

Exhibit D

Opinion of C. Ehlermann

OPINION

of

Professor Claus-Dieter Ehlermann

**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

THE UNITED STATES OF AMERICA,

Respondent/Party

November 4, 2002

Table of Contents

I.	The Object of this Opinion	1
II.	The Measures at Issue.....	2
III.	The National Treatment Obligation in WTO Law.....	4
A.	'Like products'	5
1.	Meaning of the Term 'Like products' in Article III:4 of the GATT 1994 – Considerations of Principle.....	5
2.	Examining 'Likeness' under Article III:4 – Questions of Methodology	8
3.	The Appellate Body's 'Like Product' Analysis 'In Concreto' in the <i>Asbestos</i> Case.....	9
4.	Overall Appreciation of the Appellate Body's Determination of 'Likeness' under Article III:4	12
5.	The Application of the Appellate Body's Approach in <i>Asbestos</i> to the Products at Issue in the Present Case	14
B.	Less favourable treatment.....	19
1.	Meaning of the Term 'Treatment No Less Favourable Than That Accorded To 'Like Products' of National Origin' in Article III:4 of the GATT 1994 – Considerations of Principle	19
2.	Application of these Principles of Interpretation to the Californian Measures	27
IV.	The relevance of 'intent' in a WTO national treatment case	31
V.	A final comment on intent	35

I. The Object of this Opinion

1. I write this opinion, principally, on the basis of the expertise in WTO law on national treatment I developed during my tenure on the Appellate Body of the WTO, where I served as a member from 1995 to 2001 (and as a presiding member in 2001).
2. My opinion in the present case focuses on what approach I believe the WTO Appellate Body would be likely to take under the national treatment obligation of WTO law if it were presented with the same facts as those with which you are faced. My opinion assumes the facts in evidence, as presented by the complainant, and focuses on the legal analysis.
3. My opinion relies, whenever and as much as possible, on existing WTO Appellate Body Reports. However, not all the issues arising in this case, and in particular not all of those arising under the national treatment obligation of Article III GATT 1994, have been decided in WTO 'jurisprudence'. In coming to my conclusions, I therefore cannot always rely on established WTO 'case law', but have to explain my own understanding of the law and the way in which I believe this law is likely to develop.
4. To be clear from the outset, this opinion does not have the ambition of determining whether or not the Californian measures actually constitute a violation of WTO law. The goal of this opinion is rather to provide a comprehensive view of the analysis the WTO Appellate Body would undertake in examining a discrimination claim under Article III:4 GATT, notably in respect of 'likeness' and 'less favourable treatment'.
5. I will also comment on the relevance of 'intent' in such a GATT discrimination claim, in particular in relation to Article XX GATT. I will not make an attempt to analyse exhaustively whether the WTO Appellate Body, having found that the Californian measures constitute discrimination, would subsequently find that these regulations could nevertheless be justified under the GATT's public policy exceptions, notably those relating to environmental protection, embodied in Article XX(g) GATT. My discussion of Article XX will primarily focus on the possible relevance of protectionist intent in a regulation that would perhaps otherwise be justified as an environmental regulation.

6. Finally, I will comment on the balance that I see in the regulation of 'like products'. In short, I rely on Appellate Body *dicta* to hold that disfavouring imported 'like products' amounts to protection of the corresponding domestic 'like products'.

II. The Measures at Issue

7. Methanex challenges three measures adopted by the State of California:¹
- first, a labelling requirement for MTBE-containing gasoline (a requirement which is currently in force),
 - second, an impending ban on MTBE (which was to apply from December 31, 2002 but has been postponed until December 31, 2003), and
 - third, a ban on all gasoline oxygenates other than ethanol (which was to apply from December 31, 2002 but has been postponed until December 31, 2003).

All these measures apply exclusively to the territory of the State of California.

8. I understand these measures to be as follows: first, the labelling requirement is in force. By Executive Order D-5-99, issued on March 25, 1999, the Governor of California required that all gasoline containing MTBE be labelled at the gasoline pump.² On December 16, 1999, the California Air Resources Board ('CARB') implemented the Governor's labelling requirement, specifically providing that gasoline containing MTBE be labelled at the pump as follows: '*Contains MTBE. The State of California has determined that the use of this chemical presents a significant risk to the environment.*'³ I understand that no other gasoline oxygenates, such as ethanol, are subject to this labelling requirement.
9. Second, I understand that there is an impending ban on MTBE in gasoline, which was to come into force by December 31, 2002, but which has been postponed until December 31,

¹ See Methanex's Second Amended Statement of Claim, sect. III.

² See Methanex's Second Amended Statement of Claim, sect. V. E. 2.; Executive Order D-5-99 by the Governor of the State of California, para. 7.

³ See Methanex's Second Amended Statement of Claim, sect. V. E. 2.; Cal. Code Regs. tit. 13, § 2273(a).

2003.⁴ This ban was called for in Executive Order D-5-99, where the Governor of California instructed the California Energy Commission in consultation with the CARB to develop a timetable *'for the removal of MTBE from gasoline at the earliest possible date, but not later than December 31, 2002.'* On September 2, 2000, regulations adopted by the CARB pursuant to the Governor's Executive Order went into effect, which would have prohibited the use of MTBE in Californian gasoline as of December 31, 2002 ('CaRFG3 Regulations')⁵, but for the postponement to December 31, 2003.⁶

10. Additionally, these regulations will prohibit the marketing of *'California gasoline which has been produced with the use of any oxygenate other than ethanol or MTBE unless a multimedia evaluation of use of the ether in California gasoline has been conducted and the California Environmental Policy Council ... has determined that such use will not cause a significant adverse impact on the public health or the environment.'*⁷ I understand that through this regulation not only MTBE, but also methanol as a gasoline oxygenate will be banned.⁸
11. I note that the last two of these measures are not yet in force, however for the sake of this opinion, I will analyse them as if they were. I note that as a matter of WTO national treatment law, the fact that adopted legislative texts already exist, and their already resulting

⁴ I understand that by Executive Order D-52-02 of March 14, 2002, the Governor of California noted that *'strengthened underground storage tank requirements and enforcement have significantly decreased the volume and rate of MTBE discharges since Executive Order D-5-99 was issued in March of 1999'* and remarked that *'the current production, transportation and distribution of ethanol is insufficient to allow California to meet federal requirements and eliminate use of MTBE on January 1, 2003'*. The Governor of California ordered *'that by July 31, 2002, the board shall take the necessary actions to postpone for one year the prohibitions of the use of MTBE, and other specified oxygenates in California gasoline, ...'*. Therefore, notwithstanding the recognition that strengthened underground storage tank requirements and enforcement have significantly decreased the volume and rate of MTBE discharges since Executive Order D-5-99, the ban on the use of MTBE and methanol in California gasoline was not abandoned, but it was only postponed until December 31, 2003, see Methanex's Second Amended Statement of Claim, sect. V. E. 3. b).

⁵ See Methanex's Second Amended Statement of Claim, sect. V. E. 2.; Cal. Code Regs. tit. 13, § 2262.6.

⁶ See Methanex's Second Amended Statement of Claim, sect. V. E. 3. b).

⁷ See Cal. Code Regs. tit. 13, § 2262.6(c); Methanex's Second Amended Statement of Claim, sect. V. E. 2.

⁸ See Methanex's Second Amended Statement of Claim, sect. V. E. 3. b); Cal. Code Regs. tit. 13, § 2262.6(c). Since methanol is not an ether, but an alcohol, the uncertainty of any future determination that use of methanol does not cause adverse effects is reinforced by the regulation's reference solely to the *'evaluation of use of the ether'*.

chilling effect on the use of methanol,⁹ would more than likely establish that these measures were ripe for consideration.¹⁰

III. The National Treatment Obligation in WTO Law

12. Methanex's detailed challenge of these measures under NAFTA is laid out in its pleadings. In short, I understand that Methanex, a Canadian producer of methanol, considers that these Californian measures discriminate against foreign methanol investors (either because they disadvantage methanol itself as an oxygenate and/or as the key ingredient of MTBE, an ether-based oxygenate) and favour domestic ethanol producers.
13. The purpose of this opinion is to provide the arbitrators with insight into how a WTO analysis would resolve the question as to whether the disputed Californian regulations amount to unlawful discrimination, i.e., constitute a national treatment violation within the meaning of Article III:4 GATT. That analysis would inquire into whether the Californian regulations afford 'less favourable treatment' to imported products than to 'like products' of national origin. In WTO law, the analysis would not stop at a finding of less favourable treatment; the defending party would be expected to plead that any such 'less favourable treatment' could be justified by a public policy exception, notably related to the environment or public health, as detailed in Article XX GATT.
14. As mentioned above, I will not enter into an analysis of Article XX GATT, but I will address the question to what extent a government's intent to discriminate against imported products is relevant to a finding of unlawful discrimination within the meaning of Article III:4 GATT, or its possible justification under one of the public policy exceptions of Article XX GATT.

