

**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.

**CLAIMANT METHANEX CORPORATION'S
SECOND AMENDED STATEMENT OF CLAIM**

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GLOSSARY OF ACRONYMS

ADM	Archer Daniels Midland
AIT	Canada's Agreement on Internal Trade
AMA	American Medical Association
API	American Petroleum Institute
CAA	Clean Air Act
CAAA	Clean Air Act Amendments of 1990
Cal. EPA	California Environmental Protection Agency
CARB	California Air Resources Board
CaRFG3	California Phase 3 Reformulated Gasoline Regulations
CEC	California Energy Commission
CEH	Chemical Economics Handbook-SRI International
CFTA	Canada-United States Free Trade Agreement
CIWMB	Cal. EPA, Integrated Waste Management Board
EC	European Commission
EIA	United States Energy Information Administration
EPA	United States Environmental Protection Agency
ETBE	Ethyl tertiary butyl ether
FTC	Federal Trade Commission
GAO	United States Government Accounting Office
GATT	General Agreement on Tariffs and Trade
GEC	Governors' Ethanol Coalition
IEA	International Energy Annual
IRAC	International Agency for Research on Cancer
LACMTA	Los Angeles County Metropolitan Transportation Authority
LUSTs	Leaking underground storage tanks
MMT	Methylcyclopentadienyl manganese tricarbonyl
MTBE	Methyl tertiary butyl ether
NAFTA	North American Free Trade Agreement

NIEHS	National Institute for Environmental Health Sciences
NO _x	Nitrogen oxides
NRDC	Natural Resources Defense Council
NTP	National Toxicology Program
PCB	Polychlorinated biphenyl
RFA	Renewable Fuels Association
RFG	Reformulated Gasoline
RVP	Reid Vapor Pressure
TAME	Tertiary-amyl methyl ether
BE	Tertiary-butyl alcohol
TSE	Toronto Stock Exchange
UC	University of California at Davis
UCLA	University of California Los Angeles
USDA	United States Department of Agriculture
USITC	United States International Trade Commission
USTs	Underground gasoline storage tanks
WTO	World Trade Organization

I. INTRODUCTION

1. In its First Partial Award of August 7, 2002, the Tribunal rejected the United States' various admissibility objections. (*See* Aug. 7, 2002 Award ¶ 126.) It also concluded that "certain allegations" contained in Methanex's Draft Amended Claim, as supplemented in subsequent written and oral submissions, could establish the Tribunal's jurisdiction over Methanex's claims. (*See id.* ¶ 172(4).) In order to confirm its jurisdiction in this matter, the Tribunal directed Methanex to submit a "fresh pleading" together with evidence supporting its allegations. (*See id.* ¶¶ 161-66, 172(5).) Accordingly, Methanex respectfully submits this Second Amended Statement of Claim, along with accompanying evidential materials, with the understanding that this submission complies with the requirements set forth in the Partial Award.

2. Those evidentiary materials, as well as the legal authorities on which Methanex relies, are compiled in separate appendices. In addition, the Tribunal will find attached to this Second Amended Statement of Claim each of the following:

3. At Exhibit A to this Claim is the Second Affidavit of Michael Macdonald, Senior Officer of Methanex Corporation ("Macdonald Aff."). This affidavit describes Methanex's operations and the oxygenate industry, including the production and use of methanol, ethanol, MTBE, and ETBE. Mr. Macdonald's affidavit also makes clear the binary purchasing choice between methanol and ethanol for California's gasoline refiners, blenders, and distributors, and their near-universal decision to use methanol-based MTBE before the California measures tilted these markets to the exclusive benefit of ethanol. In addition, Mr. Macdonald's affidavit also describes California's decision, in its latest regulations, to prohibit the use of methanol as an oxygenate in California gasoline.

4. In addition, Methanex had intended to supply another factual affidavit from one of the California refiners affected by the California measures. That refiner, however, ultimately

declined to provide Methanex with that affidavit, informing Methanex's counsel that it had made that decision because the refiner feared retaliation by the State.

5. At Exhibit B is an affidavit by Robert Wright, Director of Government and Industry Relations for Methanex ("Wright Aff."). Mr. Wright's responsibilities include representing Methanex during legislative activities that may affect the methanol industry. His affidavit describes his involvement in the legislative activities that preceded the ban on the use of MTBE in California gasoline. In particular, Mr. Wright attests that, during that time period, a meeting took place in the office of the President *Pro Tempore* of the California Senate, Senator Burton, who told the attendees, which included representatives of the methanol and MTBE industry — including three representatives of Methanex — that they were, to paraphrase him, "out of luck." Mr. Wright avers that the President *Pro Tempore* left no uncertainty of his understanding that the intentions and effects of the MTBE prohibition were directed at, and intended to be felt by, the methanol and methanol-based MTBE industry, and that the President *Pro Tempore* specifically mentioned Methanex and the negative impact the MTBE ban would have on the company's stock price.

6. At Exhibit C is the expert opinion of Sir Robert Jennings, former President of the International Court of Justice, on the meaning of Article 1101(1) of NAFTA ("Jennings Op."). Sir Robert first observes that the "legally significant connection" requirements of Article 1101(1) cannot be considered in isolation from the substantive provisions of Chapter 11, which are the provisions of the greatest legal significance here. He further notes that, as mandated by Article 1131, account must also be taken of the full range of relevant international law, including both treaty law and judicial decisions. Specifically, Sir Robert suggests that WTO/GATT decisions,

as well as municipal competition law, constitute two particularly relevant bodies of direct precedent on questions of national treatment and discriminatory intent.

7. At Exhibit D is the expert opinion of Claus-Dieter Ehlermann, former Chairman of the Appellate Body of the World Trade Organization in 2001 and a member of that Body from 1995 to 2001 (“Ehlermann Op.”). Professor Ehlermann’s expert opinion covers the principle of nondiscrimination, or national treatment, and he concludes that there is a “like” relationship between methanol and ethanol within the meaning of the national-treatment provision of GATT. He also concludes that the California measures afford foreign products such as methanol “less favorable treatment” than domestic products such as ethanol, in violation of GATT’s national-treatment requirements. Professor Ehlermann further states that intent is not necessary to a finding that GATT’s national-treatment provision had been violated, although it is relevant to an analysis of the introductory clause of GATT’s public policy exception. Professor Ehlermann concludes that where two products are in a “like” relationship, and consumer choice is essentially binary, disfavoring one of those products amounts to favoring the other.

8. At Exhibit E is an expert report prepared by Exponent, a scientific consulting company, which addresses the purported role of leaking underground gasoline storage tanks (“gasoline USTs”) in relation to the California measures. The report, entitled *Evaluation of UST/LUST Status in California and MTBE in Drinking Water (2002)* (“Exponent Report”), is a detailed investigation into the present state of the gasoline UST situation in California. Exponent concludes that compliance in California with existing laws barring leaking gasoline USTs has improved, the number of new leaking gasoline USTs (“LUSTs”) identified has decreased, and as a consequence (just as previous studies had predicted), MTBE is being detected in groundwater far less than before.

9. At Exhibit F, in compliance with Articles 18 and 20 of the UNCITRAL Arbitration Rules and the Tribunal's Partial Award of Aug. 7, 2002, are Chapter 11 of NAFTA, which serves as the United States' offer to arbitrate; Methanex Corporation's Consent to Arbitrate and Waiver of Other Dispute Settlement Procedures, which serves as acceptance of that offer; and the Parties' names and addresses.

10. There is one fundamental aspect of this fresh statement of claim that is worth noting at the outset. Methanex has tried to make clear throughout that this is a straightforward dispute over an ordinary type of international wrong — economic protectionism — and not an effort to expand international guarantees in a way that would threaten nations' or states' ability to enact or enforce valid and nondiscriminatory environmental laws. An extensive body of both municipal and international case law demonstrates that the United States' efforts to protect its domestic ethanol industry from "foreign" competitors under the guise of environmental protection is a common type of impermissible treatment. Far from representing an abuse or an unwarranted extension of the Chapter 11 process, Methanex's refusal simply to accept the consequences of California's unlawful protectionism comports exactly with the investment guarantees Chapter 11 was meant to provide.

II. THE PARTIES

11. The Claimant, Methanex Corporation ("Methanex"), is a Canadian company originally incorporated under the laws of the Province of Alberta (Canada) and now continuing under Canada's *Business Corporations Act*. Headquartered in Vancouver, British Columbia, Canada, Methanex supplies methanol to manufacturers around the world for use in a wide variety of products and applications. Methanex is an investor protected by Chapter 11 of NAFTA.

12. Methanex's sole business is the production, transportation, and marketing of methanol, which is a liquid petrochemical made from feedstocks containing carbon and hydrogen. Methanol is a clean and reliable source of energy, and it is a leading candidate for many future fuel-cell applications. Methanol is also the essential oxygenating element of MTBE, a safe, clean, and economical gasoline component. Methanex "is the largest producer and marketer in the world, accounting for approximately 17% of global methanol capacity." Chemical Economics Handbook ("CEH") Marketing Research Report, *Methanol*, at 5 (July 2002) ("CEH Report, *Methanol*") (FA 15).¹ As of 2000, Methanex owned methanol production facilities around the world having an annual capacity of approximately 7.0 million tons. These plants were and are located in the United States, Canada, Chile and New Zealand, as well as, through joint venture agreements, in Trinidad and Tobago. *Id.* Methanex has no facilities in the Middle East; indeed, it is a stable, reliable and nearby supplier of energy to the United States. Roughly one-third of the methanol marketed by Methanex is utilized in the fuel sector, principally for use in the creation of MTBE, which has been extremely successful at reducing air pollution throughout North America and indeed the world.

13. Methanex Methanol Company ("Methanex U.S.") is a Texas general partnership of two U.S. corporations, Methanex, Inc. and Methanex Gulf Coast, Inc., both of which are incorporated under the laws of the State of Delaware. Methanex owns, indirectly, 100 percent of the shares of both partners.

14. Methanex U.S. markets methanol throughout North America, and maintains some inventory in the U.S. All shipments by Methanex and its subsidiaries in or to the United States are booked through Methanex U.S. Methanex ships its methanol directly from its wholly-owned

¹ All references to factual materials are, for the Tribunal's convenience, hereafter

Canadian plants into the United States for consumption by U.S. customers. When the Methanex Fortier plant in Louisiana (described below) was operating, many of the shipments for U.S. consumption originated there. Additional shipments for U.S. consumption originate at other Methanex production facilities around the world.

15. In 1998, Methanex U.S. sold 1,973,335 metric tons of methanol in the United States. Approximately forty percent of those methanol sales were made to third parties that use methanol for the production of MTBE. These 1998 shipments included approximately 130,000 metric tons of methanol that were shipped to California refineries for MTBE production. Notably, however, Methanex's shipments to California have been declining sharply since the enactment of the California measures at issue here — totaling only 99,973, 88,001, and 50,895 metric tons for the years 1999, 2000, and 2001, respectively. Some of these U.S. sales were shipped from Methanex's Canadian plants directly to U.S. customers.

16. Methanex Fortier, Inc. ("Methanex Fortier") is a U.S. corporation incorporated under the laws of the State of Delaware. Methanex indirectly owns 100 percent of the shares of Methanex Fortier. Methanex Fortier owns and operates, *inter alia*, a methanol production facility in the State of Louisiana that was temporarily idled in 1999 due to market conditions; that facility continues to be idle to this day. The California measures detailed herein, together with similar measures taken and threatened elsewhere in the United States, will continue and worsen a tendency toward oversupply in the methanol industry, further extending the idling of Methanex Fortier. In addition, the California measures, which bar methanol and methanol-based MTBE from the valuable California oxygenate marketplace, will depress the price of every gallon of methanol sold by Methanex U.S., and indeed every gallon of methanol sold worldwide.

(continued...)

followed by a reference to the factual appendices, as indicated by "FA__."

17. Methanex U.S., Methanex Fortier, and their respective operations, goodwill, and market share, as well as Methanex's own goodwill and market share, are investments in the United States within the meaning of NAFTA Article 1139.

18. The Respondent United States of America is the governmental body that, under the provisions of NAFTA, is responsible for actions taken by the federal and state governments of the United States. Accordingly, it is liable for damages attributable to California's violations of NAFTA Chapter 11.

III. THE CHALLENGED MEASURES

19. Methanex challenges two measures adopted by the State of California: California Executive Order D-5-99 and California Code of Regulations, title 13, § 2260 *et seq.* ("CaRFG3 Regulations").

20. California Executive Order D-5-99, enacted by California Governor Gray Davis on March 25, 1999, directed the California Air Resources Board ("CARB") to ban the use of methanol-based MTBE as an oxygenate in California gasoline effective December 31, 2002. Among other things, Executive Order D-5-99 also directed several state agencies to take steps intended to create an in-state ethanol industry as the replacement for MTBE. In addition, the Executive Order required "prominent identification at the pump of gasoline containing MTBE" until the ban took full effect.

21. The Executive Order was ostensibly based on a 1998 study conducted by employees of the University of California at the direction of the California legislature. University of California-Davis, *Health & Envtl. Assessment of MTBE* (Nov. 1998) ("UC Report") (FAs 36-40). The study was one of a series of important events leading up to the measures that Methanex is challenging, and thus is highly relevant to Methanex's claims in these proceedings. *See* Section V(E)(1), below.

22. The second measure that Methanex challenges is the set of CaRFG3 Regulations adopted by CARB on September 2, 2000, which implemented Executive Order D-5-99. In implementing Governor Davis' Executive Order, the CaRFG3 Regulations prohibited the use of MTBE as of December 31, 2002, and facilitated its accelerated removal from all California gasoline prior to that date. The CaRFG3 Regulations went beyond merely banning MTBE, however: They also provided that *only* ethanol, which is almost entirely a domestic U.S. product, could be used as an oxygenate in California gasoline. Consequently, the regulations banned not only MTBE, but methanol as well, from competing with ethanol in the California oxygenate market.

23. The United States is responsible for these California measures under NAFTA, *see* NAFTA Article 105, and under international law generally.

IV. THE NATURE OF METHANEX'S SHOWING OF INTENT

24. In this section of its fresh pleading, Methanex provides an analysis of the law governing proof of impermissible intent.

A. Intent Is Proven By Inference, Both At Common Law And Under Statutes And Other Legal Regimes Requiring Proof Of Intent

25. In a Year Book case dating to the fifteenth century, Chief Justice Brian said that it was "common knowledge that the thoughts of man shall not be tried, for the devil himself knoweth not the thought of man." Y.B. 7 Edw. IV, f. 2, pl. 2 (1477). Notwithstanding this ancient dictum, the days are long past when Chief Justice Brian's view held sway. In the words of a prominent U.S. appellate judge, Henry Friendly: "Now it is daily business for judges and juries to plumb 'the mainsprings of human conduct.'" *Prudential Ins. Co. of Am. v. Gray Mfg. Co.*, 328 F.2d 438, 444-45 (2d Cir. 1964) (quoting *Comm'r v. Duberstein*, 363 U.S. 278, 289 (1960)).

26. Even so, Chief Justice Brian made a salient point about proof of intent: Direct proof of an actor's intent simply cannot be obtained. "[T]he basic problem . . . is that "direct evidence" of intent cannot exist, at least in the sense of evidence which, if believed, would establish the ultimate issue of intent to discriminate.'" *Tyler v. Bethlehem Steel Corp.*, 958 F.2d 1176, 1183 (2d Cir. 1992) (quoting C. Sullivan, *Accounting for Price Waterhouse: Proving Disparate Treatment Under Title VII*, 56 Brook. L. Rev. 1107, 1138 (1991)). Finders of fact therefore recognize the need to resort to such inferential or circumstantial evidence because, in dealing with matters of intent, direct proof is rarely (if ever) available. See, e.g., *Re Fording Coal Ltd. & U.S.W.A.*, 1998 C.L.A.S.J. 670412, at *51 (B.C. 1998) ("As motive is subjective, it may be established by inference in the absence of specific proof of intent.") (internal quotation marks and citation omitted); *Anya v. Univ. of Oxford*, [2001] E.W.C.A. Civ. 405, at *5 (C.A. 2001) (stating that a finding of intentional discrimination "will therefore usually depend on what inferences it is proper to draw from the primary facts found by the tribunal") (internal quotation marks and citation omitted); J. Wigmore, *2 Evidence in Trials at Common Law* § 242, at 44 (1979) ("[I]ntent as a separate proposition for proof does not commonly exist.").

27. This is borne out in particular areas of the law. In criminal law, for example, every crime requires the combination of a particular *actus reus* (action) with a particular *mens rea* ("guilty mind"). Since many crimes (such as murder in the first or second degrees) require that the criminal act be done with a specific intent, the criminal law has adopted the understanding that "[i]ntent ordinarily may not be proved directly, because there is no way of fathoming or scrutinizing the operations of the human mind." *United States v. Chiantese*, 560 F.2d 1244, 1256 (5th Cir. 1977). Thus, in criminal cases, the government need not "introduce any extraordinary evidence that would conclusively demonstrate [the defendant's] state of mind.

Rather . . . the Government may prove [*mens rea*] by reference to facts and circumstances surrounding the case.” *Liparota v. United States*, 471 U.S. 419, 434 (1985). Criminal intent may be inferred from “any statement made and [any act] done or omitted by the defendant, and all other facts and circumstances in evidence which indicate his state of mind.” *Chiantese*, 560 F.2d at 1256.

28. In tort law, too, the finder of fact is generally left to infer the defendant’s state of mind from the circumstantial evidence. In *Wilson v. Pringle*, [1986] Q.B. 237 (Ct. App. 1986), for example, the Court of Appeal recognized that the issue of hostile intent is a “question of fact . . . [that] may be imported from the circumstances.” *Id.* at 253; *see also, e.g., Prosser & Keeton on the Law of Torts* § 8, at 36 (5th ed. 1984).

