to confer a benefit on the other. Consequently, it is irrelevant to the Commerce Clause inquiry that the motivation of the legislature was the desire to aid the makers of the locally produced beverage rather than to harm out-of-state producers.[252]

151. The United States has itself embraced and advocated the same principle in international trade proceedings involving national treatment. In *Japan – Measures Affecting Consumer Photographic Film and Paper*, for instance, the United States argued:

> Regardless of whether Japan sought to hinder imports or merely help domestic producers, the direct consequences of its actions were to diminish opportunities for foreign photographic material manufactures to distribute their products. . . . [B]y creating distribution channels open exclusively to domestic manufacturers, Japan intentionally enhanced competitive opportunities for domestic manufacturers to the detriment of imports.[253]

152. The U.S. does not dispute this principle. It thus concedes that the operative legal rule is that intent to benefit and intent to harm are simply opposite sides of the same coin where discrimination is concerned, and that proving an intent to benefit proves an intent to harm.

153. Here, there can be no serious dispute that the California measures were intended to and have greatly benefited the U.S. ethanol industry. As described above, there is ample evidence that California and Davis intended to benefit the U.S. ethanol industry: Davis' own words when he announced the ban that he intended to create a huge ethanol market in California,

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

[253] Panel Report, WT/DS44/R ¶ 7.2 (1998).

with or without the federal waiver; the simultaneous mandate to study the creation of a California ethanol industry; the premature designation of ethanol as an MTBE substitute before it had been thoroughly studied; the banning of all of ethanol competitors; the payback to ADM; and the fact that ADM has profited so handsomely. All of this shows California's intent to benefit the U.S. ethanol industry, and thus the measures by definition intend to harm domestic ethanol's foreign competitors. That is sufficient to meet the Tribunal's test. Even without more, the Tribunal's required showing of intent to favor and intent to harm would be evidentially satisfied.

154. Second, Methanex argued that the suitability of a measure to its purported purpose will shed light on whether the measure was based on some improper motive.[254] Evidence that a better solution was available, but not implemented, can indicate the presence of illicit intent.[255] The U.S. does not dispute this rule.

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[254] Second Amended Claim at ¶ 33.

[255] *Id.* Principle Three: The general suitability of a given decision to its proffered purpose will shed considerable light on whether that decision was based on some improper motive. A "conscientious decision maker.. .considers the costs of a proposal, its conduciveness to the ends sought to be attained, and the availability of alternatives less costly to the community as a whole," but when "a decision obviously fails to reflect these considerations with respect to any legitimate objective [such failure[supports the inference that it was improperly motivated." *P. Brest, Palmer v. Thompson*: An Approach to the Problem of Unconstitutional Legislative Motive, 1971 Sup. Ct. Rev. 95, 120-21. Similarly, evidence that a better solution was available to a decision maker and was not taken can also indicate the presence of illicit intent. *See, e.g*., *L. Simon, Racially Prejudiced Governmental Actions: A Motivation Theory of the Constitutional Ban Against Racial Discrimination*, 15 San Diego L. Rev. 1041, 1125 (1978) (noting, in the discrimination context, that "[p[roof of less imperfect means could well tip the scales if the plaintiff has produced other evidence of prejudice, as, for example, evidence of social context or legislative history").

155. Here, the United States does not bother to argue that the MTBE ban was the best solution, and the record shows undisputedly that it was not. Surface-water MTBE contamination was solved completely by banning two-stroke engines, not by banning MTBE.

156. The same is true for groundwater contamination. If California truly had been concerned with protecting the environment, it could have enacted many other more suitable measures: actually complying with the longstanding federal UST upgrade mandate; accelerating its own program to fix its leaking gasoline underground storage tanks; stringently enforcing its UST laws; or even prohibiting the future use of such tanks unless and until the problem was fixed, as required by federal law.[256] That fixing the leaking tanks was the best solution is shown by the fact that groundwater contamination by MTBE is – as California officials candidly admit – on the way to being solved. Moreover, fixing the leaking tanks protects California from the components of gasoline that are harmful, such as benzene.

157. Alternatively, California could have banned the use of **all** potentially harmful chemicals leaking from its underground gasoline storage tanks — including ethanol and benzene — and not just MTBE. Instead, it singled out one component of gasoline, one that is not the most serious contaminant, but one that is ethanol's direct competition. Thus, singling out ethanol's competition implies an intent to benefit ethanol, not to protect the environment.

158. Finally, the fact that the EU and many European nations rejected an MTBE ban in favor of strict tank enforcement is further evidence that a ban was not the proper solution.

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[256] 40 C.F.R. §§ 280.40, 280.7.

159. The only reasonable inference to be drawn from California's adoption of a defective, unsuitable measure is that its primary intent was not to protect the environment, but to benefit U.S. ethanol, and thus to harm its "foreign" competitors.

160. Third, Methanex argued that when a government decision is motivated by a variety of factors, proof of an illicit motive will invalidate the decision even if the actor also had (or might have had) a permissible motive for doing the same act: "[I]t is incorrect to pose the question of motivation [as:] did the decision maker make this decision to serve legitimate or to serve illicit purposes. . . It is entirely possible that he had both objectives in mind, but the rule should be invalidated if the illicit objective played any material role in the decision."[257] The U.S. does not dispute this rule.

161. Here, the evidence of improper motive on the part of California, Davis, and Burton is overwhelming. First, as former Senator Warren Rudman admitted, as the U.S. Solicitor General argued, and as the U.S. Supreme Court found: "make no mistake – money affects outcomes." Davis solicited ADM's money, and he gave ADM the California oxygenate market in return. Second, even discounting ADM's cash, Davis and California intended to foster a California ethanol industry to replace MTBE. These protectionist, illicit, and unfair motives establish an intent to benefit ethanol, and thus an intent to harm methanol.

162. Fourth, Methanex argued in its Second Claim that where the intent behind a government measure is at issue, courts and tribunals will presume that the relevant executives or

[257] Brest, *supra*, at 119 n.123.

legislators intended the measure to have the natural, probable, and foreseeable consequences that flow from it.[258]

163. Here, there is no doubt that California knew the ban would harm Methanex. That is clear from Senator Burton's injudicious but candid remarks. Moreover, the U.S. does not deny that it was both foreseeable and foreseen that an MTBE ban would harm foreign methanol producers. Nor could it, given the EPA's express recognition of that consequence. The EPA recognized that "the use of domestic, renewable ethanol would clearly reduce high value energy imports relative to imported **methanol or MTBE**."[259] The U.S. also does not deny that the EPA recognized that assisting ethanol producers meant harming methanol producers: "Revenues and net incomes of domestic methanol producers and **overseas producers of both methanol and MTBE** would likely decrease due to reduced demand and prices."[260]

164. Because the harm to Methanex and foreign methanol producers from an MTBE ban was probable, foreseeable, and foreseen, it is logical to infer that that harm to Methanex was, as a matter of law, intended by California.

165. Fifth, Methanex argued that illegal intent can be inferred from the evidence that anti-foreign bias against methanol and MTBE pervades national politics in the United States, and

[258] *See, e.g.*, Note, *Reading the Mind of the School Board*: *Segregative Intent and the De Facto/De Jure Distinction*, 86 Yale L.J. 317, 328 n.57 (1976) (noting that "[t]he principle that an actor is held to intend the reasonably foreseeable results of his actions has impressive common law antecedents," and citing as examples H.L.A. Hart, *Punishment and Responsibility* 120-21 (1968); W. Prosser, *The Law of Torts* § 8 (4th ed. 1971); and *Restatement (Second) of Torts* § 8A, cmt. b (1965)). The U.S. does not dispute this principle.

[259] Regulation of Fuels & Fuel Additives: Renewable Oxygenate Requirement for Reformulated Gasoline, 58 Fed. Reg. 68,343 (Dec. 27, 1993) (codified at 40 C.F.R. § 80) (emphasis added) (22 JS tab 28).

[260] *Id.* at 68,350 (emphasis added).

that nationalistic bias has been spurred on by ADM and others in the U.S. ethanol industry. As discussed above,[261] the U.S. does not seriously dispute this evidence of bias, arguing about only one statement by California Senator Mountjoy.

166. From this evidence, the Tribunal can and should draw several important conclusions. **First**, that methanol — and Methanex itself — have been unfairly pilloried in the U.S. political arena as "foreign." Second, that this anti-foreign bias against methanol and its products pervades the U.S. political decision making processes at every level, including California. **Third**, that the U.S. domestic ethanol lobby does everything it can to both inflame and proliferate the bias against methanol as a "foreign" product. And **fourth**, that this same impermissible bias played a substantial part in motivating the California officials responsible for the challenged measures.

167. The record could hardly be clearer. The evidence shows that California intended to benefit the U.S. ethanol industry, that the ban would do nothing to benefit the environment, that the ban was corruptly motivated, that California knew the ban would harm Methanex, and that MTBE and methanol are routinely labeled as "foreign." The only reasonable conclusion is that California intended to harm Methanex.

B. The California Measures Violate The National Treatment Obligations Of Article 1102

168. Article 1102 requires a three-step analysis. **First**, the Tribunal must determine whether the U.S. ethanol industry is "in like circumstances" with Methanex and its

[261] *See supra* ¶¶ 45-51 (noting that the U.S. ethanol industry is one of the most heavily protected in the world).

investments.[262] **Second**, if they are in like circumstances, the Tribunal must determine whether **any** portion of the domestic ethanol industry received better treatment than Methanex and its investments did. **Third**, if the Tribunal finds that Methanex is not accorded the most favorable treatment, then the burden shifts to the U.S. to justify the disparate treatment accorded to methanol producers by showing that the measures should be permitted because they implement valid environmental goals.

1. The Like Circumstances Requirement Serves As A Gatekeeper Against Remote Claims

169. As Methanex noted in its Second Claim and its Motion to Reconsider, Article 1102's "like circumstances" requirement serves a key gatekeeper function. It forecloses the possibility that a remote supplier to a damaged producer could establish a national treatment violation.[263] A truly remote supplier is not in like circumstances with a favored producer because remote suppliers do not compete with such producers.