⁹ See Methanex's Second Amended Statement of Claim, sect. V. D.

¹⁰ Legislation which has been adopted but which has not yet entered into force has been examined in the WTO, see for example Appellate Body Report, *Chile – Taxes on Alcoholic Beverages (Chile – Alcoholic Beverages)*, adopted 12 January 2000, WT/DS87, 110/AB/R, where in 1999, the Appellate Body considered a Chilean system for the taxation of alcoholic beverages that would only enter into force in 2000. As mentioned in the text, such legislation can already have a 'chilling' effect, in that it can have an impact on the behaviour of economic operators similar to that resulting from rules that are not mandatory but rather discretionary. See for example, *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, report of the Panel of 22 December 1999, at paras. 7.88, 7.91 and 7.92.

15. Article III:4 calls for national treatment in all the internal rules of the Members, and reads as follows:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

16. According to Article III:4, the obligation to accord to imported products 'treatment no less favourable' is limited to 'like products' of national origin. It is therefore necessary to examine first the meaning of 'likeness' in Article III:4. I will then turn to the meaning of 'less favourable treatment'.

A. 'Like products'

1. Meaning of the Term 'Like products' in Article III:4 of the GATT 1994 – Considerations of Principle

17. The term 'like products' has often been addressed in GATT or WTO dispute settlement proceedings.¹¹ However, the meaning of the word 'like' in Article III:4 of the GATT 1994 has so far only been once examined by the Appellate Body, i.e. in the *Asbestos* case.¹² The following analysis will rely on this – leading – case.
18. According to the Appellate Body Report in *Asbestos*, the ordinary meaning of the word 'like' alone is inconclusive. It is therefore necessary to turn to the relevant context of Article III:4 GATT 1994. Most important is in this respect Article III:1 GATT 1994.¹³ The 'general principle' set forth in Article III:1 – that government measures should not be applied 'so as to

¹¹ See Appellate Body, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products (European Communities - Asbestos)*, WT/DS135/AB/R, adopted 5 April 2001, at its footnote 58.

¹² Cited above at footnote 11.

¹³ Article III:1 GATT reads: 'The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.'

afford protection to domestic products' – 'informs' the rest of Article III and acts as a 'guide to understand and interpreting the specific obligations contained' in the other paragraphs of Article III, including paragraph 4. Thus, Article III:1 has particular contextual significance in interpreting III:4, as it sets forth the general principle pursued by that provision.¹⁴

19. In its Report in *Japan – Alcoholic Beverages*, the Appellate Body had described the 'general principle' articulated in Article III:1 as follows:

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III 'is to ensure that internal measures 'not be applied to imported and domestic products so as to afford protection to domestic production''. Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. ... Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products ...¹⁵ (underlining added)

20. Referring to this statement, in *Asbestos*, the Appellate Body states that the term 'like product' in Article III:4 must be interpreted to give proper scope and meaning to this principle. There must be consonance between the objective pursued by Article III, as enunciated in the 'general principle' articulated in Article III:1, and the interpretation of the specific expression of this principle in the text of Article III:4. This interpretation must, therefore, reflect that, in endeavouring to ensure 'equality of competitive conditions', the 'general principle' in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, between the domestic and imported products involved, 'so as to afford protection to domestic production'.¹⁶

¹⁴ *European Communities - Asbestos*, (cited above at footnote 11), para. 93 with references to Appellate Body, *Japan – Taxes on Alcoholic Beverages (Japan – Alcoholic Beverages)*, WT/DS8,10,11/AB/R, adopted 1 November 1996, DSR 1996:I, at para. 111.

¹⁵ *Japan – Alcoholic Beverages*, (cited above at footnote 14), at paras. 109 and 110.

¹⁶ *European Communities - Asbestos*, (cited above at footnote 11), at para. 98.

21. Article III:4 only uses the word 'like', while Article III:2, through its 'Ad Note', explicitly says that it applies to both 'like' and 'directly competitive or substitutable products'.¹⁷ The Appellate Body addresses this textual difference in *Asbestos*, and says:

As products that are in a competitive relationship in the marketplace could be affected through treatment of imports 'less favourable' than the treatment accorded to domestic products, it follows that the word 'like' in Article III:4 is to be interpreted to apply to products that are in such a competitive relationship. Thus, a determination of 'likeness' under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products. ... We are not saying that all products which are in some competitive relationship are 'like products' under Article III:4. In ruling on the measure at issue, we also do not attempt to define the precise scope of the word 'like' in Article III:4. Nor do we wish to decide if the scope of 'like products' in Article III:4 is co-extensive with the combined scope of 'like' and 'directly competitive or substitutable' products in Article III:2. However, we recognize that the relationship between the two provisions is important, because there is no sharp distinction between fiscal regulation, covered by III:2, and non-fiscal regulation, covered by Article III:4. Both forms of regulation can often be used to achieve the same ends. It would be incongruous if, due to a significant difference in the product scope of these two provisions, Members were prevented from using one form of regulation – for instance fiscal – to protect domestic production of certain products, but were able to use another form of regulation – for instance, non-fiscal – to achieve those ends. This would frustrate a consistent application of the 'general principle' of Article III:1.¹⁸ (underlining added)

22. The Appellate Body therefore concludes that the scope of 'like' in Article III:4 is broader than the scope of 'like' in Article III:2, first sentence. In view of the different language of Article III:2 and Article III:4, the Appellate Body concludes also that the product scope of Article III:4, although broader than the first sentence of Article III:2 (where 'like' is mentioned), is certainly not broader than the combined product scope of the two sentences of Article III:2 ('like' plus 'directly competitive or substitutable').¹⁹ The Appellate Body

¹⁷ Article III:2 GATT reads: 'The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.' Article III:2 refers to an Ad Note, which says: 'A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.'

¹⁸ *European Communities - Asbestos*, (cited above at footnote 11), para. 99.

¹⁹ *European Communities - Asbestos*, (cited above at footnote 11), para. 99.

recognizes however expressly that, by interpreting the term 'like products' in this way, it gives that provision a relatively broad scope – although no broader than the product scope of Article III:2.²⁰

2. Examining 'Likeness' under Article III:4 – Questions of Methodology

23. Turning to the question of how to proceed in determining whether products are 'like' under Article III:4, the Appellate Body states that this assessment must be made on a case by case basis. The Appellate Body notes that the Report of the Working Party on *Border Tax Adjustments* has outlined an approach that has been followed and developed by several panels and the Appellate Body itself in its Report *Japan – Alcoholic Beverages*.²¹ This approach has, in the main, consisted of employing four general criteria in analysing 'likeness': (i) the properties, nature and quality of the products; (ii) the end-uses of the products; (iii) consumers' tastes and habits – more comprehensively termed consumers' perceptions and behaviour – in respect of the products; and (iv) the tariff classification of the products.²² These four criteria comprise four categories of characteristics that the products involved might share: (i) the physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes.²³
24. The Appellate Body observes that these general criteria provide a framework for analysing the 'likeness' of particular products on a case by case basis. These criteria are simply tools to assist in the task of sorting and examining the relevant evidence. They are neither treaty-mandated nor a closed list of criteria that will determine the legal characterization of products. More important, the adoption of a particular framework to aid in the examination

²⁰ *European Communities - Asbestos*, (cited above at footnote 11), para. 100.

²¹ *Japan - Alcoholic Beverages*, (cited above at footnote 14), para. 113, and in particular, footnote 46.

²² The fourth criterion, tariff classification, was not mentioned by the Working Party on Border Tax Adjustments, but was included by subsequent panels.