29. These and other legal contexts where intent is relevant therefore recognize that “intent must be inferred from conduct of some sort,” and that it is thus “permissible to draw usual reasonable inferences as to intent from the overt acts.” *Cramer v. United States*, 325 U.S. 1, 31 (1945). So the law has recognized that, where an actor’s intent is a critical element of a claim or defense, intent can — indeed, it must — be proven inferentially. The Tribunal recognized this important principle in its August 7, 2002 Partial Award (¶ 149) by “accept[ing] that it is open to Methanex to rely on reasonable inferences; and it may rely generally on circumstantial materials.”

30. We sketch out here some basic principles relevant to the inferential “intent” inquiry that we urge the Tribunal to undertake.

31. Principle One: “The chief method of ascertaining a decisionmaker’s motivation involves the drawing of inferences from his conduct,” and that conduct is to be “viewed in the

context of antecedent and concurrent events and situations.” P. Brest, *Palmer v. Thompson: An Approach to the Problem of Unconstitutional Legislative Motive*, 1971 Sup. Ct. Rev. 95, 120-21.

32. Principle Two: Even so, there will be cases where more direct evidence of the decisionmaker’s intent will be uncovered during the course of a proceeding. In *S.D. Myers, Inc. v. Canada*, for example, the case of illegal discrimination under NAFTA Article 1102 was laid bare by the discovery of “smoking gun” evidence of intentional discrimination. See *S.D. Myers, Inc. v. Canada* (Partial Award) ¶ 169 (Nov. 13, 2000) (detailing statement of discriminatory intent by Canadian Minister of Environment, obtained through cross-examination of attendee at meeting where statement was made). It is also worth noting that the Chapter 11 Tribunal in that case concluded that: “Insofar as intent is concerned, the documentary record *as a whole* clearly indicates that the Interim Order and the Final Order were intended primarily to protect” the domestic industry “from U.S. competition.” *S.D. Myers* (Partial Award) ¶ 194 (emphasis added). Of course, Methanex awaits its opportunity to avail itself of the procedures to obtain additional evidence that it and the United States previously agreed upon. (See Letter from V.V. Veeder, Q.C. to Christopher F. Dugan, Esq. et al. (Oct. 21, 2002) at 2.)

33. 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 decisionmaker . . . 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.” Brest, *supra*, at 121-22. Similarly, evidence that a better solution was available to a decisionmaker 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”).

34. Principle Four: Intent to cause harm will be inferred where that harm is the natural, probable, and foreseeable consequence of taking a particular action. “[W]here the known danger ceases to be only a foreseeable risk . . . and becomes in the mind of the actor a substantial certainty,” the actor is presumed to have intended to cause that dangerous result. *Prosser & Keeton on Torts, supra*, § 8, at 36. Where the intent behind an executive or legislative enactment is at issue, courts and tribunals similarly presume that the executives or legislators at issue intended the edict to have the natural, probable, and foreseeable consequences that flow from it. *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)).

35. Principle Five: When, as is often the case, a 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 decisionmaker 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.” Brest, *supra*, at 119 n.123.

36. Principle Six: Where the actor attempts to justify his act by claiming that a different, permissible intent actually motivated him, but the finder of fact concludes that the justification offered is unreasonable, the factfinder may naturally infer, from the unreasonableness of the proffered excuse itself, that the act was motivated by an impermissible intent. See, e.g., *Chief Constable of West Yorkshire v. Vento*, [2001] IRLR 124, at *7 (Employment Appeal Tribunal) (“Having found less favourable treatment, we are obliged to look to the respondent for an explanation of the treatment of the applicant. If we consider the explanation to be inadequate or unsatisfactory, it is legitimate for us to infer that discrimination was on grounds of sex.”) (internal quotation marks and citation omitted); *Rex v. Rozolinsky*, 1 C.R. 89 (Quebec Court of King’s Bench, Appeal Side 1946) (where defendant’s explanation is not only not compatible with his innocence but is unreasonable and improbable, the charge must be held to have been proven); *Corfu Channel Case* (U.K. v. Albania), 1949 I.C.J. 4, 18 (Merits Judgment of Apr. 9) (holding that where the direct evidence of liability is in respondent’s exclusive control, a claimant must “be allowed a more liberal recourse to inferences of fact and circumstantial evidence,” and also concluding that the incredible nature of a denial serves as proof that the proposition denied is true); *Cheek v. United States*, 498 U.S. 192, 203-04 (1991) (noting that the more unreasonable the stated beliefs are, the more likely the jury is to infer invalid motive); see also *United States v. Urfer*, 287 F.3d 663, 665 (7th Cir. 2002) (Posner & Easterbrook, JJ.) (stating that reasonableness of belief is a factor for the jury to consider in determining an actor’s intent); *United States v. Hilgefjord*, 7 F.3d 1340, 1344 (7th Cir. 1993) (same).

B. Intent In International And Municipal Law Concerning Economic Discrimination Is Likewise Inferred From Objective Facts And Circumstances

37. These guiding principles find particular application for purposes of this case in areas of the law, both international and municipal, that guarantee free and fair competition.

1. EC Trade Discrimination Law

38. The European Court of Justice infers discriminatory intent from the objective circumstances when applying the discrimination law of the European Communities. In *E.C. Commission v. Denmark*, for example, the Court invalidated a Danish law that applied one tax rate to aquavit and another, higher rate to virtually all other alcoholic beverages. See [1981] 2 C.M.L.R. 688 ¶ 37.

39. Although many of the imported alcoholic beverages which competed with aquavit in the Danish marketplace were very similar to aquavit in terms of ingredients and production processes, the law was drawn expressly to exclude the competitive imports from the favorable tax treatment accorded to aquavit. See *id.* ¶¶ 35-36. Yet Denmark denied that its system for taxing alcoholic beverages was protectionist because “the contested tax system makes no distinction between imported products and domestic products . . . [;] thus imported aquavit benefits from the rate of tax levied on domestic aquavit, whilst other domestic alcoholic beverages are subject to the same rate of tax as imported products.” *Id.* ¶ 26.

40. But the Court had no trouble finding discriminatory or protectionist intent on these facts, even though the tax system contained no “formal distinction according to the origin of the products”:

Viewed by itself, the tax system introduced by the Danish legislation contains incontestable discriminatory or protective characteristics. Although it does not establish any formal distinction according to the origin of the products, it has been adjusted so that the bulk of the domestic production of spirits

comes within the most favourable tax category whereas almost all imported products come within the most heavily taxed category. These characteristics of the system are not obliterated by the fact that a very small fraction of imported spirits benefits from the most favourable rate of tax whereas, conversely, a certain proportion of domestic production comes within the same tax category as imported spirits. It therefore appears that the tax system is devised so that it largely benefits a typical domestic product and handicaps imported spirits to the same extent.

Id. ¶ 36; *see also id.* ¶¶ 18, 32.

2. Municipal Law Analogues

a) Dormant Commerce Clause

41. The U.S. Constitution provides, in its Commerce Clause, that “[t]he Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” U.S. Const., art. I, § 8, cl. 3. The U.S. Supreme Court has interpreted this clause not only as providing a positive commerce-regulating power to the U.S. Congress, but also as having a “negative” or “dormant” component that forbids state protectionism or discrimination against commerce originating from outside the state in question. *See generally* L. Tribe, *American Constitutional Law* § 6-2 (3d ed. 2000).

42. Because “[a] finding that state legislation constitutes ‘economic protectionism’ may be made on the basis of either discriminatory purpose or discriminatory effect,” *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984) (internal citation marks omitted), the question of “discriminatory purpose” often arises in Dormant Commerce Clause jurisprudence. Consistent with general principles of proving intent, and the particular approaches of the international legal regimes discussed above, U.S. courts also regularly infer protectionist intent from surrounding circumstances for purposes of the “Dormant” Commerce Clause. As the U.S. Supreme Court has recognized, it is a “rare instance where a state artlessly discloses an avowed purpose to discriminate against interstate goods.” *Dean Milk Co. v. Madison*, 340 U.S. 349, 354 (1951).

Thus, courts reviewing state measures under the Dormant Commerce Clause claims are frequently able to find discriminatory intent from the surrounding circumstances.

43. Not surprisingly, one of the leading cases dealing with discriminatory (protectionist) intent involved a state taxation scheme that favored ethanol. In *New Energy Co. v. Limbach*, 486 U.S. 269 (1988), the U.S. Supreme Court reviewed an Ohio statute that treated ethanol as a preferred fuel. The Court began its opinion by describing the special, protected status that ethanol held in the U.S. economy: “The product was originally promoted as a means of achieving energy independence while providing a market for surplus corn Ethanol was, however (and continues to be), more expensive than gasoline, and the emergence of ethanol production on a commercial scale dates from enactment of the first federal subsidy, in the form of an exemption from federal motor fuel excise taxes, in 1978.” *Id.* at 271.

44. The challenged Ohio law provided fuel dealers with an additional state tax credit for each gallon of Ohio-produced fuel ethanol they used. *Id.* The Ohio credit was available for the use of fuel ethanol produced in another state, but only if that state granted similar tax advantages to ethanol produced in Ohio. *See id.* Ohio argued that its preference for in-state ethanol — and its concomitant penalization of out-of-state ethanol — was justified, because it “encourages use of ethanol . . . to reduce harmful exhaust emissions, both in Ohio itself and in surrounding States whose polluted atmosphere may reach Ohio.” *Id.* at 279. The Supreme Court recognized that “the protection of health is a legitimate state goal,” and (for purposes of legal argument only) it was willing to “assume . . . that use of ethanol generally furthers it.” *Id.*

45. But, the Court observed, it was able to infer protectionist intent from Ohio’s asserted justification, because the explanation it offered the Court simply was not credible. *See id.* at 279, 280. As the Court said, “there is no reason to suppose that ethanol produced in a State

that does not offer tax advantages to ethanol produced in Ohio” would not provide the same alleged health benefits as Ohio ethanol. *Id.* at 279. Based on this and similar objective facts, the Court concluded: “It could not be clearer that health is not the purpose of the [tax] provision, but is merely an occasional and accidental effect of achieving what is its purpose, favorable tax treatment for *Ohio*-produced ethanol.” *Id.* (emphasis in original).

46. The U.S. Supreme Court followed a similar course to reach a similar conclusion in *Dean Milk Co. v. Madison, supra*. There, it reviewed a local ordinance that forbade the sale of milk within the city limits of Madison, Wisconsin, unless the milk had “been processed and bottled at an approved pasteurization plant within a radius of five miles from the central square of Madison.” 340 U.S. at 350. The city claimed that the ordinance was a facially neutral public health measure intended to ensure the safety of its milk supply. *See id.* at 354.

47. The Court concluded, however, that the “practical effect” of the ordinance was to “exclude[] from distribution in Madison wholesome milk produced and pasteurized” out of state. *Id.* It then rejected the city’s proffered public health excuse because the evidence showed that the city had considered and rejected a “reasonable nondiscriminatory alternative[]” recommended by both its own Health Commissioner and the “milk sanitarian of the Wisconsin State Board of Health.” *Id.* at 354-56. Accordingly, the Court had no difficulty concluding that “[i]n thus erecting an economic barrier protecting a major local industry against competition from without the State, Madison plainly discriminates against interstate commerce.” *Id.* at 354.²

² This same analysis — and the same result — can be found in numerous U.S. Supreme Court cases stretching back over more than 125 years. *See, e.g., Chemical Waste Mgmt., Inc. v. Hunt*, 504 U.S. 334, 346 (1992) (concluding that the evidence showed “an obvious effort to saddle those outside the State with most of the burden”) (internal quotation marks and citation omitted); *Hunt v. Wash. State Apple Adver. Comm’n*, 432 U.S. 333, 352 (1977) (noting evidence of protectionist intent); *Foster-Fountain Packing Co. v. Haydel*, 278 U.S. 1, 10, 13 (1928) (same); *Railroad Co. v. Husen*, 95 U.S. 465 (1877) (same).

48. In sum: As the U.S. Supreme Court has long recognized, “in whatever language a statute may be framed, its purpose must be determined by its natural and reasonable effect.” *Railroad Co. v. Husen*, 95 U.S. 465, 472 (1877) (internal quotation marks and citation omitted). And where “[t]he reach of the statute [is] far beyond its professed object,” the professed object of that statute will be found to be a “pretense.” *Id.*

b) Anti-Discrimination Law

49. Municipal anti-discrimination law provides another useful analog for this case. Like NAFTA’s Article 1102, municipal anti-discrimination law is designed to prevent, *inter alia*, government action that is based on unlawful biases.

50. As with all intent-based legal regimes, municipal anti-discrimination law cautions that “[i]t is important to bear in mind that it is unusual to find direct evidence of . . . discrimination.” *Anya*, [2001] E.W.C.A. Civ. 405, at *5 (internal quotation marks and citation omitted). Accordingly, municipal anti-discrimination law, including Canadian, English, and U.S. law, holds that “[a]s motive is subjective, it may be established by inference in the absence of specific proof of intent.” *Id.* (internal quotation marks and citation omitted); *see also id.* (a finding of intentional discrimination “will therefore usually depend on what inferences it is proper to draw from the primary facts found by the tribunal”); *Re Fording Coal Ltd.*, 1998 C.L.A.S.J. 670412, at *51 (internal quotation marks and citation omitted); *Reg’l Econ. Cmty. Action Program, Inc. v. Middletown*, 294 F.3d 35, 49 (2d Cir. 2002) (“Discriminatory intent may be inferred from the totality of the circumstances.”) (internal quotation marks and citation omitted), *cert. denied*, 2002 WL 977157 (Oct. 7, 2002).

51. Where intentional discrimination is alleged, the relevant circumstances from which discrimination may be inferred include “[t]he historical background of the decision . . . particularly if it reveals a series of official actions taken for invidious purposes.” *Vill. of*

Arlington Heights v. Metro. Hous. Dev. Corp., 429 U.S. 252, 267 (1977). Similarly, “the specific sequence of events leading up to a challenged decision [and] contemporary statements by members of the decisionmaking body” may also be relevant. *Middletown*, 294 F.3d at 49 (internal quotation marks and citation omitted). Other pertinent factors include, but are by no means limited to: disproportionately discriminatory impacts; patterns that cannot be explained by discrimination-neutral terms; departures from standard procedures; and the measure’s legislative history. *See, e.g., Vill. of Arlington Heights*, 429 U.S. at 266-68.

c) Competition/Antitrust Laws

52. Municipal competition and antitrust laws also provide a particularly relevant legal context upon which to draw: Like NAFTA generally and Article 1102 in particular, such laws are designed to achieve both economic fairness and efficiency by ensuring equality of competitive opportunity. *See, e.g., Associated Gen. Contractors of Cal., Inc. v. Cal. State Council of Carpenters*, 459 U.S. 519, 538 n.38 (1983) (noting that the purpose of the U.S. antitrust laws is to protect “the freedom to compete”).

53. Like virtually every other area of the law, competition and antitrust law also recognizes that “[i]ntent is rarely established by direct evidence; almost invariably, it is established by circumstantial evidence.” *Consol. Gas Co. v. City Gas Co.*, 912 F.2d 1262, 1285 (11th Cir. 1990) (opinion of Johnson, J., concurring in part and dissenting in part), *vacated as moot*, 931 F.2d 710 (11th Cir. 1991); *see also United States v. United States Gypsum Co.*, 438 U.S. 422, 435 (1978) (wrongful intent “must be established by evidence and inferences drawn therefrom”); *Dir. of Investigation & Research v. NutraSweet Co.*, 32 C.P.R. (3d) 1, *35-*36 (Competition Tribune 1990) (“In most situations, of course, the purpose of a particular act will have to be inferred from the circumstances surrounding it.”).

54. Importantly, evidence that an action has been “undertaken with knowledge of its probable consequences” can establish the intent to cause those consequences. *United States Gypsum*, 438 U.S. at 444. This principle is recognized around the world. *See, e.g., NutraSweet Co.*, 32 C.P.R. (3d) 1, at *35 (“a corporation can be taken to intend the necessary and foreseeable consequences of its acts”); *Dir. of Investigation & Research v. Laidlaw Waste Systems Ltd.*, 40 C.P.R. 3d 289, 342 (Competition Tribune 1992) (anticompetitive “intention is almost impossible of proof in many cases involving corporate entities unless one stumbles upon what is known as a ‘smoking gun’”); *Napp Pharm. Holdings Ltd. v. Dir. Gen. of Fair Trading*, 64 B.M.L.R. 165 ¶ 456 (2002) (“[T]he fact that certain consequences are plainly foreseeable is an element from which the requisite intention may be inferred.”).

55. But anticompetitive intent can also be inferred from a virtually unlimited range of other circumstances as well. *See, e.g., Twin City Sportservice, Inc. v. Charles O. Finley & Co.*, 676 F.2d 1291, 1309 (9th Cir. 1982) (inferring intent to fix prices from, among other things, the defendant’s “repeated use of lavish loans, advances, and cash payments . . . to secure long-term contracts and contract extensions”).

C. Particularly Where The Market Has Essentially Two Competitors, Discrimination Is A “Zero-Sum Game,” Meaning That An Intent To Favor One Competitor Is, By Definition, An Intent To Disfavor The Other

56. All anti-discrimination legal regimes recognize that an intent to favor one competitor demonstrates, by definition, an intent to harm the disfavored competitors. This is so true as to be a virtual tautology: A state-imposed benefit to one competitor, or class of competitors, functions as a burden on all competitors who are not provided with the benefit, and the natural and foreseeable consequence of benefiting one competitor is a harm to the non-favored competitors. Application of this principle in this case should cause the Tribunal to conclude that evidence that California and its officials intended to benefit the ethanol industry,

without more, also demonstrates that California intended to harm ethanol's competitors — methanol, methanol-based MTBE, and Methanex.

57. While this inferential rule applies in all cases alleging discrimination of any kind and among any number of competitors, it has particular evidential force in the context of this case, where essentially only two competing products are vying for the same customers in the same market — where there are only two competitors, an advantage to one is achieved only at an opposite and equal disadvantage to the other. Thus, it makes no difference whether the evidence shows an intent to favor one competitor rather than an intent to disfavor the other, because the intent to aid one competitor necessarily establishes the intent to disfavor the other. Notwithstanding this inferential rule, the evidence in this case is more than sufficient to establish a specific intent to disfavor foreign investors and their investments, not just to favor their domestic competitors. *See* Section VI, below.