170. Those are not the facts of this case. Here, methanol and ethanol do compete directly as oxygenates used in the manufacture of RFG and oxygenated gasoline.

2. The Meaning of "Like Circumstances"

171. In its Second Claim, Methanex made two principal arguments concerning the meaning of like circumstances. First, it argued that "like" does not mean "identical." Second, it

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[262] Amended Statement of Defense at ¶ 284 ("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.") (emphasis added).

[263] *See, e.g.,* Amended Statement of Defense at ¶ 222 (arguing that Methanex' claims "would allow not only the party directly affected by a government regulation, but any other downstream [sic] entity selling products to that party, to have recourse under Chapter Eleven.").

argued that the critical test of like circumstances is competition: if two investments compete with each other, in the sense that one can take business away from the other, then they are in like circumstances. The U.S. ignores these arguments (pretending that Methanex' only argument is a "like products" argument).

172. The U.S. response is curious. The U.S. never attempts to affirmatively define what "in like circumstances" means. It does concede that the Tribunal should take a "broad" account of all the circumstances – a point with which Methanex agrees. But it does not go beyond that. Instead, it argues – contrary to a "broad" interpretation – that because Methanex is not in identical circumstances with U.S. ethanol producers, it is not in "like circumstances." And it essentially ignores Methanex' second argument, that "like circumstances" is a competitive test.

a) "Like" Does Not Mean "Identical"

173. The U.S. response argues that the appropriate test is whether Methanex and its investments received treatment no less favorable than that accorded their U.S. **counterparts**.[264] This is the wrong test. Counterpart means "duplicate" or "exact copy;"[265] the U.S. argument would require a comparison of Methanex and its investments with U.S. investors that have exactly the same or identical investments as Methanex, *i.e.*, methanol producers. There is no support for the U.S. mirror-image comparison, which impermissibly narrows the scope of Article 1102. "Like" means "similar," not "identical," and the U.S.' persistent advocacy of a narrow standard cannot be reconciled with the language of NAFTA.

[264] Amended Statement of Defense at Heading III, (emphasis added).

[265] NEW SHORTER ENGLISH OXFORD DICTIONARY, at 528 (4th ed. 1993) ("A duplicate, an exact copy"); *see* BLACK'S LAW DICTIONARY, at 354 (7th ed. 1999) ("One of two or more copies or duplicates of a legal instrument").

174. A broad definition of "like circumstances" is confirmed when Article 1102 is read in light of its object and purpose. As the U.S. acknowledges, "[t]he objective of the NAFTA relevant to the investment chapter is to '**increase substantially** investment opportunities in the territories of the Parties.'"[266] Investment opportunities are increased by preventing NAFTA members from favoring domestic investors. A narrow interpretation of Article 1102 that only permits comparisons of investors in precisely the same circumstances undermines this goal. Article 1102 requires a broader comparison here than this U.S. approach permits.

b) "Like Circumstances" Means A Competitive Relationship

175. In its Second Amended Claim, Methanex cited NAFTA precedent that establishes that Article 1102 requires a comparison of those investments that are in a competitive relationship.[267] The *S.D. Myers* case held: In like circumstances "invites an examination of whether a non-national investor complaining of less favourable treatment is in the same 'sector' as the national investor … 'sector' has a wide connotation that includes the concepts of 'economic sector' and 'business sector.'"[268] It further held that "It was precisely because [the U.S. foreign investor] was in a position to take business away from its Canadian competitors that [the Canadian domestic investors] lobbied the Minister of the Environment to ban exports when the U.S. authorities opened the border."[269] The U.S. does not dispute this interpretation of

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[266] Amended Statement of Defense at ¶ 303, *citing* NAFTA art. 1102(1)(c) (emphasis added).

[267] *See* Second Amended Claim at ¶¶ 299-303 (the critical test for "likeness" is competition)

[268] *S.D. Myers v. Canada* (Partial Award) ¶ 250 (Nov. 13, 2000).

[269] *Id.* at ¶ 251.

NAFTA, or offer a competing one. Instead, it argues that, as a factual matter, ADM does not compete with Methanex and its investments.[270] The U.S. is wrong.[271]

(1) The Commercial Reality Is That Methanol and Ethanol Do Compete In The U.S. Oxygenate Market

176. As noted, the *S.D. Myers* competition test focuses on two issues: whether the investments are in the same "economic sector," and whether one investment is in a position to take business away from another.

177. The relevant economic sector here is the production and sale of oxygenates used in the manufacture of RFG and oxygenated gasoline. Both ethanol and methanol are oxygenates, and both are used in the manufacture of RFG and oxygenated gasoline. The fact that each oxygenate is used in slightly different ways in the gasoline manufacturing process is irrelevant, and the U.S. has offered no reason why it should be relevant.

178. The evidence here is undisputed that, at least at the integrated refiner level, U.S. ethanol producers have indeed taken business away from Methanex U.S. Integrated refiners never bought MTBE – they bought either methanol or ethanol. Methanex U.S. used to sell oxygenates to those integrated producers; now ADM does. Again, the fact that the two

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[270] *See* Amended Statement of Defense at ¶ 306 ("Methanex offers neither evidence nor, indeed, even argument to support the proposition that ADM is in like circumstances with *its investments*.") (emphasis original); *see also id.* 307 ("Methanex makes no attempt to explain how ADM could be considered to be in like circumstances with it.").

[271] *See, e.g.*, Second Amended Claim at ¶ 304 ("Methanex and other methanol producers are in 'like circumstances' with U.S. domestic ethanol producers because … they both compete … for customers in the oxygenate market."); *see also id.* at ¶¶ 77-83 (explanation of how ADM could be considered to be in like circumstances with Methanex and its investments).

oxygenates are used at different stages in the manufacturing process does not affect their competitiveness. An integrated refiner will still buy one or the other to oxygenate its gasoline.

179. Indeed, the U.S. itself had admitted and acknowledged the direct competitive relationship between ethanol and methanol. The U.S. EPA, in considering the impact of requiring ethanol to be used as an oxygenate, concluded: "the use of domestic, renewable ethanol would clearly reduce high value energy imports relative to imported methanol or MTBE."

180. This past U.S. admission of a direct competitive relationship conclusively establishes that methanol and ethanol producers are in "like circumstances."

c) A Traditional GATT and WTO National Treatment Analysis Similarly Confirms That Methanol and Ethanol Are "Like"

181. The U.S. assertion that the international law of the GATT and WTO is not relevant to these proceedings is difficult to take seriously.[272] These proceedings are governed by international law, and the body of GATT and WTO cases offer useful – "indeed very useful" in the words of Sir Robert Jennings – guidance on how to deal with national treatment claims.[273] "Not to consider this body of direct precedents … would be a departure from normal international law practice that would be difficult to justify."[274]

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[272] *See*, *e.g.*, Amended Statement of Defense at ¶ 304 ("[T]he GATT and WTO authorities cited by Methanex are inapposite"); *see also id* .at ¶¶ 297-303 (arguing why GATT and WTO authorities are not relevant to a national treatment claim under NAFTA chapter eleven).

[273] *See* Expert Opinion of Sir Robert Jennings ("Jennings Expert Op."), attached to the Second Amended Claim, at 10 ("Jennings Expert Op.").

[274] *See* Jennings Expert Op. at 11.

182. Applying the WTO "like products" test correctly shows that methanol and ethanol would be considered "like" for purposes of national treatment provision.[275] As Professor Ehlermann notes, evidence regarding end-use and consumer tastes and habits "is more important" than other criteria.[276] Moreover, "products with a wide spectrum of end-uses may be considered to be 'like' only insofar as their end-uses and the corresponding consumer tastes and choices overlap; the same products will be unlike to the extent as their respective end-uses and the corresponding consumer tastes and habits differ."[277]

183. It is precisely these key factors that the U.S. ignores. Both methanol and ethanol provide the essential oxygenating element for RFG (which shows similar end-uses). Consumers such as integrated refiners consider them to be competing oxygenates, and but for the California measures, these consumers would be using methanol, not ethanol, to manufacture oxygenated gasoline.[278] They are thus "like products."

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[275] *See* Expert Opinion of Professor Claus-Dieter Ehlermann ("Ehlermann Expert Op."), attached to the Second Amended Claim, ¶ 55 ("it is my opinion that there are sufficient common elements here to expect that a WTO Panel or the Appellate Body would conclude that, on the whole, there is a 'like' relationship between methanol and ethanol within the meaning of Article III:4 GATT [sic].") ("Ehlermann Expert Op.").

[276] *See* Ehlermann Expert Op. at ¶ 37; *see also id.* at ¶ 56 (giving priority to evidence regarding end-uses and consumer tastes and habits over physical properties and tariff classification).

[277] *See id.* at ¶ 38 (emphasis original).

[278] *See* Second Amended Claim at ¶¶ 175-176 (discussing prohibitive costs of ethanol). The U.S. claim that "[s]ome [integrated refiners] may have decided to cease MTBE production for reasons other than the ban" is simply not credible. Amended Statement of Defense at ¶ 237. Moreover, it concedes that at least some *did* decide to cease MTBE production because of the ban.

184. The U.S. response is correct, however, in that the GATT "like **products**" standard is a narrower test than the NAFTA Article 1102 "in like **circumstances**" standard.[279] Because methanol and ethanol are "like" for purposes of the GATT's narrow test, they necessarily must be "in like circumstances" for purposes of the NAFTA's broad Article 1102 test.

3. The Measures Treat Methanex and Its Investments Less Favorably Than The Domestic Ethanol Industry

185. If Methanex and its investments and the U.S. ethanol industry are in like circumstances, there is no serious dispute that Methanex is not receiving national treatment. Under Article 1102, Methanex and its investments are entitled to the "most favorable treatment" accorded to "investments of [the U.S.'] own investors," that is, any member of the U.S. ethanol industry.[280] Methanex can no longer sell methanol to California refiners that buy oxygenates to

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[279] *See* Amended Statement of Defense at ¶ 301 ("Article 1102 contemplates that *broad account* be taken of the circumstances of the treatment, the investor and the investment … the GATT provision *narrowly focuses* on the good in question and whether it is like other goods.") (emphasis added) (footnotes omitted).