²³ *European Communities - Asbestos*, (cited above at footnote 11), para. 101.

of evidence does not dissolve the duty or the need to examine, in each case, *all* of the pertinent evidence.²⁴ When all the relevant evidence has been examined, panels must determine whether that evidence, as a whole, indicates that the products in question are ‘like’ in terms of the legal provision at issue. The Appellate Body notes, however, again that, under Article III:4, the term ‘like products’ is concerned with competitive relationships between and among products. And it concludes its general considerations on how to assess ‘likeness’ in Article III:4 with the sentence: ‘Accordingly, whether the *Border Tax Adjustments* framework is adopted or not, it is important under Article III:4 to take account of evidence which indicates whether, and to what extent, the products involved are – or could be – in a competitive relationship in the marketplace.’²⁵ (underlining added)

3. The Appellate Body’s ‘Like Product’ Analysis ‘In Concreto’ in the *Asbestos Case*

25. In its Report in *Asbestos*, the Appellate Body reversed the Panel’s finding that (i) chrysotile asbestos fibres, on the one hand, and PCG fibres – PVA, cellulose and glass fibres, on the other, as well as (ii) cement based products containing chrysotile asbestos fibres and cement-based products containing PCG fibres, are ‘like products’ under Article III:4. The Appellate Body concluded that Canada had not satisfied its burden of proof that these fibres/cement based products are ‘like products’ under Article III:4. Although not as relevant as the preceding general and methodological considerations, the Appellate Body’s criticism of the Panel Report provides useful insights into the analysis of ‘likeness’ in Article III:4.
26. In the *Asbestos* case, the Panel had followed the *Border Tax Adjustments* Report approach. After reviewing the *first* criterion, ‘properties, nature and quality of the products’, the Panel concluded that chrysotile *fibres* are ‘like’ PVA, cellulose and glass fibres. The Panel found that it was not decisive that the products do not have the same structure or chemical composition, nor that asbestos is unique. Instead, the Panel focused on market access and whether the products have the same applications and can replace each other for some

²⁴ *European Communities - Asbestos*, (cited above at footnote 11), para. 102.

²⁵ *European Communities - Asbestos*, (cited above at footnote 11), para. 103.

industrial uses. The Panel also declined to introduce a criterion on the health risk of a product.

27. Under the *second* criterion, 'end use', the Panel stated that it had already found, under the first criterion, that the products have certain identical or at least similar end-uses and it did not, therefore, consider it necessary to elaborate further on this criterion. The Panel declined to take position on 'consumer' tastes and habits', the *third* criterion, because the criterion would not provide clear results. Finally, the Panel did not regard as decisive the different tariff classification of the fibres. Based on this reasoning, the Panel concluded that chrysotile asbestos fibres and PCG fibres are 'like products' under Article III:4. Applying its reasoning for fibres, and noting that the individual *cement based products* have the same tariff classification, irrespective of their fibre content, the Panel concluded that these cement-based products are also 'like' under Article III:4.²⁶
28. According to the Appellate Body, having adopted an approach based on the four criteria set forth in *Border Tax Adjustments*, the Panel should have examined the evidence relating to each of those four criteria and, then, weighed all of that evidence, along with any other relevant evidence, in making an overall determination of whether the products at issue could be characterized as 'like'. For the Appellate Body, it was inappropriate for the Panel to express a conclusion after examining only one of the four criteria, i.e., only some of the evidence.²⁷
29. Although it is always dangerous to isolate and highlight certain passages of a complex reasoning, I believe that it is useful to underline for the purposes of the present case the following passages of the Appellate Body's analysis of the four criteria set forth in *Border Tax Adjustments*.
30. On the *first* criterion:

²⁶ *European Communities - Asbestos*, (cited above at footnote 11), paras. 105-108.

²⁷ *European Communities - Asbestos*, (cited above at footnote 11), para. 109.

We believe that physical properties deserve a separate examination that should not be confused with the examination of end-uses. Although not decisive, the extent to which products share common physical properties may be a useful indicator of 'likeness'. Furthermore, the physical properties of a product may also influence how the product can be used, consumer attitudes about the product, and tariff classification.²⁸ ... In particular, panels must examine those physical properties of products that are likely to influence the competitive relationship between products in the marketplace. ...²⁹

31. On the *second* criterion and *third* criteria:

[W]e note that these two criteria involve certain of the key elements relating to the competitive relationship between products: first the extent to which products are capable of performing the same, or similar, functions (end-uses), and, second, the extent to which consumers are willing to use the products to perform these functions (consumers' tastes and habits). Evidence of this type is of particular importance under Article III of the GATT 1994, precisely because that provision is concerned with competitive relationships in the marketplace. ... Thus, evidence about the extent to which products can serve the same end-uses, and the extent to which consumer are – or would be willing – to choose one product instead of another to perform those end-uses, is highly relevant evidence in assessing the 'likeness' of those products under Article III:4 of the GATT 1994.³⁰ 'We consider this especially so in cases where the evidence relating to properties establishes that the products at issue are physically quite different. In such cases, in order to overcome this indication that the products are *not* 'like', a higher burden is placed on complaining Members to establish that, despite the pronounced physical differences, there is a competitive relationship between the products such that *all* of the evidence, taken together, demonstrates that the products are 'like' under Article III:4 of the GATT 1994.³¹

32. Relevant passages which address specifically the *second* criterion are the following:

[T]he Panel's analysis of end-uses is based on a 'small number of applications' for which the products are substitutable.... Although we agree that it is certainly relevant that products have similar end-uses for a 'small number of applications', or even for a 'given utilization', we think that a panel must also examine the other, different end uses for products. It is only by forming a complete picture of the various end uses of a product that a panel can assess the significance of the fact that products share a limited number of end-uses.³² 'There is ... no evidence on the record regarding the nature and extent of the many end-uses for chrysotile asbestos and PCG fibres which are not overlapping. ... Where products have a wide range of end-uses, only some of which overlap, we do not believe that it is sufficient to rely solely on evidence

²⁸ *European Communities - Asbestos*, (cited above at footnote 11), para. 111.

²⁹ *European Communities - Asbestos*, (cited above at footnote 11), para. 114.

³⁰ *European Communities - Asbestos*, (cited above at footnote 11), para. 117.

³¹ *European Communities - Asbestos*, (cited above at footnote 11), para. 118.

³² *European Communities - Asbestos*, (cited above at footnote 11), para. 119.

regarding the overlapping end-uses, without also examining evidence of the nature and importance of these end-uses in relation to all of the other possible end-uses for the products. In the absence of such evidence, we cannot determine the significance of the fact that chrysotile asbestos and PCG fibres share a small number of similar end uses.³³

33. Relevant passages for the *third* criterion are the following:

[T]he physical properties may differ completely, yet there may be strong evidence of similar end-uses and a high degree of substitutability of the products from the perspective of the consumer.³⁴ '[I]n a case such as this, where the fibres are physically very different, a panel cannot conclude that they are 'like products' if it does not examine evidence relating to consumers' tastes and habits. In such a situation, if there is no inquiry into this aspect of the nature and extent of the competitive relationship between the products, there is no basis for overcoming the inference, drawn from the different physical properties of the products, that the products are not 'like'.³⁵

34. The Appellate Body's discussion of the *fourth* criterion is very short. On the one hand, the Appellate Body declares that, in the absence of a full analysis of the three other criteria, it cannot determine what importance should be attached to the different tariff classifications of the fibres.³⁶ On the other hand, it states that 'while this element is not, on its own, decisive, it does tend to indicate that chrysotile and PCG fibres are not 'like products' under Article III:4 of the GATT 1994.'³⁷

4. Overall Appreciation of the Appellate Body's Determination of 'Likeness' under Article III:4

35. The Appellate Body Report in *Asbestos* is careful not to prejudge future trade disputes in which the question of likeness will be central. The Appellate Body therefore repeats that 'likeness' has to be determined on a case by case basis. The same cautious attitude motivates the approach to the *Border Tax Adjustments* Report and the insistence that the products at

³³ *European Communities - Asbestos*, (cited above at footnote 11), para. 138.

³⁴ *European Communities - Asbestos*, (cited above at footnote 11), para. 120.

³⁵ *European Communities - Asbestos*, (cited above at footnote 11), para. 139. I do not reproduce here the passages of the Appellate Body Report about health risks, in particular carcinogenicity, as they are not relevant to the present case.

³⁶ *European Communities - Asbestos*, (cited above at footnote 11), para. 124.

³⁷ *European Communities - Asbestos*, (cited above at footnote 11), para. 140.

issue have to be examined according to *all* the four criteria traditionally linked to the analysis undertaken according to this Report.