58. The United States conceded exactly that point at the July 2001 hearings when it described the “foundation” of Methanex’s intentional discrimination claim as an allegation of “intent to benefit the U.S. domestic ethanol industry.” (July 12, 2001 Tr. at 303:18-20.) As the United States correctly noted, that “makes sense, because why would California have any interest in injuring foreign-owned producers — foreign-owned suppliers of products or services, if not to benefit the U.S. domestic ethanol industry. . . . If it’s not to benefit domestic ethanol producers, then why would there be any intent to discriminate against anybody else?” (*Id.* at 303:20-304:7.)

59. The WTO Appellate Body confirmed the point in *European Communities — Measures Affecting Asbestos and Asbestos-Containing Products*, Appellate Body Report, WT/DS135/AB/R ¶ 100 (Mar. 12, 2001). “[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.” *Id.* ¶ 100. Professor Ehlermann similarly notes both the logic and inevitability of the conclusion. (*See Ehlermann Op.* ¶¶ 107-08 (Ex. D).)

60. The U.S. Supreme Court has confirmed the same point in the analogous context of the U.S. Constitution’s “Dormant” Commerce Clause, discussed above. Like NAFTA generally, and Article 1102 specifically, “[t]his ‘negative’ aspect of the Commerce Clause prohibits economic protectionism — that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.” *New Energy Co.*, 486 U.S. at 273 (citation omitted). As the quoted language demonstrates, a “design[]” to “benefit in-state economic interests” can only be accomplished by having the concomitant design to “burden[] out-of-state competitors.” *Id.*

61. This principle — that an intent to benefit the favored class is the same as an intent to burden the disfavored class — found particular application in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), a highly analogous Dormant Commerce Clause case. There, the U.S. Supreme Court 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.’” *Id.* at 273 (citation omitted).

62. The Court quickly rejected that 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 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.

Id. (emphasis added).

63. A leading constitutional scholar, Professor Laurence Tribe, has recognized this principle as an unexceptional one. In his treatise *American Constitutional Law*, Professor Tribe concludes that “benefit[ing] in-state economic interests” and “burdening out-of-state competitors” are the same thing in the context of “economic protectionism.” Tribe, *supra*, § 6-6, at 1066.

64. Indeed, the United States has itself embraced the same principle in 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.

Panel Report, WT/DS44/R ¶ 7.2 (1998); *see also European Communities — Trade Description of Sardines*, Panel Report, WT/DS231/R/Corr.1 ¶¶ 7.44-7.46 (May 29, 2002) (Corrigendum June

10, 2002) (noting that not only the express purposes, but also the corresponding negative implications of State action must be taken into consideration).

65. Another analogy from municipal discrimination law makes the point perfectly clear: An employer who has a hundred positions to fill decides that he will only consider white (or male) applicants. As a matter of practical common sense, no one would ever believe that an employer who only intended to favor white (or male) applicants had no intention of disfavoring black (or female) ones. The U.S. courts have acknowledged that an intent to provide “favorable treatment” to the members of one group is, by definition, an intent to deny “equal protection” to nonmembers of that group. *McNamara v. Chicago*, 138 F.3d 1219, 1222 (7th Cir. 1998). As the U.S. Supreme Court held in *Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989), a case involving an admittedly intentional program designed to set aside government contracts to benefit certain minorities, such a program necessarily “denies certain [non-minority] citizens the opportunity to compete.” *Id.* at 493.

66. In sum: Intent to favor and intent to disfavor are simply opposite sides of the same coin where discrimination is concerned. Because the U.S. measures are, on their face, intended to favor domestic ethanol producers and only domestic ethanol producers, they by definition intend to harm — *i.e.*, to deny national treatment to — domestic ethanol’s foreign competitors. Even without more, the Tribunal’s required showing of intent to favor and intent to harm would be evidentially satisfied. But as we set forth in detail below, there is much more evidence of California’s intent to favor the largely domestic ethanol industry, and its intent to harm its mostly foreign competitors (including Methanex), than just that.

V. THE METHANOL INDUSTRY, THE OXYGENATE MARKETPLACE, THE PROBLEM OF LEAKING GASOLINE USTs, AND THE CALIFORNIA MEASURES

67. The following factual synopsis explains the nature and use of methanol and MTBE (and its ethanol and ethanol-based competitors) as oxygenates; explores the nature of the U.S. and California marketplaces for oxygenates, including the direct competition there between methanol and ethanol; describes the limited market choices available to oil refiners, merchant oxygenate producers, and gasoline blenders; outlines the status of MTBE as “the oxygenate of choice in California” (despite the heavy subsidies and other governmental protections granted solely to ethanol); and concludes with the history of the two California measures at issue.

A. Methanol And Ethanol Are Essentially Interchangeable With One Another As Oxygenates, As Are Their Respective Ethers (MTBE And ETBE)

68. Under relevant U.S. law, “[o]xygenate means any substance which, when added to gasoline, increases the oxygen content of that gasoline.” 40 C.F.R. § 80.2. Oxygenates are very effective anti-pollutants because they make gasoline burn more cleanly. *See* U.S. Energy Information Administration (“EIA”), *International Energy Annual 1999*, Glossary, at 260 (Feb. 2001) (“EIA Glossary”) (FA 17). “Oxygenates contribute to improved combustion, thereby reducing CO and hydrocarbon emissions in motor vehicle exhaust.” California Air Resources Board (“CARB”), *An Overview of the Use of Oxygenates in Gasoline*, at 16 (Sept. 1998) (FA 3).

69. As a result of the U.S. Congress’ passage of the Clean Air Act Amendments of 1990 (“CAAA”), 104 Stat. 2399 (1990) (“1990 CAAA”), the U.S. Environmental Protection Agency (“EPA”) mandates the use of oxygenated gasoline in areas with heavy air pollution, including many areas in California. *See* 40 C.F.R. § 80 *et seq.* Although other chemicals could also be used, the most “common” chemicals added to make oxygenated gasoline are ethanol, methanol, methyl tertiary butyl ether (“MTBE”), ethyl tertiary butyl ether (“ETBE”), tertiary-

Butyl Alcohol (“TBA”), and tertiary-Amyl Methyl Ether (“TAME”). EIA Glossary, at 260 (FA 17); CEH Marketing Research Report, *Gasoline Octane Improvers/Oxygenates*, at 10 (May 2002) (“CEH Report, *Gasoline Octane Improvers/Oxygenates*”) (FA 14).

70. As the United States recognized when it enacted the 1990 CAAA, both methanol and ethanol can be used directly as oxygenates. For example, the legislative history of the 1990 CAAA states: “Among the changes made will be the addition of oxygenates produced from ethanol and *methanol* — non-crude oil fuel additives.” *Clean Air Act Amendments of 1990: Senate Debate*, Pub. L. No. 101-549, 104 Stat. 2399, *reprinted in* 1990 CAAA Leg. Hist. 731, 972 (quoting U.S. EPA, “The New Clean Air Act and Energy: Fuel Switching Under the Clean Air Act Amendments,” (Sept. 12, 1990)) (*appended to* Sen. Baucus’ remarks) (emphasis added)). Elsewhere, the legislative record acknowledges: “There are several fuels that can be blended with gasoline to form oxygenated fuels, including ethanol, ETBE (an ethanol derivative), *methanol*, and MTBE (a methanol derivative).” *Clean Air Act Amendments of 1990: House Debate*, Pub. L. No. 101-549, 104 Stat. 2399, *reprinted in* 1990 CAAA Leg. Hist. 2446, 2516 (emphasis added); *see also* Regulation of Fuels and Fuel Additives: Renewable Oxygenate Requirement for Reformulated Gasoline, 59 Fed. Reg. 39,258, 39,260 (Aug. 2, 1994) (codified at 40 C.F.R. pt. 80) (discussing a “proposed renewable oxygenate requirement . . . defined in the proposal as ethanol and *methanol* from renewable sources, and their ether derivatives”) (emphasis added); *Clean Air Act Amendments of 1990: House Debate, supra*, 1990 CAAA Leg. Hist. at 2518 (“Another potential oxygenated blend is a methanol/gasoline blend. Like ethanol, methanol can be splash blended with gasoline.”).

71. Methanol and ethanol are both alcohols; the methanol molecule and the ethanol molecule differ only by the presence of one additional carbon group in the ethanol molecule. *See*

CARB, *An Overview of the Use of Oxygenates in Gasoline* at 16, 19 (FA 3). Methanol is generally produced from natural gas; ethanol is derived primarily from corn, an agricultural commodity for which the United States is, by far, the world's largest producer. See U.S. Int'l Trade Comm'n, *Methyl Tertiary-Butyl Ether (MTBE): Conditions Affecting the Domestic Industry*, Investigation No. 332-404, at 3-37, D-1 (Sept. 1999) ("USITC") (FA 42); *World Corn Production, Consumption and Stocks*, available at <http://www.corn.org/web/wcornprd.htm> (last visited Oct. 24, 2002) (FA 178).

72. Alternatively, both methanol or ethanol can be used as a feedstock to produce a derivative ether oxygenate — MTBE and ETBE, respectively. CARB, *An Overview of the Use of Oxygenates in Gasoline*, at 22 (FA 3); USITC, at 3-36 (FA 42). MTBE and ETBE are not alcohols. Rather, they are ethers derived by using their respective alcohol feedstocks as their starting ingredients and reacting them with isobutylene, which is a captive by-product of the gasoline refining process. In either case, it is the alcohol — methanol or ethanol — that adds the oxygenate component to the final product. (Macdonald Aff. ¶ 10.) The purpose of reacting the alcohol oxygenate with isobutylene is to create properties that make the final product easier to transport, store, and use in gasoline than alcohols. (*Id.*) Thus, in essence, isobutylene serves as a convenient delivery device for methanol's oxygen, eliminating the handling and volatility problems (described below) caused by alcohol oxygenates.

73. The production process for MTBE and ETBE is essentially identical; the single basic difference between MTBE and ETBE production is whether methanol or ethanol is the starting ingredient. For this reason, plants producing MTBE could easily be converted to produce ETBE if that were necessary, USITC, at 3-41 (FA 42), and have in fact been so converted. (Macdonald Aff. ¶ 10.) However, a production plant that was set up to manufacture

MTBE could not be reconstructed to produce ethanol, for the simple reason that because of the differences in the physical properties of alcohols and ethers, the infrastructure and production processes needed to produce and transport ethers are vastly different from those needed to produce alcohols. (*Id.* ¶¶ 11, 13.)

74. Alcohols are more difficult to handle and store than ether oxygenates. Water dissolves much more readily in alcohols (like ethanol and methanol) than it does in hydrocarbons and ethers, creating an alcohol/water mixture that separates from the gasoline. American Petroleum Institute, *Alcohols: A Technical Assessment of Their Application as Fuels*, at 23 (Pub. No. 4261, July 1976) (“API — *Alcohols*”) (FA 1). In fact, less than one-half of one percent water contamination will cause methanol and ethanol to separate from gasoline, and “[g]asoline as conventionally transported . . . is exposed to water in volumes often *greater* than 1 percent.” *Id.* at 9, 23 (emphasis added). Additionally, alcohols are more corrosive than hydrocarbons and ethers to the metals, plastics and certain other materials present in the existing gasoline distribution system. *See id.* at 23.

75. As a result, using alcohols as oxygenates instead of ethers requires one of two things. Either gasoline production and distribution systems must be altered to exclude water and replace materials that might corrode more rapidly in the presence of alcohol, or an entirely separate distribution system must be used. *See id.* To date, gasoline refiners and distributors have generally chosen the latter option when using alcohols as oxygenates: Alcohol oxygenates are separately transported to gasoline distribution terminals, where those alcohols are “splash blend[ing]” with gasoline to create a final reformulated gasoline product; the final reformulated gasoline product is then trucked to retail outlets. *See Bd. on Energy & Env'tl. Sys., Comm'n on*

Eng'g & Technical Sys., Nat'l Research Council, *Review of the Research Strategy for Biomass-Derived Transportation Fuels*, App. D, at 45 (FA 69).

76. For purposes of analyzing the competition in the marketplace, the most important points are these. *First*, once the necessary infrastructure is in place for using an alcohol oxygenate, either methanol or ethanol could be used. *Second*, no matter which type of oxygenate is used — methanol, ethanol, MTBE or ETBE — it is the methanol or ethanol that provides the oxygenating capability. Thus, whether methanol and ethanol are added at the same or different points in the gasoline production process is irrelevant to the competition between them.

B. Oxygenate Consumers Have A Binary Choice Between Methanol And Ethanol

77. As discussed above, gasoline refiners and distributors blend oxygenates with gasoline in order to produce reformulated gasoline. The methods for producing oxygenates and blending them into gasoline vary depending upon the type of oxygenate used and, more critically, the type of oxygenate consumer. There are three significant groups of oxygenate consumers: integrated oil refineries, merchant ether-oxygenate producers, and wholesale gasoline blenders. Methanol and ethanol compete with each other for the business of each of these groups of customers.

1. Integrated Oil Refiners Have A Binary Choice Of Oxygenates

78. Integrated oil refiners are petroleum refiners that have vertically integrated the production and blending of oxygenates into their core petroleum refining operations. *See* USITC, at 3-1 to 3-2 (FA 42); EIA, *Petroleum Supply Annual 1999*, at 166, 173 (FA 19); (Macdonald Aff. ¶ 13). These refiners typically combine their captive stream of isobutylene with methanol or ethanol to produce MTBE or ETBE, respectively, and blend the oxygenate ether

with gasoline to create the final reformulated gasoline product. EIA, *MTBE Production Economics*, at 3 (last modified Apr. 5, 2001) (FA 18).

79. Instead of producing MTBE or ETBE, these refiners could also choose to “splash blend[]” an alcohol oxygenate into gasoline at their distribution terminals. (Macdonald Aff. ¶ 9.) But for the California measures, either ethanol or methanol could be used for splash blending, subject to their individual technical requirements. (*Id.*) In short, whether these integrated oil refiners use an alcohol oxygenate, or opt to produce their own ether-based oxygenate, they have a binary choice: buying methanol, or buying ethanol. Because these refineries have been prohibited from using MTBE or methanol as oxygenates, they must obviously stop purchasing methanol and instead buy ethanol.

80. For example, the current contract between Methanex U.S. and Valero, an integrated oil refiner in California, anticipates California’s ban of MTBE, providing Valero shall, “upon prompt notice to [Methanex], have the right in its sole discretion to restrict or cease acceptance of an amount of [methanol] which, on a percentage basis, represents the reduction in demand for [Valero’s] MTBE,” when this reduction in demand is caused by a law that “has caused an adverse effect on [Valero’s] production of or demand for MTBE in California.” Sales Contract between Methanex Methanol Co. and Valero Refining & Marketing Co. art. 10.0 (Dec. 1, 2001) (attached to Macdonald Aff. at Tab 1). Thus, the California MTBE ban will cause Valero to stop buying methanol from Methanex and instead buy ethanol.

2. Merchant Ether-Oxygenate Producers Also Have A Binary Choice

81. Merchant ether-oxygenate producers have the same binary choice between methanol and ethanol. Typically, these merchant plants produce isobutylene from butane (because they do not themselves produce a captive stream of isobutylene), and then react that isobutylene with methanol to produce MTBE. See EIA, *MTBE Production Economics*, at 3 (FA

18). Like integrated refiners, these merchant plants also have the choice of buying ethanol to make ETBE rather than buying methanol to make MTBE. Prior to the California measures, these merchant producers historically chose to buy methanol. As a result, methanol producers like Methanex compete directly — not indirectly — with ethanol producers to supply U.S. and California ether-oxygenate producers. (Macdonald Aff. ¶¶ 15, 25-27.)

3. Gasoline Blending Plants Have A Wider But Similar Choice Of Oxygenates

82. Gasoline blending plants and distributors do not themselves produce oxygenates. Rather, they purchase oxygenates made by others and then blend them with their own gasoline. Gasoline blending plants in California have relied primarily on methanol-based MTBE as the oxygenate of choice, California Energy Commission (“CEC”), *Supply and Cost of Alternatives to MTBE in Gasoline*, at 1 (Feb. 1999) (“CEC, *Supply and Cost Report 1999*”) (FA 9), purchasing MTBE from merchant MTBE producers. Nevertheless, under the U.S. Clean Air Act, they have had the theoretical option of buying an alcohol oxygenate — either ethanol or methanol — and splash-blending it with their gasoline at the distribution terminal.

83. Historically, then, this class of oxygenate consumer has also had a choice between buying methanol-based MTBE or ethanol-based ETBE, or a choice between methanol or ethanol. But the California measures are now eliminating that choice — indeed, they are eliminating all competition and creating a monopoly for ethanol in the marketplace. Methanol producers are directly and foreseeably harmed by this intentional shift to an ethanol monopoly.

C. The U.S. And California Oxygenate Markets

84. Before the ban was announced, the result of these binary choices was that U.S. and California oxygenate consumers overwhelmingly made methanol the oxygenating compound of choice, primarily in the form of methanol-based MTBE: “Although several compounds

compete with MTBE — most notably ethanol in the United States — MTBE is the primary oxygenated compound for use in RFG [reformulated gasoline].” CEH Report, *Gasoline Octane Improvers/Oxygenates*, at 6 (FA 14); *see also* Section V(A), above. In 1999, the United States consumed 12,467 thousand metric tons of MTBE. CEH Report, *Gasoline Octane Improvers/Oxygenates*, at 40 (FA 14). By comparison, the United States consumed only 4,672 thousand metric tons of ethanol for use as both an oxygenate and as a fuel extender. *See* CEH Marketing Research Report, *Ethyl Alcohol*, at 34 (May 2002) (“CEH Report, *Ethyl Alcohol*”) (FA 13). MTBE’s dominance of the U.S. oxygenate market, despite ethanol’s heavy subsidies and other government protections, has in turn created a substantial demand for methanol — approximately 3,344 thousand metric tons in 1999 alone. As the world’s largest producer and marketer of methanol, Methanex, through Methanex U.S., sells a significant percentage of the methanol used as a feed stock in the production of U.S. domestic and imported MTBE. Thus, the California measures not only reduced U.S. demand for Methanex’s only product, it reduced global demand for that commodity as well.