[280] The U.S. does not cite Article 1102(3) even once in its submission, yet this is the provision "which governs Methanex' claim" in this proceeding. Second Amended Claim at ¶ 294. (The U.S. instead cites paragraphs 1 and 2 of Article 1102. *See* Amended Statement of Defense at ¶ 284 n.479.)

> Article 1102(3) says:
>
> 3. **The treatment** accorded by a Party [to investors of another Party or to investments of investors of another Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments] **means**, with respect to a state or province, treatment no less favorable than **the most favorable treatment accorded**, in like circumstances, **by that state** or province **to investors**, and to investments of investors, **of the Party of which it forms a part**.

(Emphasis added.) *See also* NAFTA, Canadian Statement on Implementation, Jan. 1, 1994, at 148-49 ("National treatment by state, provincial and local government is defined as the best treatment provided by that government to any investor or investment.")

manufacture RFG; only the U.S. ethanol industry can make those sales.[281] That is less favorable treatment.

186. The U.S. does not actually deny less favorable treatment, but instead U.S. tries to mask it by pointing to the state of development of the California ethanol industry. Using an apples-and-oranges argument, the U.S. argues that Methanex' claim is "without foundation" because ethanol "is no less 'foreign' to California than methanol."[282] Even if ethanol were as foreign to California as methanol,[283] this would provide no justification for less favorable treatment.[284] Article 1102 indisputably requires California to treat Methanex and its investments as well as it treats other **U.S.** investors, regardless whether those U.S. investments are in California or elsewhere in the United States.

4. There Is No Valid Environmental, Health, Or Safety Justification For The MTBE Ban

187. Assuming that Methanex and its investments are in like circumstances with the U.S. ethanol industry, and that Methanex and its investments receive less favorable treatment, the U.S. argues that the less favorable treatment is justified because the California MTBE ban is a valid environmental measure. Proving that these measures qualify as valid exceptions to

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[281] The intent behind the measures is discussed in greater detail, *infra*. *See* Amended Statement of Defense at ¶¶ 207-211 (attempting to rebut claim the California measures do not harm methanol based on assertion there is no strong ethanol industry in California).

[282] Amended Statement of Defense at ¶ 207.

[283] That is certainly not California's intent. *See* California Energy Commission, *Staff Report: Ethanol Supply Outlook for California* 3 (Oct. 2003) (14 JS tab 15 at 383-384) (emphasis added) (indicating that "a [small] number of [ethanol] projects are in planning, some of which could begin construction and be in operation in the 2004 –2006 time period.").

[284] *See* Amended Statement of Defense at ¶ 207-211 (attempting to rebut claim the California measures do not harm methanol based on assertion there is no strong ethanol industry in California).

NAFTA's substantive obligations is a burden that falls squarely on the U.S., something it cannot do based on these facts.

a) The U.S. Bears The Burden Of Proof That These Are Valid Environmental Measures

188. There is no provision in NAFTA Chapter 11 explicitly permitting environmental exceptions to the national treatment obligation.[285] The closest general exception in the NAFTA is Article 2101, which specifically incorporates the standards of Article XX of the GATT. GATT and WTO case law clearly places on the U.S. the burden of proof regarding the validity of an environmental measure that denies national treatment.

189. GATT and WTO case law routinely allocate the burden of proof.[286] As articulated in the *Wool Shirts and Blouses* case,[287] the complaining party must make a *prima facie* case. It does so by presenting evidence and argument "sufficient to establish a presumption" that the other Member's measures or omissions are inconsistent with its WTO obligations.[288] Once that presumption is established, it is then up to the respondent to submit evidence and argument to rebut the presumption. The burden of proof rests upon the party,

[285] *See* Article 1108 (providing general reservations and exceptions); *see also Id.* at 1114 (permitting environmental measures that are "consistent with" other chapter 11 provisions).

[286] *See EC - Measures Concerning Meat and Meat Products* (*Hormones*), AB-1997-4, WT/DS26/AB/R, WT/DS48/AB/R (16 January 1998) (Adopted 13 February 1998) (hereinafter "*Hormones Appellate Body Report"*, paras. 97-109*; European Communities - Customs Classification of Certain Computer Equipment*, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R (June 5, 1998) (Adopted June 22, 1998) (hereinafter "*LAN Appellate Body Report"*, para. 103 n.97 ("the rules on the burden of proof are those which we clarified in *United States - Shirts and Blouses*"); *see also* David Palmeter & Petros Mavroidis, *Dispute Settlement in the World Trade Organization* § 4.13 (1999) (burden of proof).

[287] *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, AB-1997-1, WT/DS33/AB/R (25 April 1997) (adopted 23 May 1997) (hereinafter "*Wool Shirts and Blouses Appellate Body Report*").

[288] *Id.* at 14.

whether complaining or defending, **who asserts the affirmative of a particular claim or defense**.[289] This general principle of international law is not limited to GATT and WTO cases.[290]

190. At the WTO, precisely how much and precisely what kind of evidence the U.S. will be required to produce to establish its defense necessarily varies from case to case. The key, however, is that the burden of establishing a national treatment violation is on the complaining party, *i.e.*, Methanex, whereas the burden of establishing an affirmative defense, such as the limited exception for environmental measures, rests on the defending party, [291] *i.e.*, the U.S.

b) Exceptions To National Treatment Are Narrowly Construed

191. The WTO provides an exception to its national treatment regime for environmental measures, but it is a very narrow exception. Under the WTO regime, the U.S. must prove that the measures were "necessary" to protect human, animal, or plant life or health. Then, it must prove that, in order to achieve California's objective, there existed no alternative that was less restrictive with respect to other NAFTA investors and their investments.

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[289] *See United States - Standards for Reformulated and Conventional Gasoline*, AB-1996-1, WT/DS2/AB/R (29 April 1996) (Adopted 20 May 1996) (hereinafter "*Reformulated Gasoline Appellate Body Report*") (the United States as respondent had the burden of proof regarding Article XX of the *GATT 1994,* which sets forth general exceptions).

[290] *See* Amended Statement of Defense at ¶ 104 n.190 (referencing the general principle articulated in Article 24 of the UNCITRAL Arbitration Rules that the burden of proof falls on the party asserting a position); *see also*, *e.g.*, *Iran v. United States (Case No. A/20)*, 11 Iran-U.S. Cl. Trib. Rep. 271, 274 (1986) ("The Tribunal Rules provides that [e]ach party shall have the burden of proving the facts relied on to support his claim *or defense*.") (emphasis added).

[291] *Wool Shirts and Blouses Appellate Body Report*, pg. 14 ff. *See Reformulated Gasoline Appellate Body Report* (the United States as respondent had the burden of proof regarding Article XX of the *GATT 1994*).

192. The reason for these stringent procedures is clear: local interests often try to use pseudo-environmental measures to disguise the more favorable treatment they seek vis-à-vis foreign competitors.[292] Indeed, there have been three such NAFTA cases already. In *S.D. Myers*,[293] *Metalclad*,[294] and *Ethyl*,[295] state and national governments improperly used health and environmental regulations to disguise trade and investment restrictions that favored domestic interests.[296]

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[292] *See* Second Amended Claim at ¶¶ 239-259 (noting prior NAFTA chapter 11 cases have rejected attempts to protect domestic investors based on purportedly environmental measures).

[293] *See, e.g., S.D. Myers* (Partial Award) ¶ 130 (date) (a NAFTA chapter 11 case where a U.S. company that wanted to export hazardous chemical compounds – PCBs – from Canada for treatment and disposal in the U.S. was impermissibly prevented from doing so because of a Canadian export ban purportedly enacted for environmental reasons).

[294] *See, e.g., Metalclad Corp. v. United Mexican States*, Case No. ARB(AF)/97/1 ¶¶ 28-69 (Aug. 30, 2000) (another NAFTA chapter 11 case where a U.S. claimant alleged that municipal authorities in Mexico had, among other things, issued an illegitimate "Ecological Decree" designating the area covering its investment in a hazardous waste disposal facility as a "preserve" on which such a facility could not be operated); *see id.* ¶ 111 (although decided on other grounds, if it had reached the issue the tribunal concluded that "the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.").

[295] *See, e.g.,* J. Soloway, *Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy*, 8 Minn. J. Global Trade 55, 58 (1999) (noting that Canada agreed to settle a NAFTA chapter 11 case regarding a Canadian ban on international and inter-provincial trade of a gasoline additive – MMT – purportedly based on environmental measures); *see also* Agreement on Internal Trade, *Report of the Article 1704 Panel Concerning a Dispute Between Alberta and Canada Regarding the Manganese-Based Fuel Additives Act*, File No. 97/98 – 15 – MMT – P058 (Decision) at 7 (June 12, 1998) (municipal action brought by the Government of Alberta, with the support of the Governments of Quebec, Nova Scotia, and Saskatchewan, against the Canadian federal government challenging the ban as an unjustifiable barrier against inter-provincial trade).

[296] *See, e.g.,* Soloway, *supra*, 8 Minn. J. Global Trade at 58 ("There is a general perception that firms and their governments are attempting to fill the 'protection gap' left by falling border barriers with the discriminatory application of environmental regulations."); D. Farber & R. Hudec, *GATT Legal Restraints on Domestic Environmental Regulations*, in *2 Fair Trade and Harmonization: Prerequisites for Free Trade?* 59, 60 (J. Bhagwati & R. Hudec eds., 1996) (acknowledging "the danger that environmental regulations may be captured by protectionists who will use them as a 'guise for erecting barriers to imports.'").