36. The Appellate Body Report in *Asbestos* is however clearly motivated by one fundamental principle. According to this principle, 'likeness' under Article III:4 has to be determined in view of the objective or (in the terminology of the Appellate Body) 'general principle' articulated in Article III:1. That 'general principle' is to avoid protectionism and to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, between the domestic and imported products involved so as to afford protection to domestic production.
37. The choice of this fundamental principle of interpretation has logical consequences for the analysis of the evidence under the traditional *Border Tax Adjustments* approach. Although *all* the evidence under the four criteria has to be examined carefully, evidence under the second (end-uses) and third criterion (consumer tastes and habits) is more important than evidence related to the first (physical properties) and fourth criterion (tariff classification). The reason is obvious. The competitive relationship, in the marketplace, of products is determined by the extent to which the products are capable of serving the same or similar end-uses (second criterion), and the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand (third criterion). On the contrary, the competitive relationship, in the marketplace, is not necessarily determined by their physical properties or their tariff classification.
38. The emphasis on the 'general principle' of Article III:1 for the interpretation of 'likeness' under Article III:4 has one further important logical consequence. Products may be 'like' in respect of certain end-uses and consumer tastes and choices, while they are unlike in respect to other end-uses and consumer tastes and choices. In other words, 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. Any other approach would allow protectionist regulations, contrary to the 'general principle' of Article III:1, in favour of domestic products which have wide spectrum of end-uses which overlap only partially with the end-uses of imported products. I am of course mindful of the

Appellate Body's criticism of the Panel's insufficient analysis of the (limited) overlap of end-uses of chrysotile asbestos and PCG fibres. I do not believe, however, that the Appellate Body excludes in any way the possibility of that products are 'like' with respect to certain (and unlike with respect to other) end-uses. The Appellate Body's criticism is addressed to the insufficient collection and examination of the evidence of the full spectrum of respective end-uses. This criticism cannot be interpreted as having a broader significance, as a broader interpretation would be incompatible with the fundamental approach to 'likeness' in Article III:4, i.e., the need to avoid protectionism, following the 'general principle' articulated in Article III:1.

5. The Application of the Appellate Body's Approach in *Asbestos* to the Products at Issue in the Present Case

39. Applying this law to the case at hand, one sees that at the foundation of Methanex's complaint is a concern that the Californian regulations upset the competitive relationship between methanol and ethanol. These regulations do so by disadvantaging MTBE, of which methanol is a prime ingredient, and by disadvantaging methanol directly. Methanex maintains that by advantaging ethanol, which is free of the restrictions imposed by the Californian rules, California consequently disadvantages methanol.
40. If one were to apply a GATT analysis as to whether these measures constitute a national treatment violation, a primary question would be whether methanol and ethanol are 'like products' within the meaning of Article III:4 GATT.
41. As explained above, such a determination requires an analysis of at least: (i) the physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes.
42. First, I have looked at the physical properties of methanol and ethanol. I understand from the Methanex pleadings that there are some differences in the physical characteristics of

methanol and ethanol, but that they are closely related chemicals that share certain common traits.³⁸ In particular, I have noted that both products are alcohols, with methanol being an alcohol generally produced from natural gas while ethanol is an alcohol derived primarily from corn.³⁹

43. In evaluating the relevance of these facts, it appears that, overall, the physical properties of methanol and ethanol are not 'very different', in the meaning of *Asbestos*. Accordingly, the competitive relationship between the two products would be more easily evidentiary of a 'like product' relationship between methanol and ethanol than in other cases, notably, *Asbestos*, where the physical characteristics of the products were found to be 'very different'.⁴⁰ As will be explored below, a strong competitive relationship does appear to exist, according to the Second Amended Statement of Claims.⁴¹
44. I am also aware that the tariff classifications in the United States of methanol and ethanol are different, examined under criterion (iv) of the 'like product' analysis. This factor suggests that methanol and ethanol are not 'like'. Yet I do not find this element to be particularly persuasive, either for or against 'likeness'.
45. As I have explained above, 'likeness' rather turns on points (ii) and (iii), end uses and consumer perceptions.
46. On point (ii), end uses, methanol and ethanol do have some different end uses, but they share one important end use, as oxygenates used in the production of reformulated gasoline. They also share other end uses, directly as fuels for combustion engines. Methanol and ethanol can each be used directly as oxygenates, or they can be transformed into ethers (MTBE and ETBE, respectively), and those ethers can be used as oxygenates.⁴² I note from the Second

³⁸ See Methanex's Second Amended Statement of Claim, sect. V. A.

³⁹ See Methanex's Second Amended Statement of Claim, sect. V. A.

⁴⁰ Compare to *European Communities - Asbestos*, (cited above at footnote 11), para. 136.

⁴¹ See Methanex's Second Amended Statement of Claim, sect. V. B.

⁴² See Methanex's Second Amended Statement of Claim, sect. V. A.

Amended Statement of Claim that the production process of both ethers is essentially identical (reaction with isobutylene).⁴³

47. In other words, methanol and ethanol are '*capable of performing the same, or similar, functions (end-uses)*', within the meaning of *Asbestos*.⁴⁴
48. Admittedly, use in the reformulation of gasoline is not the only end use of methanol or ethanol. A reading of the materials submitted by Methanex⁴⁵ indicates that methanol has other applications, such as the production of a variety of chemical products. Ethanol also has other applications (e.g., in the solvent, chemicals industry).⁴⁶
49. However, I note that 93.7 % of the methanol consumed in California in 2001 was used for the production of MTBE.⁴⁷ For its part, MTBE is used exclusively as an oxygenate in the fuel industry. Furthermore, more than 86% of ethanol consumed in California in 2001 was used directly as an oxygenate in the fuel industry.⁴⁸ In earlier years, the primary use for methanol and ethanol in California has been in the production of reformulated gasoline as well.⁴⁹
50. Therefore, in the present exercise, we are in fact comparing much more than an 'overlapping end-use' as was the case in *Asbestos*: rather, we are comparing the products in their most important end-use. This is a very different exercise than the one the Appellate Body commented on in *Asbestos*, when it warned against comparing only certain end-uses of

⁴³ See Methanex's Second Amended Statement of Claim, sect. V. A.

⁴⁴ *European Communities - Asbestos*, (cited above at footnote 11), at paras. 112 and 118.

⁴⁵ See Chemical Economics Handbook – SRI International, CEH Marketing Research Report Methanol (July 2002), pp. 19-59.

⁴⁶ See Chemical Economics Handbook – SRI International, CEH Marketing Research Report Ethyl Alcohol (May 2002), pp. 42-48.

⁴⁷ See Tab 149 of Claimant's Appendix of Factual Material.

⁴⁸ See Tab 149 of Claimant's Appendix of Factual Material.

⁴⁹ See Tab 149 of Claimant's Appendix of Factual Material, see *infra* footnotes 74 to 77.

products and criticized the Panel for limiting its end-use analysis to a 'small number of applications' for which the products are substitutable⁵⁰:

[w]here products have a wide range of end-uses, only some of which overlap, we do not believe that it is sufficient to rely solely on evidence regarding the overlapping end-uses, without also examining evidence of the nature and importance of these end-uses in relation to all of the other possible end-uses for the products. In the absence of such evidence, we cannot determine the significance of the fact that chrysotile asbestos and PCG fibres share a small number of similar end uses. (underlining added)⁵¹

51. As I have said above, I do not think that *Asbestos* stands for the proposition that when products have many different end uses, they cannot be 'like'. On the contrary, products may be 'like' in respect of certain end-uses and consumer tastes and choices, while they are unlike in respect to other end-uses and consumer tastes and choices. As I have cautioned above, any other approach would, unacceptably, allow protectionist regulations.
52. Furthermore, as to criterion (iii) of the 'like product' analysis, consumer tastes and habits, I have noted that the key players in the production and sale of reformulated gasoline (i.e., integrated oil refiners, merchant ether oxygenate producers and gasoline-blending plants) consider methanol and ethanol to be substitutable, or potentially capable of being substitutable.⁵²
53. Those tastes and habits do not appear, as was the case in *Asbestos*, to be influenced by the alleged health or environmental risks. To explain, in *Asbestos*, the dangers to human health posed by asbestos were notorious and overwhelming, which is not the case here.
54. The fact that certain consumers now seem to prefer one oxygenate or another does not detract from my belief that these oxygenates (in particular, methanol and ethanol) would be considered substitutable in a GATT-national treatment analysis, given that actual consumption patterns appear to be influenced in large part by the disputed regulations. In assessing the 'like product' relationship in a GATT-national treatment analysis, such disputed

⁵⁰ *European Communities - Asbestos*, (cited above at footnote 11), paras. 137 f.

⁵¹ *European Communities - Asbestos*, (cited above at footnote 11), para. 138.