85. In most respects, the California oxygenate market mirrors the larger U.S. market. However, some critical differences do exist. Most importantly, while the United States does have a domestic methanol industry, California does not — there are no methanol production plants located anywhere in California. *See* CEH Report, *Methanol*, at 12-14 (FA 15). Indeed, only a small amount of the methanol directly consumed in California from 1993 to 2001 — an average of 20.2 thousand metric tons — was produced anywhere in the United States. *See* California Market Data Table, *Methanol* (FA 149).

86. Most of the methanol consumed in California during that same period came from Canada. Of the 185.5 thousand metric tons of methanol per year consumed in California over

that span, 134.2 thousand metric tons (or seventy-two percent of that California consumption) were produced in Canada. *Id.* The average amount of methanol imported to California from anywhere outside the United States in that timeframe was 165.3 thousand metric tons; thus, Canadian methanol imports accounted for eighty-one percent of all direct methanol imports to California. *Id.* Only 20.2 thousand metric tons of methanol, per year, came from U.S.-produced methanol sources. Methanex was the largest supplier to the California marketplace for methanol. (Macdonald Aff. ¶ 23.)

87. California also differs from the larger U.S. market in that the state has historically had no significant ethanol industry within its borders. CEC, *Costs and Benefits of a Biomass-to-Ethanol Production Industry in California*, at II-11 to II-13 (2001) (“CEC, *Biomass-to-Ethanol Report 2001*”) (FA 7). In fact, most of the U.S. ethanol industry is located in the nation’s Midwest, where — not coincidentally — the bulk of both U.S. grain production and state-level ethanol protectionism have until recently been concentrated.

88. As in the greater national market, methanol-based MTBE has long been “the oxygenate of choice” in California. Cal. EPA, *Briefing Paper on MTBE*, at 1 (Apr. 24, 1997) (updated Sept. 3, 1998) (“Cal. EPA, *MTBE Paper*”) (FA 10). Because of California’s size, and the 1990 CAAAs’ requirement that oxygenated gasoline be used in certain pollution-affected areas, California was not merely one state out of fifty, but accounts for a large and critical share of demand in the MTBE market. At the time of the 1999 California MTBE ban, California used “over 100,000 barrels of MTBE daily; representing over one third of total U.S. consumption and almost 25 percent of the worldwide market.” *See Strickers, The Unintended Consequence of Reformulated Gasoline*, at 1, available at <http://www.epp.cmu.edu/csir/papers/stickers-gasoline.pdf> (citing M. McCoy, *California MTBE Ban Hits Chemical Makers*, Chemical &

Eng'g News, Apr. 5, 1999, at 9) (FA 35); *see also* CEH Report, *Methanol*, at 6 (reporting that California is the leading consumer of MTBE in the United States) (FA 15). As elsewhere, “[i]n California, most refiners have designed their refineries around the ability to use MTBE to meet state and federal requirements for oxygenated and reformulated gasoline and to provide the desired gasoline volumes.” CARB, *An Overview of the Use of Oxygenates in Gasoline*, at 5 (FA 3).

D. MTBE Is The Oxygenate Of Choice In California As Elsewhere Because It Is An Effective And Environmentally Beneficial Product

89. There is no question that MTBE has been effective in reducing pollution. It is largely responsible for substantial reductions in air pollution in California cities, and replaces many of the undesirable and toxic chemicals that were once used in the production of gasoline. These and other environmentally beneficial characteristics are among the primary factors that have made MTBE the oxygenate of choice in markets where free and fair trade is allowed. California’s stated concerns over MTBE have nothing to do with its effectiveness as an oxygenate. Rather, they result from poor regulation of underground gasoline storage tanks, which have allowed not just MTBE, but many other chemicals to escape into the environment via gasoline leaks. Yet, current research shows that the leakage problems, once speculated by California to be vast and frequent, have been minor and contained.

90. Despite the presence of many other pollutants in California’s drinking water (described above), California banned only MTBE. California’s singling out of MTBE raises serious doubts about the true intent behind its MTBE ban and eventual creation of an ethanol monopoly. If, as California acknowledged, the true problem was leaking gasoline USTs, then it was irrational to ban only one component of the reformulated gasoline contained in those tanks — MTBE — while allowing dangerous (indeed, lethal) components — such as benzene, a

known carcinogen — to continue to contaminate California’s drinking water. California’s reaction to the leaks thus has a very suspect relationship to the leakage problem it was claiming to solve.

1. MTBE Produces Significant Environmental And Other Benefits

91. MTBE has significantly decreased air pollution by improving the combustion of gasoline and reducing the carbon monoxide and hydrocarbons in automobile exhaust.

(Macdonald Aff. ¶¶ 7, 18.) Using MTBE, California’s “Cleaner Burning Gasoline program [has] reduced ozone levels in Southern California and Sacramento by 10 percent and 12 percent, respectively.” Cal. EPA, *MTBE Paper*, at 8 (FA 10). MTBE also “allow[s] refiners to use MTBE to replace undesirable and toxic components previously used to increase octane . . . and reduce[s] gasoline’s tendency to evaporate.” *The Unintended Consequence of Reformulated Gasoline*, at 6 (FA 35). Indeed, “[t]he air quality benefits achieved from the widespread use of reformulated gasoline containing MTBE have been associated with significant reductions in cancer and non-cancer risks in California and elsewhere.” *Exponent Report*, at 1 (Ex. E).

92. In 1997 and 1998, the California Environmental Protection Agency (“Cal. EPA”) summed up the “many favorable properties” of MTBE:

Because of MTBE’s many favorable properties, including its high octane rating, beneficial dilution effect on undesirable gasoline components, ease of mixing with gasoline, and ease in distribution, this chemical has become the oxygenate of choice by refineries manufacturing federal RFG and California Cleaner Burning Gasoline. Refiners have basically designed their refineries around the ability to use MTBE to meet reformulated gasoline requirements. . . . *no other oxygenate has MTBE’s unique combination of price and supply, gasoline blending, and transportation properties.*

Cal. EPA, *MTBE Paper*, at 1, 4 (emphasis added) (FA 10); *see also id.* at 7; *The Unintended Consequence of Reformulated Gasoline*, at 7 (FA 35) (“[MTBE has remained] the oxygenate of

choice because of several distinct advantages that it has when compared to ethanol. Among these are its high octane rating and ability to readily mix with gasoline.”). Other notable advantages of MTBE “are that it can be made from refinery byproducts and does not separate easily from gasoline when transported in pipelines.” *The Unintended Consequence of Reformulated Gasoline*, at 7 (FA 35).

93. Compared to MTBE, however, ethanol is plainly an inferior product, both environmentally and economically. Ethanol

has several undesirable properties as a gasoline additive. Ethanol results in higher VOC emissions from gasoline, and the higher volatility of ethanol makes it harder to meet summertime evaporative emissions criteria for RFG. In order to compensate for the higher volatility of ethanol, while maintaining performance characteristics such as cold weather starting, the “base” gasoline blend stock must be adjusted. This adjustment is costly and increases the production cost of the resulting RFG.

G. Rausser, *Social Costs of an MTBE Ban in California*, Prepared Statement for the House Comm. on Government Reform Subcomm. on Energy Policy, National Resources and Regulatory Affairs, at 6 (Apr. 23, 2002) (FA 75). In addition, “MTBE is approximately 23 percent cheaper to produce than ethanol, despite the fact that ethanol receives tax credits while MTBE does not.” *Id.* ETBE is even less cost-effective because its ethanol content is too low to take full advantage of current tax subsidies, while also providing refiners with less flexibility in meeting reformulated gasoline requirements. CARB, *An Overview of the Use of Oxygenates in Gasoline*, at 12, 20 (FA 3).

94. In sum: MTBE’s technical advantages, its superior pollution-reducing properties, and “the low cost to produce MTBE ([even without] tax subsidies),” combined to secure its place (in the untitled marketplace) as “the oxygenate of choice.” *The Unintended Consequence of Reformulated Gasoline*, at 6, 16 (FA 35).

2. MTBE Detection Is Not A Significant Concern In California

95. The California measures, including the absolute ban on MTBE, have been defended as an appropriate response to past detections of MTBE in the water supply where gasoline USTs were leaking. But such detection was not widespread, and, as the Exponent Report concludes, has not significantly impacted California's drinking water: "[T]he detection frequency of MTBE has been fairly low since widespread sampling began in 1995, and measured concentrations of MTBE in drinking water have generally not exceeded health- or aesthetic-based standards established in California." *Exponent Report*, Executive Summary, at xv (Ex. E). The MTBE report of November 1998 prepared by employees of the University of California at Davis, which is discussed in detail below, similarly recognized the minimal presence of MTBE: "We estimate that 0.3 percent to 1.2 percent of public water supply wells (65 to 165 wells) in the State have detectable levels of MTBE." UC Report, Vol. IV, *Impact of MTBE on California Groundwater*, at 62 (FA 39A).

96. Perhaps most tellingly, at about the time Governor Davis ordered it banned, MTBE did not even appear on California's list of the twenty-three contaminants found most frequently in the state's drinking water. 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) (FA 30). In fact, as this table 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." *Exponent Report*, Executive Summary, at xv (Ex. E).

TABLE 4
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-Fricke.

Contaminant	Number of samples that exceeded the MCL for this contaminant
Nitrate (as NO ₃)	1812
Manganese	989
Trichloroethylene	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 Dibromide (EDB)	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

NRDC, California's Contaminated Groundwater, Table 4, at 18 (FA 30).

97. A separate study conducted by Exponent scientists similarly found that, despite the media hype, MTBE detections in California's water resources were infrequent, and did not appear to pose any significant health risks, particularly as compared to other gasoline components:

Despite media reports about widespread MTBE contamination of drinking water supplies in California, this chemical is detected in only ~1% of all sampled drinking water sources, and detected concentrations of MTBE do not routinely exceed the state's primary MCL [maximum concentration level] of 13 ug/L.

* * *

These findings suggest that the intense efforts to regulate or decrease exposures to certain chemicals, such as MTBE, may result in few health benefits, given the relatively low detection frequency and toxicity of this chemical.

P. Williams *et al.*, *Comparative Risk Analysis of Six Volatile Organic Compounds in California Drinking Water*, Environ. Science & Technol., Sept. 26, 2002, at G (FA 44).

98. Additionally, California officials always recognized that the problem of MTBE leakage would remedy itself once California brought its leaking gasoline USTs into compliance with federal regulations. Indeed, Winston Hickox, Secretary of the California EPA, urged a delay in the MTBE ban by noting that the problem of gasoline leakage and thus MTBE detection "was being corrected through the much-improved UST management programs now in effect." *Exponent Report*, Executive Summary, at xiii (Ex. E); *see also* Cal. EPA, *MTBE Paper*, at 18 (FA 10) ("Upon completion of the [tank upgrades] program, the leaking of gasoline components, including MTBE, into soil and ground water should greatly diminish."). In fact, the UC Report itself reached the same conclusion, calculating 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 (FA 39B).

99. Ultimately, MTBE detection in California's water supply proved to be uncommon, in contrast to initial, perhaps intentionally hysterical estimates. See Section VI(G), below (summarizing the "hysteria created by ADM and conservative talk show hosts" in their efforts to displace MTBE with ethanol). Some of those initial estimates were contained in the UC Report. But, since that study was published in 1998, several subsequent studies have concluded that "future MTBE contamination of groundwater and surface waters in California is likely to be much less severe than predicted by the UC researchers." M. Pirnie, *Water Quality Impacts of MTBE: An Update Since the Release of the UC Report*, Executive Summary, at 2 (Aug. 2001) (FA 31). In fact, an April 2002 report quoted California Energy Commission analyst Gordon Schremp as concluding that "[t]he frequency of MTBE showing up in wells is a lot less than anticipated in the UC [Report]," and that the "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." S. Mehta, *MTBE Phaseout Cost in Billions, Analyst Says*, L.A. Times, Apr. 20, 2002, at B12 (FA 115).

100. In short, "recent investigations indicate that new UST standards, along with programs that limit the use of watercraft with two-stroke engines, are producing substantial reductions in petroleum releases, indicating that banning MTBE use to prevent its release to the environment is superfluous." *Exponent Report*, Executive Summary, at xiii (Ex. E).

3. MTBE Does Not Pose A Risk To The Environment

101. Many government authorities, including agencies in Germany and within the European Community, have determined that banning MTBE because of its infrequent detection

in drinking water would not benefit the environment. For example, as a result of “increasing concern in certain areas of the US [a probable reference to California] over the use of MTBE in gasoline supplies,” the German Environmental Protection Agency (“German EPA”) “was asked June 9, 1999 to prepare a paper on the possible toxicological and ecological risks of the additive.” International Fuel Quality Center Special Report: *German EPA Position Paper on MTBE* (1999) (FA 25). The German EPA 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 in fuels in Germany, nor is such a risk expected to occur in the future.” *Id.*

102. The European Commission reached exactly the same conclusion. The European Commission Working Group on the Classification and Labelling of Dangerous Substances (“EC Working Group”), “reached agreement not to classify [MTBE] as dangerous for the environment.” See European Comm’n, *Draft Summary Record*, Meeting of the Commission Working Group on the Classification and Labelling of Dangerous Substances, at 20 (Jan. 8, 2001) (FA 21). And, after conducting a thorough and extensive risk assessment of MTBE, the EC concluded that it should not recommend a ban. See European Chemicals Bureau, *European Union Risk Assessment Report, Tert-Butyl Methyl Ether (“MTBE”)*, at 246-47 (Final Report 2002) (FA 20). Consequently, MTBE will continue to be used throughout Europe to reduce air pollution. Thus:

Clearly, the direction being taken by the U.S., and California in particular, runs counter to the approach being taken to reduce gasoline releases in the rest of the world. Influenced variously by powerful lobbies and intensive press coverage, many policy makers in the U.S. are attempting to eliminate the use of MTBE in gasoline, while their counterparts in Europe, Asia, and other parts of the world support its continued use, with strict UST regulations.

Exponent Report, at 24 (Ex. E).

4. Banning MTBE Does Not Address The Problem — Leaking Gasoline USTs — That The California Measures Purport To Address

103. Had California truly been concerned about the leaking of dangerous chemicals into groundwater, all it had to do was fully enforce existing federal and state gasoline UST laws. *See* Underground Storage Tanks; Technical Requirements, 53 Fed. Reg. 37,082 (Sept. 23, 1988) (codified at 40 C.F.R. § 280); Cal. Health & Safety Code §§ 25280-25299 (Jan. 1, 1998); *see also* Methanex Corp., *California's Failure to Enforce Its Regulations Concerning Underground Storage Tanks: A Submission To The Commission On Environmental Cooperation Pursuant To Article 14 Of The North American Agreement On Environmental Cooperation*, at 1 (“*Methanex CEC Subm.*”) (FA 28). Banning MTBE from gasoline, while allowing gasoline containing ethanol, benzene, and other dangerous chemicals to continue to leak from gasoline USTs into drinking water, was simply an illegitimate way to address what California itself recognized as the actual problem.

104. There is no question that failure to enforce federal and state UST laws was the true problem, or that California and its officials knew this at the time the State enacted the measures at issue here. As California’s State Auditor acknowledged in December 1998:

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. Specifically, Health Services, the regional boards, and local agencies have not adequately enforced laws that require prompt follow-up monitoring for chemical findings and contaminated sites, notified the public about chemicals found in drinking water, and managed the complete cleanup of chemical contamination of groundwater.

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) (FA 12);³ *see generally Methanex CEC Subm.* (summarizing evidence and consequences of California's failure to adequately regulate its gasoline USTs) (FA 28).

105. The California measures did not focus on the persistent problem of leaking tanks. This is best illustrated by the fact that ethanol, to which California has now granted the oxygenate monopoly, has also been detected in California's water supply. *See* A. Bourelle, *Ethanol — the Solution to MTBE or Another Problem?*, *Tahoe Daily Tribune*, Mar. 24, 2000 (reporting that ethanol was detected in groundwater in Tahoe, California, and noting that “[ethanol] moves ‘a tad faster’ than MTBE”) (FA 80). As the Exponent Report succinctly concludes: “[T]he primary issue in ameliorating the effects of MTBE on groundwater and surface water is the adequacy of the UST standards and other regulations geared toward preventing gasoline releases (and the rigor with which they are enforced).” *Exponent Report*, Executive Summary, at xiii (Ex. E).

106. The statistics tell the same story. In 1998, when concerns over MTBE detections were at their highest, nearly half of California's 60,000 USTs were out of compliance with federal [and state] law. *Id.* at 8. Today, greater than ninety-five percent of California's USTs are finally in compliance with those laws. *Id.* And, as expected, this “[v]astly improved management of USTs since 1998 in California . . . appears to be having the desired effect of

³ The other primary source of MTBE in California's water sources was two-stroke engines used in many watercraft, a problem California has moved to address. *See Exponent Report*, at 12 (Ex. E).

reducing petroleum releases to the environment, with the concomitant effect of reducing MTBE contamination of groundwater resources.” *Id.*, Executive Summary, at xv.

107. It is also significant that California decided to proceed with the MTBE ban despite the fact that bringing its leaking gasoline USTs into compliance with federal and state law was the far less costly option. Indeed, California itself projected that the cost of the MTBE ban to California consumers would be huge, and that an immediate MTBE ban could be “dire for consumers and catastrophic for California’s economy.” *See CEC, Alternatives to MTBE*, at 3 (FA 9).