193. Countries usually act with great alacrity in eliminating true threats to human health or the environment.[297] For example, Australia and Japan imposed severe import restrictions on salmon and apples, respectively, to the stem the spread of specific diseases.[298] Similarly, the European Communities banned the importation of hormone-treated meat and meat products based on the perceived threat to human health.[299] (In contrast, California waited almost five years.)

194. When such action is taken, however, it must be based on a valid risk assessment, or countries must normally undertake, within a reasonable amount of time, a valid risk assessment to determine whether the imposed measure is based on sound science.[300] The burden of showing the existence of a valid risk assessment supported by sufficient scientific evidence

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[297] *See, e.g.,* Jim Yardley, *WHO Urges China to Use Caution in Killing Civet Cats*, N.Y. Times, at A8, (Jan. 6, 2004) (discussing China's plan to immediately exterminate civet cats in response to their perceived role in communicating the SARS virus); Warren Hoge, *As the Disease Marches On, Britain Dooms More Animals*, N.Y. Times, at A12 (Mar. 15, 2001) (discussing the slaughter of 180,000 pigs, sheeps, and cows by the British government and its plans to kill 100,000 more); Associated Press, *Disease Detectives Track Rare Malaysian Virus*, N.Y. Times, at F2 (May 4, 1999) (noting that Malaysia killed almost one million pigs in order to stem the spread of the Nipah virus); Elisabeth Rosenthal, *Chickens Killed in Hong Kong to Combat Flu*, N.Y. Times, at A1 (Dec. 29, 1997) (describing Hong Kong's "drastic" plan to immediately kill every chicken in the territory, more than 1.2 million chickens, in order to combat a "new and sometimes deadly strain of flu"); Sarah Lyall, *Britain's Daunting Prospect: Killing 15,000 Cows a Week*, N.Y. Times, at A1 (Apr. 3, 1996) (describing Britain's plan to kill about 4.7 million cows in order to combat mad cow disease).

[298] *See* Australia - Measures Affecting Importation of Salmon, WT/DS18/R (1998), ¶¶ 2.14-2.17; Japan - Measures Affecting the Importation of Apples, WT/DS245/R (2003), paras. 2.17-2.19.

[299] *See European Communities - Measures Concerning Meat and Meat Products (Hormones),* WT/DS26/R (1997), ¶¶ II.1-5.

[300] *See, e.g., Agreement on Sanitary and Phytosanitary Measures* at Art.5 (7) ("In cases where relevant scientific evidence is insufficient, a Member may provisionally adopt sanitary or phytosanitary measures on the basis of available pertinent information, including that from the relevant international organizations as well as from sanitary or phytosanitary measures applied by other Members. In such circumstances, Members shall seek to obtain the additional information necessary for a more objective assessment of risk and review the sanitary or phytosanitary measure accordingly within a reasonable period of time.").

rests on the party imposing the measure, *i.e.*, the U.S., and the WTO has repeatedly struck down measures that do not satisfy this simple precept.[301]

195. Even if this high hurdle were met, the United States would still have to demonstrate that the California measures were not, by their nature or through their application, arbitrary or discriminatory, and that the measures did not constitute a disguised restriction on international trade.[302] As shown by the *S.D. Myers* tribunal, the concept of protecting open trade applies equally to open investment: "where a state can achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it is obliged to adopt the alternative that is most consistent with open trade."[303]

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[301] *See, e.g., Japan - Measures Affecting the Importation of Apples*, WT/DS245/AB/R (2003), ¶ 202 (holding that a risk assessment requires not just a general discussion of the perceived threat, but also "an evaluation of risk...connect[ing] the possibility of adverse effects with an antecedent or cause"); *Australia - Measures Affecting Importation of Salmon - Recourse to Arbitration under DSU Article 21.3(c)*, WT/DS18/9 (1999), ¶¶ 35-36 (explaining that the arbitrator rejected Australia's request for sufficient time to conduct a valid risk assessment because the original measure was found to be inconsistent with Australia's WTO obligations based on its failure to conduct such a risk assessment before imposing the measure; *European Communities - Measures Concerning Meat and Meat Products (Hormones) - Recourse to Arbitration under DSU Article 21.3(c),* WT/DS26/15, WT/DS48/13, ¶¶ 33-39 (1998) (same); *Australia - Measures Affecting Importation of Salmon*, WT/DS18/AB/R (1998), ¶¶ 127-134 (holding that Australia failed to conduct a valid risk assessment because it neither evaluated the likelihood of the entry, establishment, and spread of the perceived threat, nor assessed the relative effectiveness of various measures in reducing the overall disease risk); *European Communities - Measures Concerning Meat and Meat Products (Hormones),* WT/DS26,48/AB/R (1998), ¶¶ 195-197 (holding that the EC measures at issue were not based on a valid risk assessment because the scientific reports presented by the European Communities did not rationally support the EC import prohibition on hormone-treated meat and meat products).

[302] *See*, *e.g.*, chapeau to Art. XX of the GATT 1994 (noting general exceptions may be adopted or enforced "[s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade").

[303] *S.D. Myers* (Partial Award) ¶ 221.

196. Methanex has argued that under Article 1102 and the international law of national treatment there is no requirement to show California's intent to harm Methanex, though Methanex has produced ample proof to that effect. Indeed, as the WTO context makes clear, to the extent that an intent requirement exists under Article 1101, it is the United States, not Methanex, that bears the burden of proving that California, in violating national treatment standards, had no intent to discriminate or act in an arbitrary manner. Methanex has provided abundant evidence to the contrary – California's intent to discriminate against foreign methanol producers.

197. The U.S. cannot carry its burden here. Based on all the evidence, such as, for example, the EU's refusal to implement a ban, the U.S. cannot show the California measures were necessary. "The decision to ban MTBE as a fuel oxygenate and mandate ethanol as a replacement cannot be justified on a scientific or technical basis because the environmental consequences of widespread use of ethanol are largely unknown. Product substitution of such magnitude is counter to commonly accepted principles of pollution prevention, which require a thorough and timely analysis of potential adverse impacts to the environment." Moreover, there were undoubtedly less restrictive measures to deal with MTBE's purported problem than a total ban, namely fixing the leaking underground gasoline storage tanks and banning 2-stroke engines from reservoirs and other surface waters. Accordingly, the United States has failed to meet its burden under Article 1102, and the Tribunal should find that the California measures violate United States' NAFTA obligations.

5. U.S. Protection of Its Ethanol Industry Violates Numerous WTO Obligations

198. As described above, the U.S. ethanol industry is among the most highly protected and supported industries in the United States and indeed the world. This support and protection violates the United States' WTO obligations. Because of these violations there is a growing risk that U.S. trade partners will challenge the ethanol programs at the WTO. The most likely candidates are those WTO members from developing nations, such as members of the G-22, that have found their promised market access for agricultural products thwarted by the U.S. commitment – despite its alleged support of free trade – to protect its farm sector by any and all means available.

199. The support and protection provided by the U.S. federal and state governments is broad and includes:

(a) preferential tax measures,
(b) requirements to use ethanol in set proportions;
(c) prohibitions on the use of competing products, including MTBE;
(d) subsidies to support ethanol production;
(e) subsidies to support the production of ethanol feedstocks; and
(f) duties imposed on imported ethanol intended to bar its entry to the U.S. market.

Taken together, these measures insulate and protect commercially non-viable U.S.-produced ethanol from the realities of a competitive international marketplace.

200. These measures violate a broad range of WTO and NAFTA trade obligations. Specifically,

(a) The preferential tax measures violate the National Treatment obligation in GATT 1994 Article III:2 and NAFTA Article 301 by subjecting imported like products to taxation in excess of those taxes imposed on domestic ethanol.

(b) The requirement to use ethanol violates the National Treatment obligation in GATT 1994 Article III:4 and NAFTA Article 301 by according more favorable treatment to domestically-produced ethanol than to imported ethanol.

(c) The requirement to use ethanol also violates GATT 1994 Article III:5, which prohibits any measure requiring the use of a specific proportion or amount of domestic product.

(d) The prohibition on the use of competing products violates GATT 1994 Article III:4 because the prohibition on the use of these products constitutes less favorable treatment than ethanol, and denies competing products the right to continue to be used in commerce. In addition, the prohibition on the use of competing products constitutes a technical regulation respecting gasoline that raises unnecessary barriers to international trade in violation of Article 2.2 of the WTO Agreement on Technical Barriers to Trade.

(e) To the extent that the like products at issue can be defined as investments for purposes of NAFTA Chapter 11, the above violations could give rise to state-to-state dispute settlement under NAFTA Chapter 20 or to fresh investor-state dispute settlement under NAFTA Chapter 11, Part B.

(f) In addition, the requirement to use ethanol is a performance requirement for purposes of NAFTA Article 1106, giving rise to either state-to-state or investor-state dispute settlement.

(g) The subsidies provided to support the use of ethanol are intended to, and have had the effect, of displacing imported energy products. Therefore, these subsidies violate Article 5(c) and 5.3(a) of the WTO Agreement on Subsidies and Countervailing Measures.

(h) As the intention of the measures taken as a whole is to support the production of ethanol for its use in place of imported energy products, the subsidies provided to support ethanol production also violate Article 3.1(b) of the WTO Agreement on Subsidies and Countervailing Measures.