⁵² See *Methanex's Second Amended Statement of Claim*, sect. V. A and B.

regulations are not to be taken into account when assessing consumer tastes and habits, as their influence should not be allowed to skew the analysis. As the Appellate Body very recently has forcefully stated:

If we were to accept that a WTO Member can 'create' consumer expectations and thereafter find justification for the trade-restrictive measure which created those consumer expectations, we would be endorsing the permissibility of 'self-justifying' regulatory trade barriers. Indeed, the danger is that Members, by shaping consumer expectations through regulatory intervention in the market, would be able to justify thereafter the legitimacy of that very same regulatory intervention on the basis of the governmentally created consumer expectations.⁵³

55. In sum, viewed as a totality, 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. As was the Appellate Body's conclusion in *Asbestos*, my conclusion is justified by the objective of avoiding protectionism and preventing Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, between the domestic and imported products involved so as to afford protection to domestic production.
56. Although I am mindful of the fact that *all* the evidence has to be examined carefully, I give priority to evidence under the second (end-uses) and third criterion (consumer tastes and habits) over the first (physical properties) and fourth criterion (tariff classification). I am most concerned about the competitive relationship, in the marketplace. Methanol and ethanol are capable of serving the same or similar end-uses, and consumers perceive and have treated the products as alternative means of performing particular functions in order to satisfy a particular want or demand. Therefore I conclude that they are 'like', and that 'less favourable treatment' of one or the other would disturb their competitive relationship.

⁵³ Appellate Body, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002, para. 305.

B. Less favourable treatment

57. Having established that there is a 'like' relationship between methanol and ethanol, the next consideration in a GATT-national treatment analysis would be whether there is less favourable treatment of imported 'like' products as compared to domestic 'like' products.
58. I note preliminarily that, consistent with the 'like product' analysis above, when I refer to methanol and ethanol below, I refer exclusively to their application in reformulated gasoline (as oxygenates, or as inputs for other oxygenates).

1. Meaning of the Term 'Treatment No Less Favourable Than That Accorded To 'Like Products' of National Origin' in Article III:4 of the GATT 1994 – Considerations of Principle

59. While the words 'like products' has been examined in depth in at least one Appellate Body report, the meaning of the terms 'treatment no less favourable' has remained largely unexplored in Appellate Body jurisprudence.
60. The issue of 'treatment no less favourable' was central in the case of *'Korea – Beef'*.⁵⁴ But in *'Korea – Beef'*, the Appellate Body had to examine a measure that provided treatment to imported beef that was formally different from that accorded to like domestic products, i. e., domestic beef. In other words, *'Korea – Beef'* dealt with a case of *de jure* discrimination.⁵⁵
61. It is however recognized that Article III:4 forbids not only *de jure* less favourable treatment, but also treatment that is *de facto* less favourable for like imported products.⁵⁶

⁵⁴ Appellate Body – *Measures Affecting Imports of Fresh, Chilled and Frozen Beef (Korea - Beef)*, WT/DS161/AB/R and WT/DS169/AB/R, adopted 10 January 2001, paras 130 ff.

⁵⁵ The same held true for Appellate Body, *United States – Tax treatment for "Foreign Sales Corporations" – Article 21.5 of the DSU*, WT/DS108/AB/RW, paras. 217 f.

⁵⁶ Panel Report, *European Communities – Asbestos*, WT/DS135/R, para. 8.156; Panel Report, *US – Standards for Reformulated and Conventional Gasoline*, WT/DS2/R, para. 6.10; *United States – Section 337 of the Tariff Act of 1930*, adopted on 7 November 1989, BISD 36S/345, para. 5.11; *Canada – Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, adopted on 18 February 1992, BISD 39S/27, paras. 5.12-5.14, 5.30 f.; *US – Measures Affecting alcoholic and Malt Beverages*, DS23/R, BISD 39S/206, adopted on 19 June 1992, para. 5.30.

62. In the present case, the Californian measures do not distinguish formally between domestic and imported products. Thus, the Californian measures make no formal distinction between imported and domestic *methanol*. In other words, the Californian measures cannot be considered to constitute *de jure* discrimination if imported and domestic *methanol* are *horizontally* compared among themselves and if the comparison is strictly limited to these subcategories of the wider groups of 'like products'.
63. However, another inquiry would be whether the Californian measures provide treatment to imported products that is different (and less favourable) than that accorded to domestic products if imported *methanol* is compared with – the 'like' – domestic *ethanol* (this is sometimes referred to as a diagonal comparison). Whether any such distinction is called *de jure* or *de facto* is a matter of terminology, but not of substance. What is a matter of substance is whether such difference in treatment *alone* is enough to establish a violation of Article III:4.
64. Or is it necessary to show in addition that the *totality* of imported products of *all subcategories of 'like products'* involved are disadvantaged when compared with the *totality* of domestic products of the same subcategories of 'like products'? In other words, is it necessary to establish that the group of imported *methanol and ethanol*, on the one hand, and the group of domestic *methanol and ethanol*, on the other, is tilted to the disadvantage of *imported methanol and ethanol*?
65. The present case thus raises an issue that is typical for situations in which a group of 'like products' is composed of distinct subcategories of products, and where imported and domestic products within each subcategory are treated in exactly the same way, but where distinctions exist in the treatment of products falling into different subcategories. If the imported products of the disfavoured subcategory are (in a simple diagonal manner) compared with domestic products of the – like – favoured subcategory, imported products are always treated less favourably than like domestic products. Yet if the *totality* of imported products (belonging to different subcategories) of a group of 'like products' has to be compared with the *totality* of domestic products of the same subcategories of the group of 'like products', there may be, or may not be, *de facto* less favourable treatment, according to the precise circumstances of the case under examination.

66. A careful examination of GATT and WTO practice shows that the diagonal approach has been applied in past cases.⁵⁷ If this approach were chosen, it would be sufficient to compare imported *methanol* with - the like - domestic *ethanol*. Imported products would be found to be treated less favourably than like domestic products.
67. I myself do not ascribe to the diagonal approach. In this regard, I make reference to the Appellate Body remarks on this issue in its Report in *Asbestos*. There, the Panel had found that (i) chrysotile asbestos fibres, on the one hand, and PCG fibres – PVA, cellulose and glass fibres, on the other hand, as well as (ii) cement based products containing chrysotile asbestos fibres and cement-based products containing PCG fibres, are ‘like products’ under Article III:4. On the basis of this finding, the Panel established less favourable treatment in a simple diagonal manner. It contented itself to the observation that the French asbestos ban *de jure* treated imported and domestic asbestos fibres and asbestos products less favourably than the like domestic substitutes.⁵⁸ The distribution of imported and domestic goods within the group of ‘like products’, i.e., the relative incidence of the ban on the two regulatory subcategories, received no attention whatsoever.
68. The Appellate Body addressed this approach. Following its general considerations of the meaning of the term ‘like products’ in Article III:4, paragraph 100 of the Appellate Body’s Report in *Asbestos* states:

We recognize that, by interpreting the term ‘like products’ in Article III:4 in this way, we give that provision a relatively broad product scope – although no broader than the product scope of Article III:2. In doing so, we observe that there is a second element that must be established before a measure can be held to be inconsistent with Article III:4. Thus, even if two products are ‘like’, that does not mean that a measure is inconsistent with Article III:4. A complaining Member must still establish that the measure accords to the group of ‘like’ *imported* products ‘less favourable treatment’ than it accords to the group of ‘like’ *domestic* products. The term ‘less favourable treatment’ expresses the general principle, in Article III:1, that internal regulations not be applied ... so as to afford protection to domestic production’. If there is ‘less

⁵⁷ See the thorough analysis of Lothar Ehring, ‘*De Facto* Discrimination in WTO Law: National and Most-Favored-Nation Treatment – or Equal Treatment?’, Jean Monnet Working Paper 12/01, (to be published in a forthcoming edition of the Journal of World Trade) <http://www.jeanmonnetprogramm.org/papers/01/0132001.html>.

⁵⁸ Panel Report, *European Communities – Asbestos*, (cited above at footnote 11), paras. 8.154 f.

favourable treatment of the group of 'like' imported products, there is, conversely, 'protection' of the group of 'like' domestic products. However, a Member may draw distinctions between products which have been found to be 'like', without, for this reason alone, according to the group of 'like' imported products 'less favourable treatment' than that accorded to the group of 'like' domestic products. In this case, we do not examine further the interpretation of the term 'treatment no less favourable' in Article III:4, as the Panel's findings on this issue have not been appealed or, indeed, argued before us. (underlining added)⁵⁹

69. Granted, this passage is only an *obiter dictum*. However, to my mind this statement constitutes the 'balancing' counterpart to the relatively wide definition of the term 'like' products developed in the Appellate Body's Report in *Asbestos*. Without this counterpart, the wide definition of the term 'like products' would have unacceptable consequences for the regulatory autonomy of WTO Members. Distinctions made by WTO Members between subcategories of 'like products' would easily found to be incompatible with Article III:4. These distinctions could be justified through Article XX of the GATT 1994. But Article XX contains only a limited list of possible justifications. The list does not comprise important regulatory concerns, such as consumer protection. In addition, Article XX is considered to be an affirmative defence for which the burden of proof lies with the defendant, while inconsistency with Article III:4 has to be proved by the complainant.⁶⁰
70. The meaning of the *obiter dictum* in paragraph 100 of the Appellate Body's Report in *Asbestos* becomes apparent if it is read in the light of the Appellate Body's Reports in the preceding taxation cases that arose under Article III:2 of the GATT, in particular in the most recent of these Reports, i. e., *Chile – Alcoholic Beverages*.⁶¹
71. It might be remembered that Article III:2 states that '*no contracting party shall ... apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.*' According to Article III:1, internal taxes

⁵⁹ *European Communities – Asbestos* (cited above at footnote 11), para.100.