108. The CEC, *Alternatives to MTBE* study further found that if MTBE were banned after three years, as California in fact chose to do, and ethanol were used as the substitute oxygenate for MTBE, then the ban would still be “costly,” with an increase in the cost of gasoline to California consumers of as much as \$991 million per year. *Id.* at 6. Indeed, the CEC study recognized that ethanol — which was ultimately chosen as the sole oxygenate for California — was “the most expensive of the alternative oxygenates.” *Id.* at 19. The UC Report also estimated — based on a 1998 draft of the above CEC Study — that the cost to California consumers of banning MTBE, and using ethanol instead, would be as much as \$608 million if a ten percent ethanol blend were used. UC Report, Vol. V, *An Integral Cost-Benefit Analysis of Gasoline Formulations Meeting California Phase II Reformulated Gasoline Requirements*, at 22 (“UC Report: Cost-Benefit Analysis”) (FA 40G). Thus, the projected cost of banning MTBE for California’s gasoline consumers was between as much as \$608 million and \$991 million per year.

109. The cost of remedying leaking gasoline USTs — which was required by law in any case — was far less. The UC Report estimated that, even adding the fixed costs of

remedying the effects of past leaks to the cost of remedying any future leaks that might occur, the total cost was “between \$7 million and \$370 million.” *Id.* at 28-29; *see also* SRI Consulting, *A Review and Evaluation of the University of California’s Report, Health and Environmental Assessment of MTBE*, at 16 (Feb. 1999) (noting that “any costs related to the clean-up of MTBE that is already in the environment will be incurred, regardless of the decision [to ban MTBE] by the state”) (FA 34). Moreover, the study acknowledged that this \$370 million figure would be an overestimate, since “technological improvements in leak prevention, detection, and monitoring . . . could result in very low annual costs. . . .” *UC Report: Cost-Benefit Analysis*, at 28 (FA 40G). But even accepting the higher \$370 million per year figure, California was still undertaking a ban that would double (and perhaps triple) the cost of simply fixing its leaking gasoline USTs — and still would not prevent any of the truly harmful components of gasoline from leaking into its groundwater.

110. The fact that California chose this irrational course of action demonstrates California’s intent to effectuate a discriminatory transfer of the oxygenate market from methanol and MTBE producers to ethanol producers.

E. History Of The Challenged Measures

1. Background Measures

111. On October 9, 1997, despite the generally isolated nature of the MTBE detections and the larger cause of which MTBE was only a part, the California Legislature passed a law directing UC-Davis to conduct a “thorough and objective” and “academically sound” study and assessment of the human health and environmental benefits and risks, if any, associated with the use of methanol-based MTBE. Senate Bill 521 (1997) (“S.B. 521”). That law, S.B. 521, also required a comparative study of the risks and benefits of MTBE’s competitors — ethanol, ETBE, and TAME.

112. Despite mandating a thorough and comparative evaluation, the California Legislature appropriated only \$500,000 for that study, which proved inadequate to properly fund the assigned work. As the Report's authors themselves admitted, "[t]his wasn't a very well funded study." 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) ("*Feb. 19, 1999 Public Hearing*") (FA 46). But even aside from the problem of inadequate funding, the authors also acknowledged that they were not given enough time to *do the full comparative analysis with which they were charged*. See, e.g., *Feb. 19, 1999 Public Hearing*, at 53:23-54:4 (one author acknowledging that the team did not have enough time to "do any kind of comparative analysis in terms of the likely movement of ethanols and oxygenate[s] as opposed to MTBE") (FA 46).

113. Despite its inadequacies, it is nonetheless worth noting what the UC Report did and did not find — as well as what it ignored. *First*, the Report concluded that concerns over the impact of MTBE use on human health were perhaps "plausible" but could not be "substantiated." UC Report, Vol. V, *MTBE: Evaluation of Management Options for Water Supply and Ecosystem Impacts*, at 8 (FA 40B). *Second*, it found that the "[t]oxicity of MTBE to [fish and] other aquatic organisms is very low." *Id.* at 9; see also UC Report, Vol. III, *Toxicity of MTBE to Freshwater Organisms*, at 6 (concluding same) (FA 38C). *Third*, it found that MTBE use in gasoline did not adversely affect the materials used in gasoline USTs, and thus did not increase the likelihood or prevalence of leaks. See UC Report, Vol. IV, *Leaking Underground Storage Tanks (USTs) As Point Sources of MTBE to Groundwater and Related MTBE-UST Compatibility Issues*, at 2 (FA 39B). *Fourth*, the report "concluded that MTBE does not [negatively] affect the

performance or longevity of the vehicle.” UC Report, Vol. III, *Effects of Oxygenates on Vehicle System Components*, at 9 (FA 38B).

114. The UC Report also made a number of notable findings with regard to replacing MTBE with ethanol. It found that “[r]eplacing MTBE with Ethanol may not change the need to treat water supplies contaminated with oxygenates and therefore would not alleviate all the *perceived* problems of MTBE.” UC Report, Vol. V, *MTBE: Evaluation of Management Options for Water Supply and Ecosystem Impacts*, at 28 (emphasis added) (FA 40B); *see also* UC Report, Vol. III, *Evaluation of Automotive MTBE Combustion Byproducts*, Executive Summary, at 3 (similar) (FA 38A).

115. It also found that “[t]he ambient concentrations of acetaldehyde and formaldehyde, both air toxics and known carcinogens, are expected to increase if ethanol is substituted for MTBE as the oxygenate of choice.” UC Report, Vol. I, *Summary & Recommendations* § 2.3, at 19 (FA 36); *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. 23, 1999) (“*Feb. 23, 1999 Public Hearing*”) (identifying some of the risks associated with ethanol) (FA 47).

116. Accordingly, the Report repeatedly cautioned that it was “crucial” that ethanol or any other “substitutes for MTBE be further evaluated before they are widely used as substitutes for MTBE. *To replace MTBE with an untested substitute would compound the current problem.*” UC Report, Vol. I, *Summary & Recommendations* § 3.11, at 28 (emphasis added) (FA 36); *see also id.*, Vol. II, *An Evaluation of the Scientific Peer-Reviewed Research and Literature on the Human Health Effects of MTBE, its Metabolites, Combustion Products and Substitute Compounds*, at 141 (“*An Evaluation of the Scientific Peer-Reviewed Research & Literature*”)

(noting that “further attention is warranted due to ethanol’s” potential health effects) (FA 37); *id.* at 163 (reiterating need for “serious evaluations of” ethanol use); *Feb. 23, 1999 Public Hearing*, at 31:19-32:12 (“We have to be very careful . . . We don’t want to rush to ethanol We know that ethanol may or may not be a good substitute [for MTBE], but we need to find out whether the toxicity [of ethanol] that I have alluded to have significance in terms of humans.”) (FA 47).

117. The Report did conclude that, from a purely economic perspective, the net costs associated with oxygenated gasoline were lower for ethanol than MTBE. *See UC Report: An Integral Cost-Benefit Analysis, Meeting California Phase II Reformulated Gasoline Requirements*, at 45 (FA 40G). But this conclusion is most telling for what it chose to ignore — in evaluating the costs, it did not account for “[t]he recently extended federal ethanol subsidy,” nor did it take into consideration additional tax incentives offered by California for in-state ethanol production. *Id.* at 20. In fact, the Report’s authors repeatedly recommended additional “government subsidies” to promote development of an in-state ethanol industry. *Id.* at 38-39; *see also id.* at 2. Although it mentioned these subsidies and incentives, the Report completely ignored their real and very substantial costs when calculating the relative costs of using ethanol. *See, e.g., id.* at 3, 7, 19-22.

2. The Challenged Measures

118. On March 25, 1999, only weeks after the public hearings on the UC Report, California Governor Gray Davis issued Executive Order D-5-99. This Order purported to be grounded in the findings of the UC Report, even though that report was admittedly rushed and underfunded, and was — on its face — equivocal at best about the safety and efficacy of ethanol as an oxygenate. Although the Executive Order expressly recognized that the cause of the purported environmental threat was “*leaking underground fuel storage tanks*,” it nevertheless paid little heed to the underlying cause of the problem and instead mandated “the removal of

MTBE from gasoline at the earliest possible date, but not later than December 31, 2002.” Exec. Order D-5-99 (emphasis added). The Executive Order also required the California Air Resources Board, whose members are appointed by the Governor, to develop new regulations governing the future oxygenate content of reformulated gasoline in California. *Id.* ¶ 6; *see also* Cal. Health & Safety Code § 39510(b) (establishing composition and authority of the Board). Notably, the Executive Order did not impose any limitations on the use of ETBE (even though ETBE shares the same characteristics that were purportedly of such concern for MTBE), or on ethanol (even though ethanol use raises its own health and environmental concerns). Thus, not only did the California measures discriminate in favor of domestic ethanol and against MTBE generally, it also carried that same discrimination into the more specific ether segment of the oxygenate market.

119. Beyond the ordered ban on MTBE, the Order also imposed a labeling requirement on all MTBE-containing gasoline sold prior to the effective date of the ban. It required “prominent identification at the pump of gasoline containing MTBE.” Exec. Order D-5-99 ¶ 7; *see also* Cal. Code Regs. tit. 13, § 2273 (implementing labeling requirement). Although the labeling requirement was imposed “[i]n order that consumers can make an informed choice on the type of gasoline they purchase,” the Order did not require labeling for gasoline containing ethanol or any other toxins. Exec. Order D-5-99 ¶ 7.

120. The Executive Order went far beyond purporting to address environmental and health issues, however — it also ordered the California Energy Commission to begin the development of a California ethanol industry, *and only an ethanol industry*. *See id.* ¶¶ 10-11. Among other things, the Order mandated state-funded studies of ethanol, *and only ethanol*, to assess the health and environmental risks of using it to replace methanol-based MTBE. *Id.* ¶ 10.

All other alternative oxygenates were simply ignored. This was a curious choice for the Governor to make, in light of the UC Report's caution that "[w]e don't want to rush to ethanol." *Feb. 23, 1999 Public Hearing*, at 31:20 (testimony of Dr. Froines of UCLA) (FA 47). Yet the Governor did just that.

121. As it was ordered to do, the California Air Resources Board ("CARB") adopted regulations that went into effect on September 2, 2000. *See* Cal. Code Regs. tit. 13, § 2260 *et seq.* ("CaRFG3 Regulations"). These regulations implemented the Executive Order by prohibiting the use of MTBE, as of December 31, 2002, in California gasoline and facilitating the removal of MTBE prior to December 31, 2002. *See id.*; *see also* Cal. Code Regs. tit. 13, § 2261(b)(3) (providing for "Early Compliance with the CaRFG Phase 3 Standards Before December 31, 2002"). Indeed, the expressly stated "intent" of the drafters was to ban, *inter alia*, all "alcohols other than ethanol." *See* Cal. EPA, Air Resources Board, *Resolution 99-39 Hearing*, Attach. B, at 2 (Dec. 9, 1999) (noting that "[t]he originally proposed regulatory language inadvertently failed to reflect staff's intent . . . that the prohibition apply to alcohols other than ethanol . . .") (FA 45).

122. CARB's latest amendments to the CaRFG3 regulations, which are to be adopted in December 2002, expressly identify methanol as one of the alternatives to ethanol that are currently banned from use after December 31, 2003. *See* CARB, Proposed Regulation Order: Amendments to the California Phase 3 Gasoline (CaRFG3) Regulations to Refine the Prohibitions of MTBE and Specified Other Oxygenates in California Gasoline Starting Dec. 31, 2003, App. A, § 2262.6(c), at 5 (Oct. 25, 2002). Thus, the regulations ban methanol from competing directly with ethanol not only in the ether segment of the oxygenate market, but in the "splash blending" area of the market as well.

123. To accommodate ethanol, however, two other significant changes to the prior regulations were made. *First*, the oxygen-content limit was raised from 3.5 percent to 3.7 percent by weight. *See* CEC, *Biomass-to-Ethanol Report 1999*, at II-7 (FA 8). The old limit of 3.5 wt. percent was established to prevent harmful increases in NOx emissions, but it also prevented refiners and blenders from adding enough ethanol to their gasoline to take full advantage of the federal ethanol tax subsidy. The new limit of 3.7 wt. percent, of course, allowed refiners and blenders to add the maximum amount of ethanol necessary to take full advantage of the subsidy. *See id.* *Second*, the new regulations raised the Reid Vapor Pressure (“RVP”) limit for reformulated gasoline just enough to “allow refiners flexibility to blend ethanol at higher RVP than possible” under the old regulations. *Id.* “In the case of ethanol and methanol, splash blending raises the volatility of the fuel mixture by roughly 1 psi and so increases evaporative hydrocarbon emissions.” *Clean Air Act Amendments of 1990: House Debate*, Pub. L. No. 101-549, *supra*, reprinted in 1990 CAA Leg. Hist. at 2518 (“Clean Air Facts” prepared by Congressman Waxman’s staff).

124. These two measures, Executive Order D-5-99 and the CaRFG3 Regulations, form the basis of Methanex’s claims in this arbitration. Both have the effect, as well as the express intent, of protecting the U.S. domestic ethanol industry from competition.

125. The advent of Governor Davis’ administration and the California measures marked a sharp change in California’s once-neutral state policy towards fuels and oxygenates. Prior to Executive Order D-5-99 and the new CaRFG3 regulations, California had followed a rigorously fair and neutral policy toward fuel types and technologies. In a speech delivered less than a year before Executive Order D-5-99, the Chairman of the CEC proclaimed that “Commission and California Air Resources Board policies are fuel-neutral — we do not support

any one fuel type or technology over another.” William J. Keese, Speech at the Fuel Ethanol in the 21st Century Conference, *Challenges and Opportunities for Biomass Fuels in California*, Sec. IV (Apr. 2, 1998), available at http://www.energy.ca.gov/papers/98-04-02_keese_ethanol.html (last visited Nov. 1, 2002) (FA 72). Chairman Keese went on to caution members of the domestic ethanol industry that “[w]hile all alternative transportation fuels are candidates under an ‘equal opportunity’ fuel neutral policy,” ethanol had a long way to go before it could “win out over others” in a competition on the merits. *Id*

126. Governor Davis’ predecessor, Governor Pete Wilson, had previously vetoed a bill intended to exempt ethanol from the restrictions imposed on all other oxygenates. In so doing, Governor Wilson responsibly detected, and laid bare, that bill’s effort to give ethanol a “market advantage” over all other oxygenates:

“This legislation, while purporting to provide access to the market, seeks to enhance the advantage of this product (ethanol). There are no regulatory barriers to its use, and state law should not be used as a means to achieve market advantage, especially when the consequences will foul our air.”

Corn Refiners Association, Corn Capsules, *California Governor Vetoes Oxygenate Bill* (Oct. 5, 1998) (quoting Governor Wilson’s Veto Announcement), available at http://www.corn.org/web/cc_1098.htm (last visited Nov. 1, 2002) (FA 89). Under Governor Wilson’s leadership, the state even intervened in a lawsuit challenging the U.S. EPA’s attempt to impose a national ethanol mandate, concluding that an ethanol requirement would result in “irreparable injury to the health and welfare of California citizens and to the environment.” Cal. EPA, *Strock Files Environmental Position in Ethanol Case*, P.R. Newswire, Aug. 1, 1994 (internal citation omitted) (FA 84). That presumably explains why ADM was so interested — and financially invested — in having Governor Davis elected.

127. Obviously, California’s “‘equal opportunity’ fuel neutral policy” ended with Governor Davis’ Executive Order D-5-99 and the subsequent regulations it ordered. Now, far from requiring ethanol to compete with either methanol or methanol-based MTBE on the merits, California has used “‘state law ... as a means to achieve market advantage.’” Corn Refiners Ass’n, *supra* (quoting Governor Wilson’s Veto Announcement).

3. Other Measures Evidencing Discriminatory Intent

a) Waiver Request

128. California recognized from the outset that its schedule for handing over the state’s entire oxygenate market to domestic ethanol exceeded ethanol’s capacity to provide the necessary supply. Consequently, California asked the U.S. federal government for a waiver from the reformulated gasoline program mandated by the Clean Air Act Amendments. *See* Letter from Gov. Davis to Carol M. Browner, Administrator, U.S. EPA (Apr. 12, 1999) (FA 62). In other words, California — having granted a monopoly to ethanol on ostensibly “environmental” grounds — nonetheless sought an order from the U.S. EPA that would have allowed gasoline with no oxygenate at all to be sold in California, principally because the domestic ethanol industry was not yet capable of assuming its monopoly

129. As the state explained in its waiver request:

If MTBE is completely phased out of California gasoline in about three years and the federal RFG oxygen mandate is not waived, California refiners would need as much as 75,000 barrels a day of ethanol per day to meet demand according to the CEC Report. The United States produces about 80,000 barrels per day of ethanol to meet current demand for all uses, with another 30,000 barrels per day of spare production currently idle. California will have to compete with other states if ethanol demand increases dramatically.

Cal. EPA, *Basis for Waiver of the Federal Reformulated Gasoline Requirement for Year-Round Oxygenated Gasoline in California*, at *5 (“Basis for Waiver”), available at

<http://www.calepa.ca.gov/Programs/mtbe/O2Waiver.htm> (last visited Nov. 1, 2002).

California's own words thus demonstrate that it *knew* that a "complete phase-out" of MTBE would hand the entire California oxygenate market to ethanol — even though the CaRFG3 regulations had not officially accomplished that handover yet.

130. California's waiver request also left no doubt that the U.S. ethanol industry would be the primary beneficiary of the MTBE ban, *even with the waiver*:

One final aspect of an oxygen waiver bears emphasis—even with a waiver of the federal RFG oxygen mandate, *a significant portion of California gasoline would still contain ethanol*

. . .

[E]ven without an oxygen mandate, ethanol as the most likely oxygenate substitute for MTBE would be expected to be in widespread use in California because of the continuing wintertime oxygenates requirements in the Los Angeles area and the octane benefits provided by ethanol.

Basis for Waiver, at *4, *7 (emphasis in original).