201. The U.S. Congress recently considered the Energy Policy Act of 2003 (the "Energy Bill"). If passed, this Bill would have enhanced the protection accorded to ethanol and exacerbated the WTO violations set out above. The Bill would have prohibited the use of MTBE nationwide and would have required the use of 5.0 billion gallons of domestically-produced ethanol by 2012. Although the Energy Bill was drafted in ostensibly trade-neutral language, the Bill was clearly intended to vastly increase the market for U.S. ethanol. Statements made by U.S. legislators demonstrated their intent to support the use of domestically-produced ethanol as a replacement for imported products. As has always been the case with the ethanol lobby, the comments generally disparaged foreign oil produced by oil sheiks in the Middle East, contrasting it with ethanol produced in the Midwest.[304]

202. The Energy Bill did not pass in 2003, but may well pass in 2004, triggering a WTO complaint.

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[304] *See* Senator Dick Durbin, Illinois, "Replacing Mideast oil with Midwest ethanol and soy-diesel is a winner for everyone but the oil sheiks," *Durbin, Daschle, Lott, Nelson and Others Lay Out Ethanol and Renewable Fuels Provision in Energy Bill*, Dick Durbin Press Release, Mar. 2, 2002. Senator Charles Grassley, a long time ethanol supporter stated in 1997, "Renewable fuels like ethanol and biodiesel will improve air quality, strengthen national security, reduce the trade deficit, decrease dependence on Saddam Hussein for oil, and expand markets for agricultural products," *Grassley Advances Ethanol Excise Tax Reform Proposal*, Chuck Grassley Press Release, Sept. 17, 2003. Senator Tom Daschle, in a July 30, 2003 letter to President Bush states that the RFS mandate in the Energy Bill, "helps free us from a dependence on foreign oil," *Daschle Asks Bush to Support Passing Ethanol Legislation Before August Recess*, Tom Daschle Press Release, July 30, 2003. Congressman Earl Pomeroy noted, "The substantial commitment to ethanol and biodiesel made in this bill will help our farmers and reduce our nation's dependence in foreign oil," *House Approves Energy Bill*, Earl Pomeroy Press Release, November 18, 2003.

C. Methanex Properly Alleged A Violation Of 1105

1. The FTC Decision Was A Suspect, *Post Hoc* Attempt To Amend The NAFTA, And Is Not Binding On The Tribunal In This Case.

203. As Professor Sir Robert Jennings has urged and Methanex has argued,[305] the Tribunal should disregard the NAFTA Free Trade Commission ("FTC") interpretation because it is nothing more than the U.S.' attempt to retroactively suppress a legitimate claim. First, it was highly unusual and suspect for the FTC to issue an interpretation in 2001 which specifically addresses a key assertion in Methanex' claim. As Sir Robert Jennings stated, "It would be wrong to discuss these three-Party 'interpretations' of what have become key words of this arbitration, without protesting the impropriety of the three governments making such an intervention well into the process of arbitration, not only after the benefit of seeing the written pleadings of the parties but also virtually prompted by them."[306]

204. Second, the July 31, 2001 "interpretation" of Article 1105 should have no material impact on this proceeding, for it cannot alter the substance of NAFTA's investment protections. While the effect of the "interpretation" is not entirely clear, if anything it confirms that "fair and equitable treatment" and "full protection and security" are part and parcel of the customary international law standard for the treatment of investors and their investments. Further, the FTC "interpretation" in no way contradicts the common sense conclusion that violations of independent treaty provisions may constitute a breach of Article 1105. Methanex

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[305] *See* Methanex' September 18, 2001 Submission in Response to the NAFTA Free Trade Commission Interpretation at 2; *See also* Second Opinion of Sir Robert Jennings, attached as Exhibit 1 to Methanex' September 18, 2001 Submission in Response to the NAFTA Free Trade Commission Interpretation.

[306] *See* Second Opinion of Sir Robert Jennings, at 5.

has claimed, and continues to claim, that a violation of 1102 also illustrates a violation of the minimum standard of treatment required by 1105.[307]

2. The U.S. Does Not Deny Methanex' Claim That Intentional Discrimination Violates The Minimum Standard Of Treatment Required By Article 1105

205. As Methanex alleged in its Second Amended Claim, Article 1105 requires the NAFTA Parties to "accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."[308] As demonstrated above, the California measures intended to discriminate against foreign investors and their investments,[309] and this intentional discrimination violates even the minimum standard of treatment required by Article 1105.

206. The United States does not deny Methanex' assertion. Rather, the U.S. relies on the FTC interpretation of 1105, and its stated defense against Methanex' 1102 claims.[310] As Methanex has shown this reliance is misplaced.

D. Methanex Has Properly Alleged A Violation Of 1110

207. Contrary to the U.S.' assertions,[311] Methanex has properly alleged a violation under Article 1110.[312] First, nothing about the "public health" measures immunizes them against

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[307] Second Amended Claim at ¶ 313.

[308] NAFTA Article 1105(1); *see* Second Amended Claim at ¶ 313.

[309] *See* § II, B-C, *supra*.

[310] *See* Amended Statement of Defense at ¶¶ 350-365.

[311] *See* Amended Statement of Defense at ¶ 387.

[312] Methanex has credibly alleged that the United States took actions "directly or indirectly… tantamount to . . . expropriation," within the meaning of Article 1110(c). In fact, the same allegations that support

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allegations of expropriation. Discriminatory protectionist measures disguised as acts to protect the public health are not entitled to *per se* deference. Second, the measures severely damaged Methanex' investments, and thus meet the threshold for a taking.

1. Intentionally Discriminatory Regulations Are Not Exempt From Liability for Expropriation

208. The United States argues that, because the MTBE ban was a regulatory action taken by California to protect the public health, it is not expropriatory.[313] The United States correctly states that, "as a general matter, States are not liable to compensate … for economic loss incurred as a result of a nondiscriminatory action to protect the public health."[314] However, this was not a health measure. It was not characterized as such by Davis, and the fact that California waited almost five years – for economic reasons – to implement the ban proves it was not a "health" measure. Second, these measures were discriminatory. The California MTBE ban was implemented with the intent to favor the U.S. ethanol industry.[315] The Tribunal owes no deference to protectionist regulations that intentionally discriminate. The California MTBE ban can and should be considered an indirect expropriation, or an action tantamount to expropriation.

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Methanex' Article 1105 claim also support its expropriation claim under Article 1110. *See, e.g., Melalclad* ¶ 104 ("By permitting or tolerating the conduct of Guadalcazar in relation to Metalclad which the Tribunal has already held amounts to unfair and inequitable treatment breaching Article 1105 and by thus participating or acquiescing in the denial to Metalclad of the right to operate the landfill, notwithstanding the fact that the project was fully approved and endorsed by the federal government, Mexico must be held to have taken a measure tantamount to expropriation in violation of NAFTA Article 1110(1).").

[313] *See* Amended Statement of Defense at ¶ 409.

[314] *See id.* at ¶ 411.

[315] *See supra* at ¶¶ 93-101.

209. The U.S. refers the Tribunal to the NAFTA Preamble, which sets forth objectives but no strict obligations, and the Preamble alone cannot support the U.S. claim that NAFTA allows such a discriminatory measure.[316]

210. The U.S. refers to NAFTA Article 1101(4),[317] but this section does not allow discriminatory acts that purportedly benefit the environment. The MTBE ban is simply not the type of regulation contemplated by Article 1101(4).

211. The U.S. also cites NAFTA Article 1114(2), but this provision exists to discourage Parties from relaxing environmental or health regulations as a means of attracting investment.[318] Designed to prevent a race to the bottom, the measure protects one Party from another Party's willingness to relax its current environmental standards to lure investors. This case does not involve Article 1114(2).

212. The U.S. argument is based on the proposition that expropriation for a public health purpose does not give rise to liability.[319] If this is the appropriate test, it would only apply in cases where the non-discriminatory action is, in fact, to protect public health. However, that is not the case here.

213. Before turning to the purported public health objective, it is important to note that the US bears the burden of proof of demonstrating that the non-discriminatory expropriation is

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[316] *See* Amended Statement of Defense at ¶ 412.

[317] *Id*.

[318] *Id*.

[319] Amended Statement of Defense at ¶¶ 409-410.

for a public health purpose. The burden of proof is with the United States because it is seeking to rely on an exception to Article 1110 disciplines to justify expropriation without compensation. As an exception, the US must establish that the public health objective is valid.

214. The US has failed to meet its burden for the following reasons. First, the MTBE ban at issue was not introduced to achieve a public health objective. Rather, the ban was introduced because of the environmental risk posed by leaking underground fuel storage tanks. The attempted reliance on a public health defense fails to meet the facts of this case and is little more than *post hoc* justification. Second, as Methanex argues above, there is no credible evidence suggesting that MTBE poses any public health risk. Third, the evidence demonstrates that California intended to replace MTBE with ethanol, a product that poses its own range of significant health risks. Finally, if this measure was indeed adopted to address a public health risk, MTBE would have been immediately banned and not phased out over time. The decision to allow a long phase-out period is a clear indication that California did not consider MTBE to pose a risk to public health. For the foregoing reasons, the Tribunal should wholly dismiss the US assertion that the expropriation was a non-discriminatory action taken to achieve a public health benefit.

215. Significantly, the U.S. ignored GATT Article XX, the clearest example of an exception provision, which allows Members to adopt measures that violate their trade obligations if those measures are necessary to achieve some legitimate objective. To maintain these measures, the Member must demonstrate that they are necessary, and that there are no other, less trade restrictive alternatives available that could achieve the same result. The U.S. has failed to show that California had no choice other than to ban MTBE; in fact, Methanex has amply

illustrated the alternatives available to California officials. The requirement that the exception only be used to the extent necessary to achieve a legitimate objective was intended to ensure that reliance on Article XX did not unnecessarily interfere with trade liberalization – the underlying purpose and objective of the GATT.

2. The U.S. Measures Expropriate Methanex' Investments

216. Under settled international law, an expropriation occurs where government action interferes with an alien's use or enjoyment of property.[320] Thus, in *Metalclad Corp.,* a NAFTA Tribunal explained that:

> expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole, or in significant part, of the use of reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.[321]

217. Expropriation can also occur where the State itself acquires nothing of value, but "has been the instrument of its redistribution."[322] The United States itself has recognized that

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[320] *See, e.g., Tippets, Abbett, McCarthy, Stratton v. Iran,* 6 Iran-U.S. Cl. Trib. Rep. 219, 225 (1984)*; Starrett Housing Corp. v. Iran, 4* Iran-U.S. Cl. Trib. Cl. Rep. 122, 154, 172 (1983)*; Restatement (Third) of Foreign Relations* § 712 cmt. g (1987)*;* L. Sohn & R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of* Aliens, *55* Am. J. Int'l L. 545, 553 (1961)*; see also Pope & Talbot, supra,* ¶ 98 (implicitly adopting an "interference with business" test for expropriation).