⁶⁰ Appellate Body Report, *US – Measures affecting imports of woven wool shirts and blouses*, WT/DS33/AB/R, DSR 1997:1, p. 335; Appellate Body Report, *US – Standards for Reformulated and Conventional Gasoline*, DSR 1996:1, p. 21; *European Communities – Asbestos* (cited above at footnote 11), paras. 147 f.; *World Trade Organization, Secretariat*, GATT/WTO Dispute Settlement Practice relating to GATT Article XX, Paragraphs (b), (d) and (g), 8 March 2002, WT/CTE/W/203, paras. 6 f.

⁶¹ Appellate Body Report, *Chile – Taxes on Alcoholic Beverages* (*Chile – Alcoholic Beverages*), adopted 12 January 2000, WT/DS87, 110/AB/R.

'should not be applied to imported or domestic products so as to afford protection to domestic products.' According to the Note Ad Article III Paragraph 2, this prohibition applies 'only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.' If domestic and imported products belonging to the same subcategory of products are subject to the same tax rate, but that tax rate is different from a tax rate on imported and domestic products belonging to another, but directly competitive or substitutable subcategory of products, the same question arises as in *Asbestos*: according to what method should one determine whether there is *de facto* discrimination, affording protection to domestic production.

72. In its cases dealing with discriminatory taxation, Appellate Body Reports have become progressively more detailed and refined. Already in its Report in *Korea – Alcoholic Beverages*, the Panel expressly endorsed an approach which put the emphasis on the tax treatment of the group of directly competitive or substitutable imported products as compared with the group of corresponding domestic products. The Appellate Body emphasized that

the panel found that, in practice '[t]here is virtually no imported soju so the beneficiaries of this structure are almost exclusively domestic producers'. In other words, the tax operates in such a way that the lower tax brackets cover almost exclusively domestic production, whereas the higher tax brackets embrace almost exclusively imported products.⁶²

73. In its Report in *Chile – Alcoholic Beverages*, the Appellate Body was even more explicit. The Appellate Body stressed

The examination ... must ... take into account the fact that the group of directly competitive or substitutable products at issue in this case is not limited solely to beverages of a specific alcohol content, falling within a *particular* fiscal category, but covers *all* distilled alcoholic beverages in *each* and *every* fiscal category under the New Chilean system.

A comprehensive examination of this nature, which looks at *all* of the directly competitive or substitutable domestic products, shows that the tax burden on imported products, most of which will be subject to a tax rate of 47 per cent, will be heavier

⁶² Appellate Body Report, *Korea – Taxes on Alcoholic Beverages* (*Korea – Alcoholic Beverages*), adopted 17 February 1999, WT/DS75, 84/AB/R, para. 44.

than the tax burden on domestic products, most of which will be subject to a tax rate of 27 per cent.⁶³

74. The following analysis will therefore follow the approach required by the Appellate Body in paragraph 100 of its Report in *Asbestos*. I will examine whether the *group* of like imported products (i.e., methanol and ethanol) is *de facto* treated less favourably than the corresponding *group* of like domestic products (i.e., methanol and ethanol).
75. The comparison of a *group* of all like imported products with the corresponding group of all domestic products raises two problems which have never been discussed in detail in any existing panel or Appellate Body report. The first of these problems concerns the side of the *imports*. Do imports from *all sources* taken together have to be weighed against corresponding domestic products? Or are only imports *from the complaining country* to be weighed against corresponding domestic products? Panel reports offer examples for both approaches, but in most cases do not take a stand at all.⁶⁴
76. The opening language of paragraph 4 (and of paragraph 2) of Article III ('The products of ... any contracting party imported ... ') seems to suggest that the comparison has to be made between the group of 'like' domestic products and the group of 'like' imports only from the single WTO Member whose national treatment right is at issue. In contrast, Article III:1 (and the second sentence of Article III:2) refer to imports in general. In addition, it might be noted that where the GATT refers to 'any contracting party', 'any product' or 'any advantage', it intends emphasize that, without exceptions, all WTO Members enjoy those rights with respect to all products.
77. More revealing than the wording of Article III:4 seems to be the 'general principle'⁶⁵ set forth Article III:1, according to which '*internal laws, regulations and requirements ... should not be applied to imported or domestic products so as to afford protection to domestic*

⁶³ *Chile – Alcoholic Beverages*, (cited above at footnote 61), paras. 52 and 53.

⁶⁴ Lothar Ehring (cited above at footnote 57) at section X C 'The Origin of Import to Be Included in the Comparison'.

⁶⁵ *European Communities – Asbestos*, (cited above at footnote 11), para. 93 with references to Appellate Body, *Japan – Alcoholic Beverages*, (cited above at footnote 11), at 111.

production. I find it difficult to accept that the question of whether a Member '*affords protection to domestic production*' or not would find different answers according to the different export position of different complainants. In addition, it is useful to note that the Appellate Body has accepted that a Member who, although being a producer, is only a potential exporter, can bring claims under the GATT.⁶⁶

78. I therefore conclude with respect to the first question ('what *imports* have to be taken into account?') that imports from *all sources* taken together have to be weighed against the corresponding domestic products, and not only imports from the complaining country.
79. The second question flowing from the necessity to compare and weigh the impact of a Member's measures on a *group* of *all* like imported products with the corresponding group of *all* domestic products concerns the *domestic* side. Normally, the domestic side will not raise any problem, as it will comprise *all* domestic products that are favoured or disfavoured by the measure at issue. However, is this approach also correct if the measure at issue is not a measure that is adopted by the central authorities of a WTO Member, but by the authorities of a region, in the present case the State of California?
80. Although at first sight intriguing, I submit that the question has to be answered in the affirmative. Article III:4 requires a comparison between imported products and like '*products of national origin*'. Article III:4 does not mention any third category of products. In the same vein, according to Article III:1, laws, regulations and requirements should not be applied to imported and '*domestic*' products so as to afford protection to '*domestic*' production. Also, Article III:2 opposes imported products to '*domestic*' products. Like Article III:4, neither of these paragraphs mentions any distinction within the category of '*domestic*' products or '*domestic*' production.
81. Furthermore, it is useful to recall the 'general principle' set forth by Article III:1, according to which laws, regulations and requirements should not be applied to imported or domestic

⁶⁶ *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS/27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, paras. 132-138.

products 'so as to afford protection to domestic production.' This general principle could easily be circumvented if Members were allowed to argue (1) that national or regional measures apply only to a limited part of their national territory and (2) that consequently only the local products of that part of their national territory should be taken into account in examining the consistency of such a measure with Article III:4. Allowing such an argumentation would neglect the fact that a regional sub-entity could at least be tempted to accord preferential treatment to products from other regional sub-entities of the same Member compared to products imported from third countries. Members might then too easily avoid the strictures of the national treatment obligation by encouraging regional measures (instead of adopting one federal measure). In those regions with little or no indigenous production, imports could then be discriminated against with impunity.

82. It goes without saying that in WTO dispute settlement proceedings the United States could be held responsible for the Californian gasoline regulations, in the event a WTO Member like Canada were to bring a national treatment complaint. This is demonstrated by the 'Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994', which is attached to Annex 1A of the WTO Agreement. This Understanding adds to Article XXIV:12 GATT, which now reads: '*Each Member is fully responsible under GATT 1994 for the observance of all provisions of GATT 1994, and shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory*' (italics added). The underlying principle is the general rule of public international law that a State is responsible for the acts of its territorial sub-units.
83. It follows that Article III:4 should be interpreted, in conformity with its wording, in comparing the treatment afforded by the disputed Californian measures to the *group of all* like imported products with the corresponding group of *all domestic* products, irrespective of where they are produced in the territory of the importing Member. Expressed differently, when analysing the impact of the Californian measures, one has to compare on the one hand the treatment afforded to the *group* of imported products consumed in California (imported from all third countries, not just the complaining country) to the treatment of the *group* of

'like products' consumed in California that is produced in the United States (in- or outside California).