131. Even though it would still be the primary beneficiary of the MTBE ban, the U.S. ethanol industry bitterly opposed the waiver. *See, e.g.*, Press Release, Nebraska Corn Board, *Call to Action: White House Considering Compromise on California Waiver* (Apr. 4, 2001), available at http://www.nebraskacorn.org/news/2001/etha_call.html (“[t]ell [the White House] that corn growers will be irreparably harmed if the California waiver is granted”) (FA 121); News Release, Office of U.S. Congressman Tom Latham (Iowa), *Latham Jumps to Action to Expand Ethanol Use* (Feb. 15, 2001), available at <http://www.house.gov/latham/PR2001/PR0215.htm> (releasing letter to Christie Todd Whitman, the new Administrator of the EPA, asking that she deny California's waiver request and encourage the state to replace MTBE with ethanol) (FA 124). Despite having the entire

California oxygenate market handed over to it, the domestic ethanol industry still demanded even more government promotion and protection.

132. On June 12, 2001, the U.S. EPA denied California's waiver request. K. Sissell, *EPA Denies California Waiver*, Chemical Week; June 20, 2001, at 9 (internal citation omitted) (FA 138). The denial of the waiver was a victory for the ethanol industry. Todd Sneller, Administrator of the Nebraska Ethanol Board, stated: "This is very good news for ethanol advocates, consumers and grain producers. This decision clears the way for a rapid increase in ethanol production capacity at existing plants and improves the prospects for financing new plants." See *EPA Denies California Oxygenate Waiver After 2 Plus Years*, Oxy-Fuel News, June 18, 2001, at *4 (internal citation omitted) (FA 91).

b) California Executive Order D-52-02 Extending The Deadline For The MTBE Ban

133. As a result of the EPA's denial of California's waiver request, the state was forced to delay the MTBE phase-out to avoid the price and supply shocks that would otherwise result from the handover of the oxygenate market to ethanol. On March 14, 2002, Governor Davis issued Executive Order D-52-02, which postponed for one year the prohibitions on using methanol-based MTBE in California gasoline. The state again recognized the benefit to ethanol that would be worked by the ban on MTBE, noting that "in order to comply with the federal requirements and also eliminate use of MTBE, California would need to import up to 900 million gallons of ethanol per year[.]" Exec. Order D-52-02. The state ultimately concluded 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[.]" *Id.*

F. The Substitution Of Methanol-Based MTBE With Ethanol In California's Oxygenate Market

134. The California measures have already caused significant shifts in California's oxygenate market. For instance, some of California's largest refiners have already announced that they will phase-out MTBE entirely in favor of ethanol throughout the state by the end of 2002, even though the California measures would allow MTBE to be used through 2003.

135. British Petroleum ("BP"), California's largest gasoline supplier, announced in May 2002 that it would replace MTBE entirely with ethanol by 2003. *See MTBE: BP to Complete Calif. Ethanol Switch by 2003*, Greenwire, Vol. 10, No. 9, May 3, 2002 (FA 112).

136. Similarly, "Houston-based Shell Oil, California's second-largest gasoline supplier behind BP, announced in June that it would phase out the use of MTBE by the end of the year and replace it with ethanol." *Shell to phase out MTBE in California ahead of deadline*, Nat'l Petroleum News, Vol. 94, No. 9, Aug. 1, 2002, at 52 ("With the announcement, both Shell and BP plan to eliminate MTBE a year ahead of Governor Gray Davis' phase-out deadline. Phillips Petroleum already blends more than 80 percent of its gas with ethanol. Together, the three companies account for 55 percent of state gasoline sales.") (FA 136).

137. Lastly,

ExxonMobil became the fourth and latest — out of the five largest — gas retailers in California to commit to accelerating the use of ethanol in that giant market. By early next year, more than 60 percent of the gasoline sold in the state will be blended with ethanol. The replacement of MTBE with ethanol in California should create a *new* 500-million-gallon a year market [for ethanol]. That's almost a year ahead of the scheduled MTBE phase-out.

GEC, Letter/Speeches American Coalition for Ethanol Annual Meeting, *A Once in a Lifetime Opportunity*, Speech by Nebraska Gov. Mike Johanns (July 18, 2002) (emphasis added)

(transcript *available at* <http://www.ethanol-gec.org/speeches/07182002.htm>) (last visited Nov. 1, 2002) (FA 71).

138. Integrated oil refineries account for approximately fifty percent of methanol-based MTBE production and consumption in the United States and California. EIA, *EIA-819M Monthly Oxygenate Telephone Report: Monthly Methyl Tertiary Butyl Ether (MTBE) Production by Merchant and Captive Plants*, App. B (Mar. 2001) (FA 16); USITC at 3-2 (FA 42). Over the last several years, Methanex has supplied methanol to at least *five* integrated oil refineries in California. (Macdonald Aff. ¶ 23.) (Ex A). Sales to integrated oil refineries account for 100 percent of Methanex's business in California. (*Id.*)

139. Methanex has been forced to reduce its exposure to MTBE-producing refiners in California in anticipation of the eventual loss of this market that is mandated by California measures. As of the date of this fresh pleading, Methanex does, however, still retain some of this business, and Attachment 1 to the Macdonald Affidavit contains one such current methanol sales contract, which, as discussed above, releases the refiner from its contractual obligations to Methanex in the event that demand for MTBE is affected by changing laws or regulations, such as the challenged measures here. (Ex. A). Methanex is thus directly impacted by the State of California's MTBE and ethanol regulations.

* * * *

140. What all of this demonstrates is that methanol, a mostly foreign commodity, is now in the process of being excluded from the California oxygenate marketplace — both *qua* methanol and in the form of MTBE — and its market share is being handed over to the domestic ethanol industry. These consequences were clearly harmful, and clearly intended by the California measures. What is more, the California measures were claimed to be grounded in the UC Report, which not only recognized that leaking gasoline USTs were the real problem faced

by California, but was also rushed, incomplete, and *did not support* the California measures that were ultimately taken in purported reliance on that Report.

141. Why did this curious result occur? Section VI, below, demonstrates that the California measures came about because California intended rank protectionism of ethanol, and concomitant punishment of methanol, methanol-based MTBE, and indeed Methanex itself. These showings not only unlock the “gate” of NAFTA Article 1101; they also unlock the mystery of why the California measures, despite their dubious efficacy and even more dubious scientific basis, continue to exist as the MTBE “problem” fades away.

VI. CALIFORNIA INTENDED TO HARM FOREIGN METHANOL PRODUCERS, INCLUDING METHANEX

142. In its August 7, 2002 Partial Award, the Tribunal ruled that Methanex’s fresh pleading should meet the “essential requirements of alleging facts establishing a legally significant connection between the US measures, Methanex and its investments.” (Aug. 7, 2002 Award ¶ 150.)

143. Specifically, the evidence and circumstances described below — and the reasonable inferences that flow from them — establish, *inter alia*, that California, in enacting the complained of measures, (1) intended to create a local ethanol industry (where no significant one had previously existed); (2) intended to benefit the U.S. ethanol industry; (3) intended to accomplish those goals by banning ethanol’s competition — namely methanol and MTBE — from the California oxygenate marketplace; (4) were motivated to protect ethanol in part by political and financial inducements (not, however, bribes) provided by the U.S. ethanol industry; and (5) intended because of nationalistic biases, both inherent and overt, to discriminate against and thereby harm Methanex and all foreign methanol producers.

144. Each of these propositions is supported by the facts that are now of record in this case, and by the reasonable inferences that can be drawn from those facts. In a number of instances, the Tribunal can draw the appropriate inferences from the fundamental unreasonableness or incredibility of the contrary justifications that have been offered to refute them — *e.g.*, California’s claim that its MTBE and methanol bans, which created an ethanol monopoly, while continuing to allow benzene and other poisonous chemicals to leak into groundwater, was motivated solely by environmental and not protectionist interests.

145. Methanex respectfully submits that the evidence and inferences discussed herein more than satisfy the jurisdictional requirements set forth in NAFTA Article 1101. However, Methanex has not yet been afforded the opportunity to take evidence pursuant to the procedures agreed upon by the parties. Thus, we also set forth below the relationship of Methanex’s pending requests for additional evidence to the facts that are currently of record.

A. The California Measures Constitute Both *De Jure* And *De Facto* Discrimination

1. California Intended To Create An In-State Ethanol Industry

146. California has been trying — without success — to develop an in-state ethanol industry for two decades. *See, e.g.*, Cal. Food & Agric. Code § 502 (1983) (establishing ethanol development incentives) (repealed Stats. 1984, Ch. 268, § 16.91). Its stated motivations for attempting to do so have been (i) to reduce the increasing economic and environmental costs of disposing of the State’s biomass waste, most notably excess rice straw (a byproduct of the state’s rice-growing farms); and (ii) to develop an in-state ethanol industry in order to generate

substantial economic benefits for the State, especially from employment in the fragile rural and agricultural sectors of its economy.⁴

147. From 1980 to 1983, the CEC undertook numerous ethanol production projects, only to conclude that each was not viable because of “economic, technical, and environmental factors.” CEC, *Biomass-to-Ethanol Report 2001*, at 9 (2001) (FA 7). The California Department of Food and Agriculture also administered a grant and loan program for ethanol projects, but has funded only one active project which, in turn, generates only a small amount of fuel ethanol per year. *Id.* Several other California agencies have also conducted ethanol research and demonstration projects over the past decade. *See, e.g., id.* (describing California Department of Food and Agriculture’s project on energy crops, the Quincy Library Group’s project on using forest products as feedstock, the California Integrated Waste Management Board’s project on using agricultural and forest residues as feedstock and the CEC’s development of a demonstration plant with bench-scale ethanol production processing in 1997). None resulted in any significant or economical ethanol production to challenge other oxygenates, or ethanol imported from the Midwest, in the California oxygenate market.

148. Although California fully recognized what it stood to gain by establishing and protecting an in-state ethanol industry, the out-of-state ethanol lobby freely offered frequent and less than subtle reminders. In the spring of 1999, Kansas Governor Bill Graves, then-Chair of the Governors’ Ethanol Coalition (“GEC”), and Iowa Governor Thomas Vilsack, then-Vice

⁴ *See* Cal. EPA, Integrated Waste Management Board (“CIWMB”), *Feasibility Study on the Expanded Use of Agricultural and Forest Waste in Commercial Products* (Jan. 1999) (FA 11); W.J. Keese, *The Growing Importance of Biomass*, Cal. Biodiversity News, Vol. 5, No. 4, Summer 1998, available at http://www.energy.ca.gov/papers/98-09-03_keese_biomass.html (last visited Nov. 1, 2002) (article by CEC Chairman stressing importance of potential fuel alcohol use for state’s excess biomass from forestry, agriculture, and solid waste) (FA 109).

Chair, sent the newly-elected Governor Davis a letter asking to meet with him concerning his pending decision on what to do about MTBE in California. The letter stated, in pertinent part:

We know that you must soon make several critical decisions regarding the use of MTBE and alternative oxygenates in California's Cleaner Burning Gasoline Program . . . To provide you with a different perspective, Governor Vilsack together with Nebraska Governor Mike Johanns, Chair of the Coalition's Marketing Committee, would welcome the opportunity to visit with you in Sacramento and to discuss with you the benefits that ethanol has afforded to each of our states. *These benefits could be enjoyed by California as well.*

GEC, *Coalition Governors Offer to Meet with California Governor*, available at

<http://www.ethanol-gec.org/spring99/index.htm> (last visited Nov. 1, 2002) (internal citation omitted) (FA 102).

149. Nonetheless, the same dismal economic prospects that have kept ethanol from competing on the merits elsewhere in the United States (*see* Section V(C), above) have left it unable to compete on the merits in California as well. During public hearings on the prospect of replacing MTBE with ethanol, a spokesman for one company involved in "risk assessment" for ethanol investors noted that, despite "having worked for probably 20 or 30 investment banks on [financing] these kind of" biomass-to-fuel projects, there was still "no existing plant" to show for *twelve years* of effort. Cal. Env'tl. Policy Council, Public Hearing, *Meeting to Consider Staff Reports on the Environmental Fate and Transport and Potential Health Effects of Using Ethanol in California Reformulated Gasoline*, at *68-*69 (Tr. Jan. 18, 2000) (comments of L. Forrest) (FA 51).

150. As that spokesman went on to explain, a local California ethanol industry could not succeed unless a "long-term market" could be "assur[ed]":

[T]he number one barrier to creating that industry is the assurance of a long-term market for ethanol here in California. Assurance: I can be very specific on that. It requires the investment folks

looking down the road and seeing a market for somewhere in the reasonable ten-year period, which is a tough, tough barrier for creating a biomassed ethanol industry in California.

Id. at *69.

151. Another speaker at those public hearings, the manager of a company that had not yet been able to build a proposed ethanol plant despite a grant from California, similarly complained that investors needed “to have a long-term market” to get “project financing for these first-of-a-kind technologies.” *Id.* at *70 (comments of N. Sumait, Manager for Arkenol Holdings).

152. California’s leaking gasoline USTs gave the state a pretext for creating the previously-nonexistent ethanol market that the ethanol lobby coveted, as well as the in-state ethanol industry that California had been unsuccessfully trying to create. California accomplished these protectionist ends by banning all of ethanol’s competitors, instead of the obvious, neutral option of addressing the underlying problem by eliminating leaking gasoline USTs. *See CEC, Biomass-to-Ethanol Report 2001*, at 2-3 (“The driving force for in-state ethanol production is the impending phase out of MTBE by December 31, 2002.”) (FA 8); 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.”) (FA 48); CARB & Cal. Dep’t of Food & Agric., *Rice Straw Burning: 1999 Report to the Legislature*, Executive Summary, at *3 (updated Nov. 21, 2000) (“*Rice Straw Report 1999*”) (“A new opportunity for the use of rice straw may result with the phase out of methyl tertiary butyl ether (MTBE) in California’s gasoline.”) (FA 6); CEC, *Biomass-to-Ethanol Hearing, Sept. 1999*, at 37:21-23 (statement of Dr. James D. Kerstetter,

Washington State University) (“You need viable markets. If you’re going to have a successful system you need markets. Somebody has to buy your product.”) (FA 48).

153. The pre-ban conduct of state officials also makes it expressly clear that California foresaw and thus intended the damage the disputed measures have caused MTBE and methanol investors generally, and Methanex specifically. Even before Executive Order D-5-99 was enacted, State Senator and ADM-meeting participant John Burton pointedly advised a room full of Methanex, methanol, and MTBE representatives that, so far as the “MTBE issue” was concerned, they were “[out of luck].” (Wright Aff. ¶ 13.) He further advised them that the damage to Methanex was certain, “[I]f one wanted to benefit from the direction in which MTBE was headed, they could sell Methanex stock short.” (*Id.*)

154. There is no doubt that California itself intended to benefit from the ban. Since banning MTBE and methanol from competing with ethanol, the State of California has diverted substantial public resources to the development of its local ethanol industry. Indeed, the Executive Order banning MTBE specifically required state agencies to take steps intended to “foster . . . biomass ethanol development in California.” Exec. Order D-5-99 ¶ 11. Already, the CEC has provided initial funding for three ethanol development projects that could produce 44 million gallons of ethanol a year by 2004. *See* CEC, *Biomass-to-Ethanol Report 1999*, at ES-3, II-14-15 (describing the Gridley, Collins Pine, and Arkenol ethanol projects) (FA 8). The Rice Straw Demonstration Project Grant Fund, a California grant program established to develop commercial uses for rice straw, has also funded projects to commercialize rice straw as a feedstock for producing ethanol. *See* CARB & Cal. Dep’t Food & Agric., *2001 Report to the Legislature: Progress Report on the Phase-Down and the 1998-2000 Pause in the Phase-Down of Rice Straw Burning in the Sacramento Valley Air Basin*, at 15 (Aug. 2001) (“*Rice Straw*

Report 2001”) (describing Arkenol Holdings, L.L.C. and Rice Straw Cooperative projects) (FA 5); *see also* Senate Bill 318 (limiting rice straw burning to 200,000 acres annually for three years starting September 1998); Cal. Health & Safety Code §§ 39750-39753 (authorizing the Rice Straw Demonstration Project Grant Fund).

155. 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 production incentive “to foster the development of new in-state production facilities to produce ethanol for use as an additive in California transportation fuel.” S.B. 1728, Legislative Counsel’s Digest, at 1. 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.” S.B. 1728.

156. The overt purpose of all these efforts, one official in charge of the effort has explained, is straightforwardly protectionist: to “capture [the] economic and environmental benefits [of the switch to ethanol] for California’s citizens.” Pat Perez, Project Manager for the CEC’s Biomass-Ethanol Project, *Speech to the 23rd Symposium on Biotechnology for Fuels and Chemicals*, at *4 (May 8, 2001) (“Speech to the 23rd Symposium”) *available at* http://www.energy.ca.gov/papers/2001-05-08_Perez_Ethanol.ppt (last visited Nov. 1, 2002) (FA 74).

157. 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, has succinctly explained the protectionist motives behind California’s switch to ethanol — “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.

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) (FA 50). California estimates the economic benefits of the ethanol monopoly alone to be "\$1 billion over [a] 20-year period, *assuming state government incentives totaling \$500 million for a 200 million gallon per year industry.*" Perez, *Speech to the 23rd Symposium*, at *5 (emphasis added) (FA 74).

2. On Their Face, The California Measures Demonstrate That The Aims Of California Were Impermissibly Protectionist And Are Thus *De Jure* Discriminatory

158. There can be no dispute that the California measures were intended to favor and protect the ethanol industry, which in the United States is almost entirely a domestic industry, and one that exists solely because of government protection. By its express terms, Executive Order D-5-99 mandated steps to foster development of a domestic ethanol industry in California, *and only an ethanol industry*, to help replace MTBE. *See* Exec. Order D-5-99 ¶ 11. Moreover, the Executive Order called for such steps even though the UC Report on which it was purportedly based had not evaluated the environmental risks associated with ethanol — as the legislation authorizing the study required. *See* S.B. 521 § 3(c)(1) (requiring UC-Davis to compare the risks and benefits of MTBE to the risks and benefits of ETBE, TAME (another oxygenate produced with methanol) and ethanol). Having failed to adequately study the alternatives, the UC Report could not have provided any basis for the California measures' conclusion that ethanol was better than MTBE, or was the best replacement for MTBE.