[321] *See also* Weiler, *supra* ("[A]n investor apparently does not need to prove that its subsidiary in the territory of another NAFTA Party has actually been taken over or shut down to seek compensation under Article 1110. It need only prove that some form of economic interest that can be identified as its `investment' under NAFTA Article 1139 has suffered from substantial interference as a result of the imposition of some government measure").

[322] A. Mouri, *The International Law of Expropriation as Reflected in the Work of the Iran-U.S Claims Tribunal* 66 (1994). *See, e.g.,* G. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal* 188 (1996); *Tippetts, supra*, 6 Iran-U.S. Cl. Trib. Rep. at 225. *See also S.D. Myers* (separate opinion of (continued...)

expropriation covers "a multitude of activities having the effect of infringing property rights."[323] Methanex has identified significant U.S. investments, including two U.S. subsidiaries, Methanex U.S. and Methanex Fortier, as well as the respective market shares, customer base, and goodwill of Methanex, Methanex U.S., and Methanex Fortier.[324] Methanex has alleged that the California measures at issue substantially interfere with the business and property rights of Methanex and its U.S. investments, and therefore constitute measures "tantamount to expropriation."[325] Methanex thus alleged that the measures at issue severely infringe its ability, and the ability of Methanex U.S. and Methanex Fortier to conduct business in the United States.

218. In response, the U.S. argues that "goodwill, market share, and customer base are not, by themselves, investments that are capable of being expropriated." The U.S. ignores the plain language of Article 1139(g), established NAFTA and international decisions, and its own corporate laws and practice. First, Article 1139(g) by its terms defines an "investment" to include "real estate or other property, **tangible or intangible**, . . . used for the purpose of economic benefit."[326] The U.S. argued in its Defense that 1139 is an exhaustive list of

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Dr. Bryan Schwartz), *supra,* ¶ 218 ("It is well settled in international law that en expropriation can include measures that transfer wealth from one private party to a third party that is favoured by the expropriating government.").

[323] Statement of the President, *U.S. Government Policy in International Investment* (Sept. 9, 1983), *reported in* [1981-88] 2 Cumulative Digest of U.S. Practice in Int'1 Law 2304, 2305; *see also* M. Whiteman, *Digest of Int'I Law* 1007 (1967); *Corn Prod. Refining Co. Claim,* 1955 Int'1 L. Rep. 333, 334.

[324] *See* Methanex' Counter-Memorial at 17; *supra* ¶ 121-132; s*ee* Methanex' Second Amended Claim at ¶¶ 317, 322.

[325] *See supra,* ¶ 217.

[326] *See* NAFTA Article 1139(g), emphasis added.

investments, and that because the definition does not specifically include goodwill, market share, or customer base, these investments cannot be expropriated. This argument must fail.

219. Article 1139(g) defines a **class** of property that qualifies as an investment, namely intangible property used for economic benefit. All property that meets that definition is a recognized NAFTA investment.

220. Both United States and Canadian law recognize goodwill as a corporate asset. In *Manitoba Fisheries v. The Queen*, the Canadian Supreme Court expressly recognized and ordered compensation for a taking of goodwill.[327] *Manitoba Fisheries* is considered to be a leading case on regulatory takings in Canada. Similarly, U.S. law recognizes that a company's goodwill, customer base, and market share are "intangible" assets routinely considered when appraising a business.[328] The United States Supreme Court defined goodwill in *Newark Morning Ledger Co. v. United States*, and determined that it was an intangible asset.[329] There is no doubt that market share, goodwill, and customer base are corporate property and assets.

221. Second, two NAFTA tribunals have expressly recognized that market share is an investment capable of supporting an expropriation claim under Article 1110. These cases

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[327] 1 S.C.R. 101, 108 (Can. 1979) ("[G]oodwill, although intangible in character is a part of the property of a business just as much as the premises, machinery, and equipment employed in the production of the product whose quality engenders that goodwill.").

[328] *See Black's Law Dictionary*, at 694-95 (6th ed. 1990) (defining "goodwill" as "an intangible asset" which includes "[t]he custom of patronage of any established trade or business; the benefit of having established a business and secured its patronage by the public" and "as property incident to business sold, favor vendor has won from public, and probability that all customers will continue their patronage"); *New Websters Comprehensive Dictionary of the English Language*, at 418 (1985) (defining "goodwill" as "the intangible value of a business, due to custom, reputation, or projected earning power").

[329] 507 U.S. 546, 556 (1993).

directly contradict the U.S. Defense, which stated that "International tribunals have similarly rejected claims that customer base, goodwill, and market share are, by themselves, property interests that can be expropriated."[330] As support for its assertion, the U.S. cites a Permanent International Court of Justice case from 1934, yet completely ignores two recent International Tribunals that reached an opposite conclusion **in interpreting NAFTA Chapter 11**.

222. In *Pope &* Talbot *Inc. v. Canada*, the Tribunal concluded that "the Investor's access to the U.S. market is a property interest subject to protection under Article 1110."[331] In *S.D. Myers,* the Tribunal recognized that "there [were] a number of other bases on which SDMI could contend that it has standing to maintain its [Chapter 11 claims] including that . . . its market share in Canada constituted an investment."[332] In fact, the *S.D. Myers* Tribunal noted that "rights other than property rights may be 'expropriated' and that international law makes it appropriate for tribunals to examine the purpose and effect of governmental measures."[333]

223. The U.S. Defense also ignored the precedent set by the Iran-United States Claims Tribunal, which explicitly recognized intangibles such as goodwill as an asset that can be expropriated. In *Amoco International Finance Corp. v. Iran*, the Tribunal held that, "a going concern value encompasses … intangible valuables which contribute to [a company's] earning power, such as contractual rights … as well as good will and commercial prospects."[334]

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[330] Amended Statement of Defense at ¶ 394.

[331] *Pope & Talbot*, *supra*, ¶ 96.

[332] 40 I.L.M. 1408, ¶ 232; *see also id.* ¶ 218 (separate opinion of Dr. Bryan Schwartz noting that "goodwill" is a "property interest known in law").

[333] *S.D. Myers, supra*, ¶ 281.

[334] 27 ILM 1314, 1377 (1988).

According to the Tribunal, to the extent that these various components exist and have economic value, they normally must be compensated, just as tangible goods, even if they are not listed in the books."[335]

224. As noted above, Methanex U.S.' assets include a substantial amount of intangible property rights, such as its goodwill, marketing rights, and customer base. The Tribunal should consider these assets as Methanex investments that were expropriated, as Article 1139(g) contemplates.

E. Although Methanex Is Not Required To Prove Proximate Cause, It Has Shown That The California Measures Were The Proximate Cause Of Methanex' Damages

225. The U.S. argues that Methanex' injuries were not "proximately caused" by California's NAFTA breaches and, therefore, Methanex' claim must fail.[336] First, Methanex has alleged that the California ban on MTBE was intended to harm the methanol industry. Methanex is not required to prove proximate cause where it has alleged intent. Second, the U.S. misstates the applicable legal standard, and Methanex is not required to prove that any losses were proximately caused by the measure at issue in the manner the United States has employed that term. Third, even if proximate cause is the applicable legal standard, Methanex has proven that it has been substantially damaged and that its damages were proximately caused by the California measures.

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[335] *Id*. at 1375. In footnote 622 of the United States' Second Amended Statement of Defense, the United States cites an article on the Iran-United States Claim Tribunal that purportedly states that goodwill cannot be an object of expropriation. The actual text of the *Amoco* case indicates otherwise. There, the Tribunal expressly stated that goodwill, as an intangible good, must be compensated.

[336] Amended Statement of Defense at ¶¶ 213-280.

1. Methanex Is Not Required to Prove Proximate Cause Where It Has Shown Intentional Harm

226. Methanex' allegations of intentional discrimination in its Second Amended Claim,[337] render the United States' causation arguments irrelevant. As Methanex demonstrated in its Request To Extend or Suspend the Current Jurisdictional Schedule, filed with the Tribunal on December 22, 2000, proximate cause is never an issue where, as in the case of discrimination, a claimant alleges that the harm was caused intentionally.[338]

227. Where a State intends to harm foreign investors or their investments, and where it succeeds in so doing, the applicable standards of legal causation are satisfied, and no additional showing of proximate cause is required. The United States itself has recognized that its proximate cause objection depends on the absence of any allegations of discrimination or other intentional wrongdoing.[339] Despite this prior acknowledgment, the United States Defense now fails to recognize that Methanex' intentional discrimination argument states sufficient causation without a showing of proximate cause.

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[337] *See* Second Amended Claim at ¶¶ 142-157.

[338] *Dix Case (U.S. v. Venez*., undated), 9 R.1.A.A. 119, 121 (1997) (In the absence of intentional injury, no compensation for remote losses); *See, e.g.,* B. Cheng, *General Principles of Law as Applied by International Courts and Tribunals* 251 (1987) ("If intended by the author, such consequences are regarded as consequences of the act for which reparation has to be made, irrespective of whether such consequences are normal, or reasonably foreseeable."); *cf. Provident Mut. Life Ins. Co. v. Germany* (U.S. v. Ger. 1924), 7 R.I.A.A. 91, 114-15 (1997); *Hickson v. Germany* (U.S. v. Ger. 1924), 7 R.I.A.A. 266, 268-69 (1997).

[339] *See, e.g.,* U.S. Mem. at 21-22, 22 n.37, 25-27, 30; First Partial Award ¶ 86.

228. In order to further support its proximate cause argument, the U.S. Defense relies on a now-familiar tactic, it simply misstates the significance of the cases it cites.[340] In a particularly telling example, the U.S. cites *Dix* for the proposition that international law consistently employs only a proximate cause standard.[341] Unfortunately, the United States leaves the most important portion of the *Dix* quote to ellipses. The complete quote directly supports Methanex' position that proximate cause must only be proven in the absence of intentional harm: "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**, in the absence of evidence of deliberate intention to injure.**"[342]

229. Because Methanex' allegations of damage resulting from intentional discrimination plainly foreclose the United States' proximate cause objections, the Tribunal should not consider such arguments.