84. Resuming the preceding considerations, I recall my main conclusions.
- a) The approach required by the Appellate Body is to examine whether the *group* of imported products (in this case constituted of methanol and ethanol), is *de facto* treated less favourably than the corresponding *group* of like domestic products (again constituted of methanol and ethanol).
 - b) *Imports* from *all sources* taken together will be weighed against the corresponding domestic products, and not only imports from Canada.
 - c) The *group* of *all* like imported products will be compared with the corresponding groups of *all domestic* products, irrespective of their place of production in the USA.

2. Application of these Principles of Interpretation to the Californian Measures

85. As indicated above, I deduce from Methanex's Second Amended Statement of Claim that ethanol and methanol, when being used as oxygenates or inputs for oxygenates, can be considered 'like products' under Article III:4 of GATT 1994.⁶⁷ In order to establish factual discrimination in the California marketplace, the *group* of 'like products' imported from *all non-US* sources has *de facto* to be treated less favourably than the corresponding *group* of *all* like *US* products.
86. Looking at the market data for *methanol* consumed in California, I see that until 1996 virtually all of it was imported from outside the US, virtually none was produced inside the US.⁶⁸ In 1997 and 1998, US production represented a market share of less than 15%, and

⁶⁷ See *supra*, sect. III.A.5.

⁶⁸ See Methanex's Second Amended Statement of Claim, sect. V. C.

between 1999 and 2001 its share barely reached one third of the market, while imports retained about two thirds of the market.⁶⁹

87. On the other hand, I understand that until 1999 almost 100% of the supply of *ethanol* that was consumed in California was coming from US producers.⁷⁰ In 2000 and 2001, imports from outside the US did not account for more than 16% of the California market, while more than 83% of the ethanol consumed was of US origin.⁷¹
88. Taking into account that in 2001, 93.7% of all methanol consumed in California was used in the production of the oxygenate MTBE, and that about 86% of all ethanol consumed in California was used as an oxygenate, the disputed Californian measures mainly disfavour imported products. Conversely, these measures in large measure favour domestic products. This is illustrated by the following tables, based on information provided by the Claimant:⁷²

⁶⁹ See Methanex's Second Amended Statement of Claim, sect. V. C.

⁷⁰ See Methanex's Second Amended Statement of Claim, sect. V. C.

⁷¹ See Methanex's Second Amended Statement of Claim, sect. V. C. Note that these figures cover ethanol for *all uses* consumed in California. Figures for the *oxygenate use only* were not available. However, since in 2000 and 2001 more than 86% of all ethanol was used as gasoline oxygenate, this import/domestic ratio for *all uses* is likely to be close to that for the *oxygenate use only*.

⁷² See Tab 149 of Claimant's Appendix of Factual Material.

Californian market in the years 1995-1997 (average per year, in thousands of metric tons)

	domestic	imports
ethanol ⁷³ (favoured)	323	0
methanol ⁷⁴ (disfavoured)	9	171

Californian market in the years 1998-2000 (average per year, in thousands of metric tons)

	domestic	imports
ethanol ⁷⁵ (favoured)	201	10
methanol ⁷⁶ (disfavoured)	35	159

⁷³ The same caveat mentioned above, in footnote 71, applies here. Since between 1995 and 1997, over 90% of all ethanol was used as gasoline oxygenate in California, the relevant import/domestic ratio is unlikely to significantly differ from the import/domestic ratio of all ethanol.

⁷⁴ As to methanol, the same caveat mentioned above, in footnote 71, applies here -- these figures refer to the ratio of imported and domestic methanol that was used in California for any purpose. But since between 1995 and 1997 over 95% of all methanol was used in California to produce MTBE, the relevant import/domestic ratio is unlikely to significantly differ from the import/domestic ratio of all methanol.

⁷⁵ Note the caveat mentioned in footnote 71, above. However, since between 1998 and 2000, over 85% of all ethanol was used in California as gasoline oxygenate, the relevant import/domestic ratio is unlikely to significantly differ from the import/domestic ratio of all ethanol.

⁷⁶ Note the caveat mentioned in footnote 71, above. However, since between 1998 and 2000, over 95% of all methanol was used in California to produce MTBE, the relevant import/domestic ratio is unlikely to significantly differ from the import/domestic ratio of all methanol.

Californian market in the year 2001 (thousands of metric tons)

	domestic	imports
ethanol ⁷⁷ (favoured)	195	37
methanol ⁷⁸ (disfavoured)	51	144

89. If one looks at the situation of all like imported products, both those that are disfavoured and those that are favoured by the Californian measures, one sees that imports by far fall into the disfavoured category. Meanwhile, the opposite is true for domestic 'like products'. Most of them are favoured. The fact that domestic methanol is also disfavoured does not offset the discriminatory (less favourable) impact of the Californian measures.⁷⁹ Accordingly,⁸⁰ this table illustrates that the disputed Californian measures afford less favorable treatment to the group of imported products that are 'like' the group of domestic products. This is true if one considers the measures as addressed to methanol directly (notably, the impending ban on methanol being used as an oxygenate itself). It is also true, by implication, if one considers the Californian measures that impose labelling requirements or a future ban on MTBE, an oxygenate for which methanol is the input.

⁷⁷ Note the caveat mentioned in footnote 71, above. However, since in 2001, about 86% of all ethanol was used in California as gasoline oxygenate, the relevant import/domestic ratio is unlikely to significantly differ from the import/domestic ratio of all ethanol.

⁷⁸ Note the caveat mentioned in footnote 71, above. However, since in 2001, 93.7% of all methanol was used in California to produce MTBE, the relevant import/domestic ratio is unlikely to significantly differ from the import/domestic ratio of all methanol.

⁷⁹ Similar examples can be found in WTO case law. For example, in the *Chile - Alcohol* case, the EU alleged that Chile's tax system favoured domestic pisco over other foreign alcoholic beverages, like whisky. The fact that domestic whisky producers also suffered the higher tax rate did not exonerate Chile's tax system. Rather, the Appellate Body looked at the fact that domestic pisco, which bore the lower tax, was economically far more important than domestic whisky, such that the group of domestic products was advantaged overall (cited above at footnote 61, see para. 67). It held that Chile's tax system, though neutral on its face, still constituted a violation of Article III:2 GATT.

⁸⁰ See also *Chile - Alcoholic Beverages* (cited above at footnote 61), paras. 64, 67; Ehrling (cited above at footnote 57), at section X A 'Quantitative and Qualitative Conditions of Asymmetry'.

90. Although it is conceivable that disadvantages affecting mainly imports and touching only on a small domestic production of one product can be offset by advantages granted to other 'like products' that are also mainly imported and not to a relevant quantity of domestic origin,⁸¹ the California measures favour ethanol, the California consumption of which is almost exclusively supplied by US production.⁸² I see no imported 'like product' of any importance, favoured by the Californian measures, which could offset the negative impact of these measures.⁸³
91. In sum, on the basis of the facts before me, I believe that the disputed Californian measures treat imported products less favourably than 'like' domestic products.⁸⁴ That would be considered a violation of Article III:4 GATT. It is notable that, while 'less favourable' treatment would be easily demonstrated using the above-mentioned 'diagonal' approach (according to which imported methanol would be compared to the like domestic ethanol), I still find 'less favourable' treatment using the stricter approach (comparing the group of domestic and the group of imported like products).
92. It should be noted that in reaching this conclusion under GATT law, I have considered the production of Methanex's US affiliates ('Methanex U.S.', 'Methanex Fortier') as being US domestic production, not imports. The reason is that GATT analysis focuses on the area of production, not on the nationality of the producer. Under NAFTA Chapter 11, this is different and Methanex enjoys protection for its investments realized in the US.

IV. The relevance of 'intent' in a WTO national treatment case

93. I would now like to discuss the relevance of discriminatory intent in a WTO national treatment analysis. In short, I do not find intent to be relevant to the determination of a

⁸¹ See also *Chile – Alcoholic Beverages* (cited above at footnote 61), paras. 64, 67; Ehrling (cited above at footnote 57), at section X A.

⁸² See Methanex's Second Amended Statement of Claim, sect. V. D.

⁸³ Therefore it is not necessary to analyse the relative market share of methanol and ethanol to establish that the disputed measures treat imported like products less favourably than domestic like products, cf. *Chile – Taxes on Alcoholic Beverages* (cited above at footnote 61), para. 67.