Compare United States — Import Prohibition of Certain Shrimp & Shrimp Products, Appellate

Body Report, WT/DS58/AB/R ¶¶ 167, 172, 176 (1998) (United States’ decision to act unilaterally despite “explicit statutory direction” to pursue multilateral negotiation supported finding of “unjustifiable discrimination”).

159. Moreover, the Executive Order did not require or even authorize the study of methanol or any other alternative to ethanol, even though methanol could have been substituted for MTBE rather than ethanol. In fact, in terms of available and demonstrated supply, methanol could have been substituted more readily than ethanol. But rather than allow methanol to compete with ethanol as a replacement for MTBE, California ordered the MTBE ban delayed to give domestic ethanol producers sufficient time to develop the necessary capacity to capture 100 percent of the oxygenate marketplace. See Exec. Order D-52-02.

160. Similarly, the regulations implementing the ban named ethanol, and only ethanol, as the replacement for MTBE. See Cal. Code Regs. tit. 13, § 2262.6(c). Under those regulations, no other oxygenate could be added to California gasoline unless and until “a multimedia evaluation” had been conducted and approved. That evaluation had been undertaken at taxpayer expense for ethanol (with questionable — at best — results), but not for methanol or any other potential alternative. See CARB, Proposed California Phase 3 Reformulated Gasoline Regulations: Final Statement of Reasons, at 7-14 (June 2000).

161. In short, the California measures on their face demonstrate that they were intended to create and favor a California ethanol industry, and to prevent MTBE, methanol or any other alternative oxygenate from competing with it.

3. Viewed In The Context Of The State’s Long-Held Desire To Develop An In-State Ethanol Industry, The Design Of The California Measures Establishes *De Facto* Discrimination As Well As *De Jure*

162. In addition to their facial favoritism of ethanol, the CaRFG3 regulations altered the rules of competition to favor ethanol in two other important ways. *First*, as discussed above,

they raised the oxygen-content limits to give ethanol greater tax advantages. *See* Section V(E), above. The old limits, imposed to prevent an increase in harmful NO_x emissions, required refiners and blenders to make reformulated gasoline with ten-percent-ethanol content by volume to take full advantage of federal tax subsidies. *See* CEC, *Biomass-to-Ethanol Report 1999*, at II-3, II-7 (FA 8). *Second*, the new regulations raised the Reid Vapor Pressure (“RVP”) limit — imposed to limit air pollution caused when gasoline evaporates — just enough to “allow refiners flexibility to blend ethanol at higher RVP than possible” under the old regulations. *Id.* at II-7. California did not accommodate methanol in the same way.

163. The European Court of Justice inferred protectionist intent under similar circumstances in *E.C. Commission v. Denmark*. As discussed above, Denmark had bestowed favored tax status on aquavit, a traditional national drink “manufactured from neutral alcohol with the addition of vegetable flavourings.” *See* [1981] 2 C.M.L.R. 688, 691 (Opinion of the Advocate General). To ensure that *only* aquavit received the favorable treatment, Denmark expressly defined it as a “beverage [that] must not be in the nature of” other beverages made from neutral alcohol such as “gin, vodka, [and] geneva.” *Id.* at 692. Although Denmark argued that its criteria for excluding other beverages made from neutral alcohol were not based on their origin, the court found it “necessary to assume that those products [which were primarily produced outside Denmark] have been listed expressly among the spirits subject to a higher rate of tax precisely because of their similarity.” *Id.* at 702. Here, too, it is “necessary to assume that” California revised its reformulated gasoline regulations to allow the use of ethanol but not methanol “precisely because of” methanol’s similarity to and ability to compete with ethanol.

164. It also bears repeating that, prior to enacting the measures at issue in this case, California’s oxygenate policy had always been “fuel-neutral.” *See* Section V(E), above (quoting

W. Keese, then-Chairman of the CEC). California's decision to ban not only MTBE, but also methanol and all other potential competitors to ethanol, marks a complete reversal of field from that longstanding policy of fairness and evenhanded treatment. Such stark departures from longstanding practice further support an inference of discriminatory intent. *See, e.g., Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585, 603 (1985) (stating that "an important change in a [long-established] pattern" supports an inference of monopolistic intent).

165. Moreover, all of these decisions were made against the background of California's express desire and overt efforts to create an in-state ethanol industry for its own economic benefit. It is therefore fair to conclude, from this evidence, that California was motivated by an illicit protectionist intent when it endeavored to ban all competition for ethanol because of ostensible environmental concerns. The desire to protect nascent or financially troubled in-state industries is never a legitimate justification for "economic protectionism." *See Bacchus Imports*, 468 U.S. at 272.⁵

B. Discriminatory Intent Can Be Inferred From The California Measures' Foreseen Disparate Impact On Foreign Investors And Their Investments.

166. The inevitable and undeniably foreseeable consequence of the California measures was the elimination of all foreign-owned competition to ethanol. Protectionist intent can be inferred from that foreseeability alone. *See, e.g., United States Gypsum*, 438 U.S. at 444 (stating that action "undertaken with knowledge of its probable consequences" is inferred to have been intended to cause those consequences); *NutraSweet Co.*, 32 C.P.R. (3d) at *35 (same); *Napp Pharm. Holdings* 64 B.M.L.R. ¶ 456 (same).

⁵ One can fairly infer, from the above discussion, that Executive Order D-5-99, and the implementing California regulations were intended to favor the domestic ethanol industry. Methanex's request for witness testimony from those individuals intimately involved in, as well as for documents informing, the development of these measures will shed further light on their underlying intent.

167. Ethanol consumed in California (as with ethanol consumed elsewhere in the United States) is supplied almost exclusively by domestic investors and their investments. Methanol, on the other hand, is supplied largely — and in California almost *exclusively* — by foreign investors and their investments. Consequently, although the California measures appeared to apply to foreign and domestic investors alike, their benefit was felt by domestic investors alone, while their costs were borne mostly by foreign investors. And as another NAFTA Chapter 11 Tribunal has recognized, one of the important “factors [that] should be taken into account” when evaluating a discrimination claim is “whether the practical effect of the measure is to create a disproportionate benefit for nationals over non nationals.” *S.D. Myers* (Partial Award) ¶ 252. Indeed, such a disproportionate impact gives rise to a strong inference of discriminatory purpose. *See, e.g., Washington v. Davis*, 426 U.S. 229, 242 (1976) (“Necessarily, an invidious discriminatory purpose may often be inferred from the totality of the relevant facts, including the fact, if it is true, that the law bears more heavily on one race than another.”)

168. The United States has previously recognized that protectionist intent can be readily inferred from measures having such a strikingly disparate impact on like foreign and domestic producers. In the *EEC Animal Feed Proteins* case, the United States correctly pointed out that “the import orientation of the [challenged] measures was clearly illustrated by the fact that over 95 percent of the” burden fell on imports. *EEC — Measures on Animal Feed Proteins*, Panel Report L/4599 ¶ 3.27 (adopted Mar. 14, 1978).

169. Numerous GATT and WTO tribunals have likewise found unlawful protectionism by inferring it from similar circumstances. In *Chile — Taxes on Alcoholic Beverages*, the panel found “the most persuasive evidence” that Chile’s tax system protected domestic products “to be that roughly 75% of domestic production will enjoy the lowest tax rate and that over 95% of

current (and potential) imports will be taxed at the highest rate” *Chile — Taxes on Alcoholic Beverages*, Panel Report, WT/DS87/R, WT/DS110/R ¶ 7.158 (June 15, 1999).

170. Similarly, in *Korea — Taxes on Alcoholic Beverages*, WT/DC75/R, the panel found that Korea’s tax system “has very large differences in levels of taxation” on directly competitive or substitutable imports as compared to soju, the favored domestic product. *Korea — Taxes on Alcoholic Beverages*, Panel Report, WT/DC75/R ¶ 10.101 (1998). As subsequently affirmed by the Appellate Body, that difference was “large enough . . . to support [] a finding . . . that it was applied so as to afford protection.” *Id.*; see also Appellate Body Report, WT/D575/R, WT/DS84/R ¶¶ 146-54 (Jan. 18, 1999). Just as with ethanol here, there was “virtually no imported soju so the beneficiaries of this structure are almost exclusively domestic producers.” *Korea — Taxes on Alcoholic Beverages*, Panel Report ¶ 10.102.

171. The European Communities’ regulation of its interstate commerce is to similar effect. As noted in *E.C. Commission v. Denmark*, the European Court of Justice had no difficulty perceiving protectionist intent in the fact that, although Denmark’s liquor-taxing system “does not establish any formal distinction according to the origin of the products, it has been adjusted so that the bulk of the domestic production of spirits comes within the most favourable tax category whereas almost all imported products come within the most heavily taxed category.” *E.C. Comm’n v. Denmark*, [1981] 2 C.M.L.R. 703 ¶ 36.

172. Here, too, the California measures — particularly changes in the reformulated gasoline regulations made to accommodate ethanol but not methanol — have “been adjusted so that the bulk” of their benefit flows to domestic ethanol investors, while all of ethanol’s foreign competitors are barred from the market. It is more than reasonable to infer that this disparate and

foreseeable impact was intentional on the part of the California decisionmakers, including Governor Davis.

173. In short, California's illicit, protectionist intent can be inferred from the immediately foreseeable, disproportionate effect that its measures would have on foreign investors such as Methanex.

C. Discriminatory Intent Is Evident In The United States' Traditional Protection Of Its Domestic Ethanol Industry

174. California's difficulties in establishing a viable ethanol industry, short of actually banning all competition for ethanol, parallel the national experience in the United States: Ethanol is so economically inefficient that the *only* way it has been able to compete in the U.S. marketplace is through subsidies, preferences, and other governmental acts that tilt the playing field in its favor.

175. Ethanol is prohibitively expensive to produce. Thus, the U.S. federal and state governments heavily subsidize its production. As noted by *Business Week* in 1987:

Ethanol is homegrown, but its economics are dismal. It costs about \$1.20 a gal. to produce — more than twice the wholesale price of gasoline. The federal government effectively makes up the difference by granting each gallon of gasohol [gasoline mixed with ethanol] a 6¢ a gal. tax exemption — equal to 60¢ for each gallon of ethanol. In about 29 states, alcohol also receives additional tax breaks ranging from 2¢ a gal. to 14¢ a gal.

M. Ivey & R. Grover, *Alcohol Fuels Move Off the Back Burner*, *Business Week*; June 29, 1987, at 100 (FA 108); *see also A Kinder, Fitter President*, *The Washington Post*, May 22, 1990, at Z11 (“For years the industry has received what amounts to a \$500 million-a-year subsidy in the form of reduced federal gasoline taxes on ethanol sold at the pump.”) (FA 110). The federal subsidy per gallon currently stands at \$0.54 per gallon of ethanol. *See* Letter Report from U.S.

Government Accounting Office (“GAO”) to Sen. Dianne Feinstein (Feb. 27, 2002), Enclosure I, at 13 (“*GAO Letter to Feinstein, Feb. 2002*”) (FA 67).

176. Indeed, 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.*” GAO Report 97-41, *Tax Policy — Effects of the Alcohol Fuels Tax Incentives*, at *4 (Mar. 1997) (emphasis added) (FA 23).

177. The purpose of these subsidies is, plainly and simply, to protect the U.S. ethanol and farming industries from competition: “[E]thanol has historically been a heavily subsidized and protected industry not for its dubious environmental benefits, but because it increases farm income and reduces U.S. dependence on imported oil.” J. Soloway, *Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy*, 8 Minn. J. Global Trade 55, 71 (1999).

178. 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). See Harmonized Tariff Schedule of the United States, Revision 4, §§ 2207.10.60, 9901.00.50 (July 12, 2002); 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) (FA 67).⁶ And any move toward even a slight easing of the protection afforded to the dominant U.S. ethanol industry against even the smallest amount of foreign competition has been met with the wrath of numerous U.S. Senators and Representatives, most of whom represent the agricultural states of the United States.

179. On May 14, 1998, Iowa Senator Charles Grassley wrote a letter to President Clinton, claiming to have been “absolutely stunned” to learn that Vice President Gore had agreed to allow four billion liters of Brazilian ethanol into the United States by the end of 1999. Letter from Senator Grassley to President Clinton (May 14, 1998) (FA 65). Senator Grassley declared that he would “take all necessary action to block” such efforts and expressed his strong objection to such an agreement:

I also request your assurances that you will strongly oppose lifting our ethanol tariffs, which would be devastating to American farmers, rural workers, and national energy security efforts. Congress and American taxpayers have no interest in extending the benefits of the ethanol tax incentive to highly-subsidized foreign ethanol producers. Congress imposed a tariff equal to the ethanol tax incentive available to gasoline marketers to ensure that the U.S. taxpayer-supported benefit is limited to U.S. producers to encourage domestic production.

Id.

180. As Senator Grassley recognized, the U.S. ethanol tariff effectively shuts the door on ethanol imports. In 2001, for instance, only 462 thousands (7 percent) of the 6,378 thousands

⁶ The only exception to this tariff rate is for ethanol imports from Caribbean countries, which can come in to the United States duty-free if they are produced from feedstock from the Caribbean country, but are subject to a ceiling of seven percent of the U.S. domestic ethanol market (sixty million gallons) if the feedstock is from a non-Caribbean country. *See* 19 U.S.C. § 2703 (a)(1) (2002); *see also* USITC, *The Impact of the Caribbean Basin Economic Recovery Act: Fifteenth Report 1999-2000*, at 4 n.17 (Sept. 2001). In any event, imports from Caribbean countries are minor, comprising only approximately three percent of the domestic market in 2000. USITC, *The Impact of the Caribbean Basin Economic Recovery Act: Fifteenth Report 1999-2000*, at 66.

of metric tons of ethanol consumed in the United States was produced outside the United States. See CEH Report, *Ethyl Alcohol*, at 29, 57 (FA 13). By way of comparison, nearly 64 percent (5,427 thousands of metric tons) of the methanol consumed in the United States that year was produced in other countries, 46 percent of which was supplied by Methanex. See United States Market Data Tables (FA 166).

181. Despite the extensive subsidies, “[t]he relatively high cost of ethanol production . . . remain[s] as [an] important constraint[] on [its] use.” U.S. Dep’t of Agric., *Bioenergy and Energy Alternatives: Program Rationale*, available at <http://www.nps.ars.usda.gov/programs/programs.htm> (last visited Oct. 26, 2002) (FA 41). Consequently, at the urging of the ethanol industry’s powerful political lobby, proposals to ban its biggest competitors — methanol and methanol-based MTBE — have become a staple of U.S. legislative action at both the federal and state level.

182. In fact, even as Methanex prepares this fresh pleading, the U.S. Congress is working to enact new federal protections for the domestic ethanol industry. Although the final details are still being worked out, the legislation is intended to “require gasoline refiners to triple their use of corn-based ethanol.” D. Morgan, *In Energy Bill, a Daschle Nod to Key Farm States*, *The Washington Post*, Feb. 19, 2002, at A4 (FA 120). In addition, the legislation calls for a ban on “the use of ethanol’s principal competitor, the petrochemical MTBE.” *Id.*

183. As with the California measures at issue in this case, there is no question that the current federal proposal to ban methanol-based MTBE, and mandate the use of ethanol, is driven by pure protectionism. As a senator from ADM’s home state of Illinois has explained while pushing the proposal:

Where we come from, ethanol is a big deal. It is a big deal because we have a lot of corn growers, farmers who need to have a

better price for their corn. They need increased demand for their sales in the United States and overseas, and we know the ethanol industry consumes about 1 out of every 6 acres of corn across America. So as we increase the demand for ethanol in America, we increase the demand for corn, raising the prices and helping our farmers to sustain their farm operations”

148 Cong. Rec. S1805, 1806 (Mar. 13, 2002) (statement of Sen. Durbin discussing S. 517).

184. Senator Grassley of Iowa (another agricultural state) — the same Senator who claimed to be “absolutely stunned” at the prospect of importing ethanol from Brazil — added:

Today, more than ever, our national security is at risk because of our dependence upon foreign energy. Today, more than ever, the Middle East oil and MTBE producers, have us literally, over the barrel. More than ever. That is the biggest change since the time California and New York Senators supported replacing Middle East oil and MTBE with home grown renewable and alternative fuels.

148 Cong. Rec. S2556, 2561 (Apr. 11, 2002) (statement of Sen. Grassley discussing S. 517).

185. Frustrated by California’s desire to buy time for its in-state ethanol industry to develop, Grassley went on to complain that California’s Senators had “come to the floor of the Senate, to offer an amendment which will help assure that Middle East oil and MTBE producers maintain and increase their grip over the United States. Today, seventy-five percent of the MTBE California uses, is produced by foreigners.” *Id.* Whether erroneously or purposely, he also claimed that “Saudi Arabia is the largest supplier of California MTBE.” *Id.* Separately, Grassley observed: “Today, California has only seven refiners, and its two largest sources for MTBE are foreign. In sharp contrast, there are 61 ethanol plants in 19 States in the United States — two of which are in California.” *Id.*

186. The same protectionist themes echo throughout the legislative record. Representative Tom Osborne of Nebraska (yet another agricultural state) has argued: “They [California] do not have to import ethanol. It is not a Midwest deal. It should not be an issue.

The money stays in the United States. Ethanol produces over \$4 billion of income for the farm economy in the United States.” 147 Cong. Rec. H5127, 5138 (Aug. 1, 2001) (statement of Rep. Osborne).

187. Senator Voinovich of Ohio (another state with a significant agricultural business) has commented: “For both national security reasons, particularly now, and as part of a comprehensive energy policy, it is crucial that we become less dependent on foreign sources of oil and look more to domestic sources to meet our energy needs, and ethanol is an excellent domestic source.” 148 Cong. Rec. S1805, 1810, (Mar. 13, 2002) (statement of Sen. Vionovich discussing S. 517).