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[340] For example, the U.S. relies on *Sambiaggio (Italy-Venez.)*, 10 R.I.A.A. 499, 521 (Italy-Venez. Mixed Comm'n of 1903), for the proposition that "NAFTA would have needed to make explicit any intention to abandon such a well-settled rule of international law as the proximate cause standard," but *Sambiaggio* is factually distinct from this case. There, the Tribunal held that in a situation where an enemy, in this case a revolutionary group, was the aggressor, and one is seeking damages for acts by that group, the "most direct and express evidence" is required. For the United States to allege that such an extreme case applies to the one before the Tribunal is inappropriate. The U.S. also cites *Provident Mutual Life Ins. (U.S. v. Germ.)*, 7 R.I.A.A. 91 (U.S.-Germ. Mixed Claims Comm'n 1924) in footnote 409 of its defense, yet it incorrectly cites to the Certificate of Disagreement of the German National Commissioner as the holding in that case. The United States does not cite to the Certificate of Disagreement of the American Commissioner which states, "these claims [by the insurance companies] are justified and should be allowed in accordance with the decisions of this Commission . . ." *Id.* at 96. Finally, the U.S. cites to *Administrative Decision No. II,* 7 R.I.A.A. 23, but fails to add that the American national could recover "whether the act *operated* directly on him, or indirectly as a stockholder *or otherwise*, whether the subjective nature of the loss was direct or indirect—is immaterial, but the *cause* of his suffering must have been the act of Germany or its agents." *Id.* at 29.

[341] *See* Amended Statement of Defense at ¶ 221 n.400.

[342] *See Dix* (*U.S. v. Venez.*), 9 R.I.A.A. at 121 (emphasis added).

2. NAFTA Articles 1116 and 1117 Do Not Require Proximate Cause

230. Articles 1116 and 1117 both require that the Claimant incur loss or damage "by reason of, **or** arising out of" the alleged breach.[343] The United States contends that the terms "by reason of" and "arising out of" mean the same thing, "a close and direct … link: the proximate cause standard."[344] In arguing that the two phrases are equal, the United States ignores the ordinary meaning of the word "or," which separates the two phrases, and it ignores the extensive municipal precedent that the two phrases refer to different standards of causation.

231. Use of the word "or" in these Articles reinforces this settled difference between the phrase "by reason of" and the phrase "arising out of." To collapse the two phrases into one proximate cause standard would contradict the ordinary meaning of the word "or," in violation of settled principles of treaty interpretation.[345] Moreover, as the *Loewen* Tribunal noted, NAFTA "must be interpreted in the light of its stated objectives," which "include . . . the increase of investment opportunities and the creation of effective procedures for the resolution of disputes."[346] In using the phrase "arising out of," Article 1116 authorizes claims for injuries caused directly *or* **indirectly** by breaches of NAFTA Chapter 11.[347]

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[343] NAFTA Article 1116 (emphasis added).

[344] Amended Statement of Defense at ¶ 219.

[345] *See* Vienna Convention on the Law of Treaties, Article 31.

[346] *The Loewen Group, Inc. v. United States*, ICSID Case No. ARB (AF)/98/3 (Jan. 5, 2001).

[347] Contrary to the U.S.' assertions in paragraph 222 of the U.S. Defense, there is little doubt that the United States could be held responsible for denials of justice on the part of a state. Article 105 of NAFTA provides: "The Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments." The U.S. Statement of Administrative Action on NAFTA declares that "no country can avoid its commitments under the Agreement by claiming that the

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232. In addition, Methanex conclusively demonstrated in its Counter-Memorial on Jurisdiction that, under municipal law, it is well-established that the phrase "arising out of" does *not* incorporate a proximate cause requirement.[348] Likewise, British and Australian law have interpreted the term **"arising out of"** as requiring less than proximate causation.[349] United States law also construes the phrase "arising out of" to connote a lesser standard than proximate causation.[350] In contrast, "by reason of" generally connotes proximate causation.[351]

233. The U.S. principally relies on *Hoffland Honey Co. v. National Iranian Oil Co.,* for the proposition that "arising out of" means proximate cause.[352] *Hoffland Honey* is inapplicable to this case and should be limited to its facts. Given the unusual and bizarre circumstances of that case, the Tribunal simply found that a U.S. beekeeper could not recover from an Iranian oil company which lawfully exported oil to the U.S. where that oil was then used to manufacture

(...continued)

measure in question is a matter of state or provincial jurisdiction." H.R. Doc. No. 103-159, 103d Cong., 1st Sess., v. 2, at 5 (1993). This was also the understanding of the U.S. Trade Representative at the time NAFTA was approved. Letter from Michael Kantor to Henry A. Waxman, Chairman, Subcomm. on Health and the Env't. (Sept. 7, 1993), H.R. Rep. No. 103-361(III), at 132 (1993), reprinted in 1993 U.S.C.C.A.N. 2858, 2862. In this respect, NAFTA codifies basic principles of international law: federal responsibility for a political subdivision's acts is well established. *See* 2 Roberto Ago, Third Report on State Responsibility, Y.B. Int'l L. Comm'n 199, 257 (1971) ("The attribution to a federal State of the acts of organs of its component states, in cases where such acts enter into consideration at the international level as a source of responsibility, is also a firmly established principle."). The U.S. State Department recognized this principle when it refused to argue that the United States was not liable for the misconduct of Texas officials; when the United States had similar claims, "we have invariably insisted on the liability of the Federal Government although the failure ... was chargeable to the officials of one of the constituent states or provinces." Political Subdivisions, 5 Green Haywood Hackworth, Digest of International Law 527, 594 (1943); *see also* DeGalvan Claim (Mexico v. United States), Opinions of the Commissioners 408 (1927).

[348] *See* Methanex' Counter-Memorial at 31-32.

[349] *Id.* at 32-33.

[350] *Id.* at 33-34.

[351] *See id.* at 34.

[352] *See* Amended Statement of Defense at 89, n.397.

agrichemicals that were sprayed on various crops eventually resulting in the unforeseeable loss of bee colonies.[353] *Hoffland Honey* is significantly different from the facts in this case and should be viewed accordingly. Moreover, Methanex is not aware of any international tribunal that has followed the reasoning in *Hoffland Honey*.

3. Methanex Has Proved Injuries Proximately Caused By The California Measures

234. Whatever the appropriate legal standard, Methanex has already proffered conclusive evidence that the California measures directly and immediately injured Methanex and its U.S. investments. The United States argues that Methanex' claim "fail[s] because the causal chain on which they rely is too remote to be sustained under established principles of international law."[354] The United States argues that each injury claimed by Methanex "fails as a matter of law to be cognizable under Articles 1116(1) or 1117(1)."[355] Finally, the United States argues that "each fails as a matter of fact because Methanex has not met its burden of demonstrating that it has actually incurred any such damage."[356] These assertions are meritless.

a) The Damages Were Directly and Proximately Caused

235. There should no longer be any doubt that Methanex has satisfied whatever remoteness or proximity test the Tribunal adopts. First, both sworn witness testimony and the independent, contemporaneous, and unbiased evidence of investment analysts shows that the California MTBE ban directly caused a downgrade to Methanex' debt rating, directly increasing

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[353] *Hoffland Honey Co. v. National Iranian Oil Co.*, 2 Iran-U.S. Cl. Trib. Rep. 41 (Jan. 26, 1983).

[354] Amended Statement of Defense at ¶ 228.

[355] *Id.* at ¶ 229.

[356] *Id.*

its cost of capital.[357] Second, the same evidence shows that the ban directly caused a decrease in the value of Methanex' share price. The U.S. cannot credibly dispute the fact of that damage.

236. Third, the sworn witness testimony, contract documents, and other uncontroverted evidence shows that as a direct result of the California ban, Methanex U.S.' own customers in California – integrated refiners such as ChevronTexaco, ExxonMobil, Valero, etc., who had never purchased MTBE – stopped purchasing methanol from Methanex U.S. and started purchasing ethanol from the U.S. ethanol industry.[358] There is nothing remote or attenuated about this shift, nor the damage it inflicted on Methanex U.S. by diminishing its sales, profits, market share, customer base, and goodwill.

237. Fourth, the evidence shows that the MTBE ban first contributed to the continuing shut down of Fortier, then to its write-off, and finally to its permanent closure.[359]

238. Finally, one of the key tests of proximate cause is whether the damage caused was foreseeable. Here, the evidence is undisputed that both California and the U.S. actually foresaw that a required shift from MTBE to ethanol would directly damage Methanex and other foreign methanol producers.[360] Accordingly, both Burton's statement and the admission of the U.S. itself fatally undercut the U.S.' remoteness defense.

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[357] *See* Third Macdonald Aff. at ¶ 31.

[358] *Supra*, ¶¶ 18-25.

[359] Third Macdonald Aff. at ¶ 10.

[360] *Supra*, ¶¶ 36-40.

b) All of Methanex' Losses Are Recoverable

239. NAFTA Article 1116 allows an investor to recover "loss or damage" due to a NAFTA breach, and Article 1117 allows an "enterprise" (*i.e.*, a local company such as Methanex U.S.) to recover the same "loss or damage." Neither section contains any limitation whatsoever on the **type** of damage that can be recovered. This is consistent with international law, which requires a damaged claimant to be made whole by recovering all its damages: the Permanent Court of International Justice articulated the standard in the well-known *Chorzow* case:

> [R]eparation must, as far as possible, wipe-out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed.[361]

Thus both NAFTA and international law make clear that Methanex can recover all the damages it can prove, regardless of "type."