⁸⁴ See *Chile – Taxes on Alcoholic Beverages* (cited above at footnote 61), para. 67; Ehrling (cited above at footnote 57), at section X A.

violation of Article III:4 GATT. As I will explain below, where I do find it relevant is in the analysis of the introductory clause (or 'chapeau') to GATT's public policy exceptions.

94. As noted at the outset, this opinion will not delve into whether, if a violation of Article III:4 GATT were established, the US could legitimately claim the public policy exceptions of Article XX, notably Article XX(g), the provision which is generally cited with regard to environmental justifications.
95. For purposes of the present proceedings under NAFTA, it may also be useful to recall what the Appellate Body has said about the relevance of 'legislative' or 'regulatory' intent under Article III GATT.
96. This issue has not so much arisen under Article III:4 GATT, but rather under Article III:2 GATT. Article III:2, second sentence, refers specifically to the 'principles set forth in paragraph 1'. Paragraph 1 of Article III mandates Members not to apply internal taxes and other internal charges, and laws, regulations and requirements '*so as to afford protection to domestic production.*' Already in its first Report addressing Article III:2, the Appellate Body has stressed that the (third) element of inquiry under Article III:2, second sentence, which must determine whether 'directly competitive or substitutable products' are 'not similarly taxed' in a way that affords protection:

... is not an issue of intent. It is not necessary for a panel to sort through the many reasons legislators and regulators often have for what they do and weigh the relative significance of those reasons to establish legislative or regulatory intent. If the measure is applied to imported or domestic products so as to afford protection, then it does not matter that there may not have been any desire to engage in protectionism in the minds of the legislator or the regulators who imposed the measure. It is irrelevant that protectionism was not an intended objective if the particular tax measure in question is nevertheless ... '*applied* to imported or domestic products so as to afford protection to domestic production'. This is an issue of how the measure in question is *applied*.

...[W]e believe that an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products. We believe it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products.

Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure.⁸⁵

97. These passages are completed in the Appellate Body's Report in *Chile – Alcoholic Beverages* by the observation:

The *subjective* intentions inhabiting the minds of individual legislators or regulators do not bear upon the inquiry, if only because they are not accessible to treaty interpreters. It does not follow, however, that the statutory purposes or objectives – that is, the purpose or objectives of a Member's legislature and government as a whole – to the extent that they are given *objective* expression in the statute itself, are not pertinent.⁸⁶

98. That being said, the Appellate Body has not hesitated to rely on official government statements to buttress its conviction that the design and structure of a tax was such as to afford protection to domestic products.⁸⁷ However, as a matter of principle, as the Appellate Body said in *Chile - Alcohol*, the analysis under Article III is an objective analysis, where the intent to confer protection is inferred from objective elements: the design, the architecture, and the revealing structure of the measure at issue.

99. However, I would see the introductory clause of Article XX differently.

100. This clause has been subject of intense scrutiny, both in *United States – Reformulated Gasoline* and in *United States – Shrimps*. For the purpose of the present analysis, the most important considerations of the Appellate Body are the following:

101. Already in *United States – Reformulated Gasoline*, its very first case, the Appellate Body stressed that:

⁸⁵ *Japan – Alcoholic Beverages*, (cited above at footnote 14), p. 119/120.

⁸⁶ *Chile – Alcoholic Beverages*, (cited above at footnote 61), para 62.

⁸⁷ Appellate Body Report, *Canada – Certain Measures Concerning Periodicals (Canada – Periodicals)*, WT/DS31/AB/R, adopted 30 July 1997, DSR 1997 I, at 475/476.

[t]he purpose and object of the introductory clauses of Article XX is generally the prevention of 'abuse of the exceptions of [what was later to become] Article XX.' [footnote omitted].⁸⁸

102. In its Report in *United States - Shrimp*, the Appellate Body repeated this statement and added:

The chapeau of Article XX is, in fact, but one expression of the principle of good faith. This principle, at once a general principle of law and a general principle of international law, controls the exercise of rights by states. One application of this general principle, the application widely known as the doctrine of *abus de droit*, prohibits the abusive exercise of a state's rights and enjoins that whenever the assertion of a right 'impinges on the field covered by [a] treaty obligation, it must be exercised bona fide, that is to say reasonably' (footnote omitted) An abusive exercise by a Member of its own treaty right thus results in a breach on the treaty rights of the other Members and, as well, a violation of the treaty obligation of the Member so acting.⁸⁹

103. The introductory clause mentions

- (a) 'arbitrary discrimination' (between countries where the same conditions prevail),
- (b) 'unjustifiable discrimination' (with the same qualifier), or
- (c) 'disguised restriction' on international trade

104. The Appellate Body has not had an opportunity to interpret, in detail, the term 'disguised restriction'. In its Reports in *United States - Reformulated Gasoline* and *United States - Shrimp*, the Appellate Body dealt mainly with the two forms of discrimination mentioned in the chapeau of Article XX. The Appellate Body has however stated that:

'[a]rbitrary' discrimination', 'unjustifiable discrimination' and 'disguised restriction' on international trade may ... be read side-by-side; they impart meaning to one another. It is clear to us that 'disguised restriction' includes disguised *discrimination* in international trade. It is equally clear that *concealed* or *unannounced* restriction of discrimination in international trade does *not* exhaust the meaning of 'disguised restriction'. We consider that 'disguised restriction', whatever else it covers, may properly be read as embracing restrictions amounting to arbitrary or unjustifiable discrimination in international trade taken under the guise of a measure formally

⁸⁸ *United States - Reformulated Gasoline* (cited above at footnote 60), p. 21.

⁸⁹ Appellate Body Report, *United States - Shrimp*, WT/DS58/AB/R, para. 158.

within the terms of an exception listed in Article XX. Put in a somewhat different manner, the kinds of considerations pertinent in deciding whether the application of a particular measure amounts to 'arbitrary or unjustifiable' discrimination', may also be taken into account in determining the presence of a 'disguised' restriction' on international trade. The fundamental theme is to be found in the purpose and object of avoiding abuse or illegitimate use of the exceptions to substantive rules available in Article XX.⁹⁰

105. I have explained earlier that the analysis under Article III is an objective one, based on the design, the architecture and revealing structure of the measure at issue. But I have also noted that the Appellate Body has not hesitated to refer to official government statements to support its conviction that the design and structure of a tax was such as to afford protection to domestic products.⁹¹
106. I am convinced that this approach is also appropriate for the examination of the criterion of 'disguised restriction' on international trade in the introductory clause of Article XX. Among the three criteria used in the introductory clause, the criterion 'disguised restriction' is the most subjective one, as the ordinary meaning of the word 'disguise' is 'conceal', 'misrepresent', 'show in false', 'cover up'.⁹² If the goal of the 'chapeau' of Article XX is to reveal an abuse which is 'disguised', official declarations or other circumstances which indicate that a measure that appears on its face to be 'related to the conservation of an exhaustible natural resource' is in reality intended to afford protection to a domestic production must be relevant.

V. A final comment on intent

107. As a final note, I do consider that where products are in a 'like' relationship, disfavouring one amounts to favouring the other. Precisely as was said in *Asbestos*, 'If there is 'less favourable treatment' of the group of 'like' imported products, there is, conversely, 'protection' of the group of 'like' domestic products.'⁹³

⁹⁰ *United States – Reformulated Gasoline*, (cited above at footnote 60), p. 25.

⁹¹ *Canada – Periodicals*, (cited above at footnote 87), at 475/476.

⁹² *The Concise Oxford Dictionary* - 7th ed., 1989.

⁹³ *European Communities – Asbestos*, (cited above at footnote 11), para. 100.

108. This follows logically from the finding that the products are 'like'. If products are 'like', it means that they are in a competitive relationship. When measures that disturb that competitive relationship intervene, they have an effect on the market. If consumer choice is 'binary',⁹⁴ then one group of 'like products' to be disadvantaged leaves the market no choice but to turn to the other group of 'like products'.

*

109. I acknowledge my independent duty to assist the Tribunal in its determination of these matters, and undertake to attend any oral hearing in these proceedings, unless otherwise ordered by the Tribunal. I understand that my duty to the Tribunal overrides any obligation to Methanex as the entity that engaged me to draft this opinion. To the best of my knowledge, the opinions and conclusions contained herein are true.

* * *
*

⁹⁴ See Methanex's Second Amended Statement of Claim, sect. V. D.

Signed in the original, Florence, Italy



Professor Claus-Dieter Ehlermann

November 4, 2002