240. Despite the absence of any textual support in NAFTA or citations to international law, the U.S. tries to manufacture out "of whole cloth" a series of damage limitations. This is not the first time the U.S. (and other NAFTA Parties) have attempted to concoct damage limitations that NAFTA tribunals have rejected. Thus, in three cases the NAFTA Parties unanimously argued that under Article 1116 an investor could not recover for damages it suffered in its home country because of treatment to its investments in a host country, such as a debt downgrade or a drop in share value, but only for damage that it had suffered "directly" in

[361] Factory at Chorzow, Merits, 1928 P.C.I.J. (Set. A) No. 17 at 47.

the host country. Three tribunals – *Pope & Talbot, S.D. Myers,* and *Mondev* – flatly rejected these concocted limitations.[362]

241. Furthermore, there is no legal basis for the damage limitations the U.S. urges. For example, it is settled NAFTA and international law that market share and good will are investments, and that any damages to them are cognizable.[363] That is especially true where, as here, the claimant has proved real economic value for goodwill and market share.[364]

242. The U.S. argues that a drop in a company's share price is not a damage to the corporation.[365] International and municipal law leave no doubt that a dramatic fall in the share price of a corporation harms not only the shareholders, but also the corporation itself.[366] The precipitous drop in Methanex' share price was thus not only a direct damage to Methanex, but it reflected the extensive damage that the California ban inflicted on Methanex' wholly-owned

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[362] *See* Todd Weiler, *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (forthcoming 2004) (manuscript at 184, on file with articles); *see also* refining to *Pope &* Talbot, *supra*, at 36; *Mondev International Ltd. v. USA*, Final Award, ICSID No. ARB(AF)/99/2, Oct. 11, 2002 at 26; *S D. Myers*, ¶¶ 229-232.

[363] NAFTA Article 1139(g) includes tangible property in the definition of investment; *Pope & Talbot, supra,* ¶ 96 ("The investor's access to the U.S. market is a property interest subject to protection under Article 1110."). *See also S.D. Myers*, *supra*, at ¶ 232 ("The Tribunal recognizes that there are a number of other bases on which SDMI could contend that it has standing to maintain a claim including that … its market share in Canada constituted an investment.")

[364] Third Macdonald Aff. at ¶ 6.

[365] Amended Statement of Defense at ¶ 279.

[366] *See* Craig W. Hammond, *Limiting Directors' Duty Of Care Liability: An Analysis Of Delaware's Charter Amendment Approach*, 20 U. Mich. J.L. Ref. 543, 551 (1987) ("The stock price will reflect any harm to the corporation."); Orit Goldring and Antonia L. Hamblin, *Think Before You Click: Online Anonymity Does Not Make Defamation Legal*, 20 Hofstra Lab. L.J. 383, 397-400 (2003) (indicating that corporations are harmed through dramatic drops in their share prices); Barry E. Adler and Ian Ayres, *A Dilution Mechanism for Valuing Corporations in Bankruptcy*, 111 Yale L.J. 83, 97 n.36 (2001) (a corporation's injury double the difference between the pre-tort stock price and the post-tort stock price).

U.S. subsidiaries, Methanex U.S. and Methanex Fortier. The *Pope & Talbot* tribunal expressly held that this type of damage is recoverable:

> [W]here the investor is the sole owner of the enterprise [*i.e.*, the local corporation] it is plain that a claim for loss or damage to its interest in that enterprise/investment may be brought under Article 1116. It remains of course for the investor to prove that loss or damage was caused to its interest, and that it was causally connected to the breach complained of.[FN: Pope & Talbot, Damages, Para. 80]

Thus, the irrefutable evidence shows that the ban damaged Methanex and its Methanex' U.S. interests, and that the ban led to the drop in Methanex' share value. Accordingly, that damage is recoverable.

243. The U.S. alleges that because Methanex' damages are "trade" damages, not "investment" damages, they are not recoverable under Chapter 11. Again, it is settled NAFTA law that a government measure can violate both the trade and the investment provisions of NAFTA, and thus cause both trade and investment damages.[367] That is the case here. As noted above, the U.S.' extensive protection of its ethanol industry – including the California measures – quite clearly violates the U.S.' NAFTA and WTO trade obligations. Many countries, especially in the G-22, can and perhaps will launch successful challenges at the WTO. But as the cases cited above recognize, those same "trade" measures can also damage and diminish the value of an investment protected by NAFTA. Methanex U.S. is incontrovertibly a U.S.

[367] *Pope & Talbot Inc.*, *supra*, ¶ 33 ("[T]he fact that a measure may primarily be concerned with trade in goods does not necessarily mean that it does not also relate to investment or investors."); *S.D. Myers*, *supra*, ¶ 294 ("The view that different chapters of the NAFTA can overlap and that the rights it provides can be cumulative except in cases of conflict, was accepted by the decision of the Arbitral Tribunal in *Pope and Talbot*. The reasoning in the case is sound and compelling. There is no reason why a measure which concerns goods (Chapter 3) cannot be a measure relating to an investor or an investment (Chapter 11)."); *See Ethyl Corp. v. Canada* ¶¶ 63-64 (Tribunal concluded that it cannot exclude claimant's claim based on Canada's argument that alleged actions also gave rise to a claim under NAFTA Chapter 3.).

investment under NAFTA, and just as incontrovertibly was damaged when the California ban forced its customers to stop buying from it. Consequently, Methanex U.S. has lost sales, profits, revenues, goodwill, customer base, and market share. The fact that these may also be "trade" losses does not undermine their status as investment losses.

244. The last issue concerns Methanex' attempts to mitigate its losses. Methanex, after the MTBE ban was announced, restructured its U.S. operations and gradually reduced its exposure to California refiners and other manufacturers of MTBE. It shifted its marketing and sales efforts to other customers in order to cushion and ameliorate the economic consequences of the ban.[368] In response to Methanex' mitigation, the U.S. now argues that it is not liable for **any** damages, because Methanex inflicted the damages on itself.

245. The U.S. position is, of course, extremely inequitable, but more important, international and municipal law are clear: while a plaintiff has a duty to mitigate its losses, the fact that reasonable steps were taken to mitigate such damages never extinguishes the plaintiffs' claims for damages it does suffer.[369]

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[368] Third Macdonald Aff. at ¶ 7.

[369] *See* 1 M. Whiteman, *Damages in International Law* 199-216 (1937) (under international law, plaintiffs have a duty to take steps to mitigate their losses, but such mitigation does not extinguish their claims or preclude their recovery for damages against the defendant); Saul Litvinoff, *Damages, Mitigation, and Good Faith*, 73 Tul. L. Rev. 1161 (1999) (under Roman law, common law, and foreign law, plaintiffs have a duty to mitigate their damages, but such efforts do not act to bar recovery against the defendants); Robert L. Dunn, I Recovery of Damages for Lost Profits 523-30(5th ed. 1998) (while plaintiffs must take reasonable efforts to mitigate its losses, such mitigation does not preclude recovery); Restatement (Second) of Torts 918 cmt. a (1979) (indicating that the obligation to mitigate does not extinguish the plaintiff's cause of action or claim to recovery); Restatement (Second) of Contracts 350 (1981) ("The injured party is not precluded from recovery…to the extent that he has made reasonable but unsuccessful efforts to avoid loss.").

F. Methanex Added No New Claims In Its Second Amended Claim

246. The U.S. Defense asserts that Methanex' Statement of Claim contained a new claim regarding California's prohibition of methanol.[370] For three independent reasons, the Tribunal should dismiss this final jurisdictional gasp by the U.S. First, Methanex alleged in its Second Amended Claim – as it did in prior filings – that the California measures violate articles 1102, 1105, and 1110 of the NAFTA; there are no new claims here. Second, the International Court of Justice case cited by the U.S.[371] is inapposite because the issues highlighted by the U.S. all relate to the *same* operative facts and California measures as those raised prior to the Second Amended Claim. Third, although the U.S. suggests that it has been prejudiced by having to respond to Methanex' claims,[372] it had over a year from the time of the submission of the Second Amended Claim to the time it responded with submission of the U.S. Defense, and therefore no prejudice can exist.

G. Any Costs Should Be Awarded Against The United States For Prolonging The Jurisdictional Phase Of These Proceedings

247. Contrary to the U.S. assertion, if any party should bear the full cost of this proceeding, it should be the U.S.[373] The U.S. persists in arguing the obvious, refusing to recognize the binary choice that has now greatly increased ADM's ethanol sales in California and greatly reduced Methanex' sales. The U.S. has engaged in "scorched earth" litigation by, for example, asserting that no record ownership of Methanex U.S. exists while ignoring the sworn

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[370] Amended Statement of Defense at ¶ 418.

[371] *Id.* at ¶ 421.

[372] *Id.* at ¶ 424.

[373] *Id.* at ¶¶ 427-444.

testimony of Mr. Macdonald. These repeated, deliberate attempts to prolong the proceedings have needlessly increased the cost of this litigation, and the U.S. should bear the burden caused by its litigation choices. If the Tribunal allows the U.S. to successfully evade and delay, it could encourage NAFTA members to throw up jurisdictional roadblocks in future cases in the hopes of sufficiently discouraging private companies from litigating these types of legitimate claims.

248. In the event that, despite the overwhelming evidence, the Tribunal decides against Methanex, it should nevertheless deny the U.S. request for fees and order that each party split the expenses of the Tribunal and the Secretariat. Such a result is proper where, as here, the "dispute rais[es] difficult and novel questions of far-reaching importance for each party."[374] Indeed, the Tribunal has already manifested an express intention that "Methanex and its legal advisors should have the best opportunity to advance Methanex' best case."[375] Methanex has done no more.

IV. CONCLUSION

249. For all the reasons set forth above, Methanex respectfully urges the Tribunal to find the United States liable under NAFTA for the California MBTE ban.

Dated: February 19, 2004

[374] *Loewen* ¶ 240. ARB(AF)/98/3 (Jun. 26, 2003).

[375] Partial Award on Jurisdiction ¶ 23.

Respectfully submitted,

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TABLE OF CONTENTS

Page