188. Earlier statements by then-EPA Administrator Carol Browner leave no doubt that efforts to justify banning “foreign” MTBE are a mere pretext for the United States’ protectionist goals. In an August 12, 1999 press conference, Browner announced that the EPA “will only be supportive of any legislation” to ban MTBE “if it protects all of the opportunities that exist for ethanol.” White House, *Press Briefing by EPA Administrator Carol Browner, DOE Assistant Secretary for Renewable & Energy Efficiency Dan Reicher, USDA Deputy Chief Economist Joseph Glauber, and Deputy Assistant to the President for Environmental Issues Roger Ballantine* (Aug. 12, 1999).

189. Not surprisingly, the domestic ethanol industry is helping to drive this pro-ethanol, anti-foreign-methanol-and-MTBE agenda. The Renewable Fuels Association (“RFA”), which describes itself as “[t]he voice of the ethanol industry,” has lobbied heavily in favor of the proposal, arguing that “[e]thanol is a national security issue. The use of ethanol directly displaces imports of foreign oil and gasoline additives, including MTBE. Today, ethanol reduces the need to import 128,000 barrels a day of oil and MTBE.” RFA, *Ethanol and Energy Security*,

available at http://www.ethanolrfa.org/factfic_ensec.html (last visited Nov. 1, 2002) (FA 176).

Even the ethanol lobby recognizes, overtly, that banning other oxygenates results in a “direc[t] displace[ment]” of those oxygenates with ethanol.

190. This is naked, nationalistic protectionism — banning “foreign” products to sustain local, domestic industries. Yet this is nothing new where ethanol and its competitors are concerned: These same nationalistic biases infect policymaking at all levels of the U.S. government — national, state, and local. These evidential materials further support the conclusion that the California measures were motivated by the same illicit protectionist intent that has infected every U.S. measure dealing with “domestic” ethanol and its “foreign” competition.⁷

D. Discriminatory Intent Can Be Inferred From The Fact That MTBE — An Effective And Environmentally Beneficial Product — Was Banned, While Dangerous Chemicals Were Not

191. In analyzing the particular California measures at issue in this case, the state’s discriminatory intent is further demonstrated by the unreasonableness of its justifications for first singling out MTBE alone for a ban, and then banning all oxygenates *but* ethanol. Although California has attempted to justify its actions on the basis that they were necessary to protect its water resources, MTBE enters groundwater because of leaking underground gasoline storage tanks — and those same leaking tanks also leach other and, in contrast to MTBE, dangerous chemicals into drinking water, such as benzene. Yet benzene — a known carcinogen that is present in all gasoline — was not banned. The obvious lack of fit between the purported end and

⁷ While Methanex already possesses substantial evidence related to California’s desire to create such an industry, it believes the Tribunal would benefit from an even more extensive exposition of such evidence. Accordingly, Methanex has requested additional evidence — such as those documents concerning ADM and other ethanol producers’ involvement in the California oxygenate market — related to California’s efforts to create its own ethanol industry and how the measures at issue in this case helped further those efforts.

the prescribed means, particularly when combined with the other, blatantly protectionist goals set forth in the California measures, should, under the evidential principles outlined in Section IV(A), above, compel any factfinder to find an illicit motive.

192. MTBE is not only a safe and effective product; it is responsible for significant environmental gains in California, the United States generally, and throughout the world. *See, e.g.,* Cal. EPA, *MTBE Paper*, at 7 (recounting environmental achievements of California's MTBE-based Cleaner Burning Gasoline program) (FA 10). Indeed, as the Executive Order banning MTBE itself recognizes, the true problem was, and is, "leaking underground fuel storage tanks." Exec. Order D-5-99.

193. But rather than address this real threat to California's water resources — a matter of simply enforcing existing laws against leaking gasoline USTs — the Executive Order attacked only one of the consequences of leaking gasoline tanks, and ignored all of the truly dangerous consequences of leaking gasoline USTs, including the release of benzene and ethanol (also a known carcinogen), as well as other toxic chemicals, into California's water supply. The MTBE ban did *absolutely nothing* to stem the continuing flow of these toxins into California's drinking water — it simply banned one, "foreign" component of gasoline.

194. Enforcing California's existing gasoline UST laws was both an achievable and scientifically more sound alternative to simply banning MTBE and replacing it with domestic ethanol. In fact, even California itself has had to acknowledge 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." Exec. Order D-52-02; *see also* Section V(D), above (discussing the rapid decline in MTBE detections as a result of California's belated enforcement of existing gasoline UST laws). Protectionist intent can thus

be inferred from the fact that the California measures banning MTBE and methanol were neither necessary to fix, nor were they even capable of fixing, the environmental concerns on which they were purportedly based.

195. Protectionist intent can also be inferred from the fact that California has not rescinded the measures even though its belated enforcement of existing gasoline UST laws is eliminating the very concerns on which it purports to justify those measures. To the contrary, at least one fuel specialist with the CEC has “noted that despite recent evidence that MTBE contamination in California is not as bad as first thought, there is virtually no chance that the governor will rescind the decision to ban the oxygenate. ‘There’s too much momentum — political and otherwise — not to go forward with the ban.’” *California Nearing Decision on MTBE Ban Deadline*, Platts Alert News Services, Sept. 20, 2001 (quoting Gordon Shremp), available at <http://www.platts.com/mtbe/related.shtml> (last visited Nov. 1, 2002) (FA 85). As one report put it:

The bottom line is that reports of LUSTs are in decline, claims against the California LUST Cleanup Fund are in decline, and reports of MTBE detections in groundwater-based drinking sources are in decline (Table 4). The risk of MTBE to the environment was overstated in the U.C. MTBE study and, in reality, has been drastically reduced. *The remaining issue of retaining MTBE in California gasoline versus assured gasoline supply problems and unavoidable price increases is — one of political and public perception.*

J. White, *California Tank Program More Protective: The Proof Is in the Improvements and the Performance*, at 5 (July 20, 2001) (emphasis added) (FA 43).

196. Protectionist intent can also be found in the existence of less protectionist means of achieving the ban’s purported goals. When a state has two or more viable means for achieving an ostensibly legitimate objective, yet chooses to employ the most protectionist

alternative rather than the least protectionist one, national and international tribunals alike regularly infer protectionist intent from that fact. *See generally* Section IV(B), above.

197. In the *Washington State Apple* case, the State of North Carolina banned all grade labeling of closed containers of apples other than the applicable U.S. federal grade; the effect of this ban was to prevent apples grown in the State of Washington — the largest producer of apples in the U.S. — from bearing the Washington State grades, which were more exacting than the U.S. federal grading system. 432 U.S. at 337. North Carolina claimed that it was simply imposing a neutral requirement designed to protect its citizens from “deception and confusion.” *Id.* at 340. But the U.S. Supreme Court did not credit that excuse, noting that if North Carolina had really wanted only “to eliminate the problems . . . created by the multiplicity of differing state grades . . . it appears that nondiscriminatory alternatives to the outright ban of Washington State grades are readily available.” *Id.* at 353-54. “For example, North Carolina could effectuate its goal by permitting out-of-state growers to utilize state grades only if they also marked their shipments with the applicable USDA labels.” *Id.* at 354.

198. In *Dean Milk*, the U.S. Supreme Court similarly found that if the City of Madison had only wanted to ensure the safety of its milk, “reasonable and adequate alternatives are available” without discriminating against commerce from outside the state. 340 U.S. at 354.

To permit Madison to adopt a regulation not essential for the protection of local health interests and placing a discriminatory burden on interstate commerce would invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause.

Id. at 356; *see also C&A Carbone, Inc. v. Clarkstown*, 511 U.S. 383, 393 (1994) (“Clarkstown has any number of nondiscriminatory alternatives for addressing the health and environmental problems alleged to justify the ordinance in question. The most obvious would be uniform safety regulations enacted without the object to discriminate.”); *Fort Gratiot Sanitary Landfill, Inc. v.*

Mich. Dep't of Natural Resources, 504 U.S. 353, 367 (1992) (finding “no valid health and safety reason” for discriminating against out-of-state waste where the state “could attain [its] objective without discriminating”).

199. In this case, if California truly had been concerned with protecting its water supply, it could have fixed its leaking gasoline underground storage tanks or enforced its UST laws. Indeed, it could have prohibited the future use of such tanks unless and until the problem was fixed, as required by federal law. 40 C.F.R. §§ 280.40, 280.7. At a minimum, California could have banned the use of *all* potentially harmful chemicals leaking from its underground gasoline storage tanks — including ethanol — and not just MTBE. The fact that it did not do so, but instead chose to ban a single component of gasoline, and the only one publicly identified as “foreign,” compels the conclusion that the ban was motivated by protectionist rather than environmental concerns.

200. Finally, protectionist intent can be inferred from the fact that the California measures will not achieve their stated purposes. In the *Washington State Apple* case, North Carolina attempted to defend its ban on state grading labels by arguing that it was necessary “to eliminate the problems of deception and confusion created by the multiplicity of differing state grades.” 432 U.S. at 353. But the Supreme Court had no trouble seeing through that argument, noting that any law “permit[ting] the marketing of closed containers of apples under *no* grades at all . . . can hardly be thought to eliminate the problems of deception and confusion.” *Id.* (emphasis in original).

201. The same is true for the MTBE labeling requirement. Executive Order D-5-99 attempted to justify the MTBE labeling requirement as necessary “[i]n order that consumers can make an informed choice on the type of gasoline they purchase.” Exec. Order D-5-99 ¶ 7. But

the labeling requirement does nothing to inform consumers that their gasoline may contain ethanol, or benzene, or any of a host of other toxins. If California had truly wanted informed consumers, *all* of gasoline's potentially harmful components would be identified at the pump. Yet only MTBE was singled out for this treatment. In the words of the U.S. Supreme Court, requiring labels identifying only MTBE "can hardly be thought to" create informed consumers. *Wash. State Apple*, 432 U.S. at 353. It can thus be inferred that California's real intent was to stigmatize MTBE, create a public perception that MTBE alone is a "dangerous" product, and thus hamper MTBE's ability to compete with ethanol.

E. Discriminatory Intent Can Be Inferred From The Role That ADM Played In Securing The California Ban On Its Competitors

202. Archer Daniels Midland ("ADM") plays a central role in all of the U.S. federal and state governments' favoritism of ethanol. It thus comes as no surprise that ADM is at the center of the California measures as well. The role of ADM's secret, and ultimately successful, efforts at influencing the state decisionmaking process yields a series of conclusions, all of which demonstrate the "legally significant connection" between the California measures and their damage to Methanex.

203. It is worth noting two important points up front. *First*, the conclusions to be drawn from ADM's role in securing adoption of the California measures are not in any way necessary to prove California's discriminatory intent. That intent is readily inferred from the wealth of other evidence in this case. But the facts and circumstances of ADM's involvement nevertheless explain *how* that discrimination came about, thereby making the inference that much more certain. *Second*, ADM's role in the promulgation of the California measures was not limited to simply ensuring adoption of the measures once they were proposed. To the contrary,

ADM played a central role in creating the hysteria leading up to proposal of the measures in the first place.

204. In fact:

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.

F. Potter, *Good politics in Iowa won't make good policy in Washington*, World Refining, Vol. 8, Issue 5, July 1, 1999 (FA 130). 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." S. Fritz and D. Morain, *Stealth Lobby Drives Fuel Additive War*, L.A. Times, June 16, 1997, at A1 (FA 101).

1. Rather Than Compete On The Merits, ADM Has Secured Its Market Domination Through Political Contributions and Lobbying

205. ADM is the U.S. ethanol industry. See, e.g., *Ethanol's Benefits Are Suspect, Fail to Withstand Close Scrutiny*, Oil Daily, July 20, 1987, at 8 (describing ADM as "the agri-business Goliath which dominates the domestic ethanol industry") (FA 94). "There's no industry in the world that's so dominated by one company." M.J. Weiss, *The High-Octane Ethanol Lobby*, N.Y. Times, Apr. 1, 1990, § 6 (Business World Magazine), at 19 (quotation marks omitted) (FA 144). In fact, ADM's share of the domestic ethanol market is thirty percent larger than the next seven largest ethanol producers' shares combined, and growing. *GAO Letter to*

Feinstein, Feb. 2002, at 22 (FA 67); *see also* P.H. Sim and S. McElligott, *Ethanol Demand to Surge on Switch from MTBE*, *Chemical Week*, Sept. 18, 2002, at 39 (FA 137).

206. As a consequence of ADM's market dominance, ADM is also "the largest beneficiary" of the federal tax subsidies for ethanol. *Ethanol Not Doing Job*, *Chicago Daily Herald*, June 25, 2000, at 16 (FA 93). "Each dollar of ADM profit from ethanol costs taxpayers thirty dollars" as a result of the subsidies. J. Lieber, *Rats in the Grain: The Dirty Tricks and Trials of Archer Daniels Midland* 96 (2000) (FA 70). John Bovard, who is a political analyst for the CATO Institute, described ADM as "the most prominent recipient of corporate welfare in recent U.S. history." J. Bovard, *Corporate Welfare Fueled by Political Contributions*, *Business & Soc'y Rev.*, No. 94, June 22, 1995, at 22 (FA 81). In total, "about 43 percent of ADM's profits came from subsidized products" in the 1990s, so that "ADM had become the number one recipient of corporate welfare." Lieber, *supra*, at 99. (FA 70)

207. ADM has secured its favored position through "a potent lobbying force, [whose] advocates on Capitol Hill include a dozen or more powerful Midwestern representatives and senators." Ivey & Grover, *supra*, at 100 (FA 108). As some critics have observed, "the ethanol industry is trying to win through political muscle what it hasn't been able to prove through clean air studies." T. Landis & J.B. Austin, *Commercial News*, Gannett News Service, Sept. 23, 1993 (FA 111).

208. Indeed, ADM has expressly acknowledged that the company does not believe in free and open competition. In 1995, ADM's then-chairman Dwayne Andreas told a reporter that "[t]here isn't one grain of anything in the world that is sold in a free market. Not one! The only place you see a free market is in the speeches of politicians. People who are not in the Midwest do not understand that this is a socialist country." Bovard, *supra*, at 22 (FA 81).

209. “Political contributions have long been a central part of” ADM’s “modus operandi.” P. H. Stone, *The Big Harvest*, Nat’l. Journal, Vol. 26, No. 31, July 30, 1994, at 1790 (FA 139).⁸ But ADM’s contributions are not motivated by altruism, nor by any principled or even consistent political beliefs. “By giving huge contributions to Democrats and Republicans, ADM makes clear that these contributions are not about ideology, beliefs or who wins the election. ADM contributions are given to guarantee that no matter who wins, ADM will have a place at the table — and access and influence in Washington.” A. McBride, *Where Soft Money Hits Taxpayers Hard*, Palm Beach Post, July 26, 1998, at 1E (FA 114). In the election cycle leading up to the latest federal proposals to protect the domestic ethanol industry, (*see* Section VI(E), above), “ADM contributed \$660,000 to the two political parties.” D. Morgan, *In Energy Bill, a Daschle Nod to Key Farm States*, The Washington Post, Feb. 19, 2002, at A4 (FA 120).

⁸ A January 22, 1995 article in the Denver Post lists some of the politicians who have supported legislation favoring the ethanol industry and what ADM has done to help them:

- Former President Clinton: Ruled for ethanol industry. (ADM had given \$306,500 to the Democratic Party since October 1992).
- Former President George H.W. Bush: Reduced EPA standard in ethanol’s favor. (ADM gave \$1.1 million to the GOP in 1991-92).
- Former President Jimmy Carter: Ordered tax breaks and import tariffs to promote domestic ethanol industry. (ADM announced a new plant opening to benefit the Carter campaign).
- Former Vice President Hubert H. Humphrey: Helped ADM pitch U.S. and foreign leaders. (ADM gave \$175,000 to Humphrey’s presidential races; enriched blind trust as trustee).
- Former Senator Bob Dole: Sponsored and protected ethanol tax break worth \$465 million a year. (ADM gave \$275,000 to the Dole Foundation for the disabled, \$1 million to the Red Cross chaired by wife Elizabeth Dole).
- Senator Tom Harkin: Tireless ethanol ally. (ADM’s Washington law firm defended Harkin and two aides in a \$450,000 libel case, and ADM absorbed two-thirds of the cost).

210. ADM also routinely hides behind other organizations to advance its views. For example, an ADM consultant assisted Barry Grossman, the founder of Oxy-Busters (a group opposed to MTBE use), “by writing and editing press releases and providing Grossman with technical material on the effects of MTBE” because the ADM consultant “felt ethanol was in jeopardy.” *MTBE Public Relations War Gets New Twist in New Jersey*, Octane Week, Vol. 11, No. 32, Aug. 5, 1996 (FA 113). “Throughout its campaign, Oxy-Busters has presented itself as a grassroots group, an environmental David fighting an industrial Goliath, with outstanding success. Yet all the while, behind the scenes, the campaign has been assisted by a professional public-relations consultant who works for the ethanol industry.” N. Phillips, *Man linked to ethanol firm aided group that opposed rival method*, Philadelphia Inquirer, July 30, 1996, at D1 (FA 129). Accordingly, it should come as no surprise that ADM’s efforts to eliminate competition from MTBE clearly hit their target with State Senator Mountjoy, who has close ties to Oxybusters of California, an ADM-funded anti-MTBE group. See National Oxybuster Contact List (FA 164); S. Fritz and D. Morain, *supra*, at A1 (“The probe recently yielded evidence allegedly demonstrating that Oxybusters receives financial support from Archer-Daniels-Midland”) (FA 101). It was Senator Mountjoy who sponsored S.B. 521, which laid the foundation for banning all of ethanol’s competition in the California oxygenate market. See S.B. 521.

211. In fact, Oxybusters and Senator Mountjoy established a symbiotic relationship in which Oxybusters’ anti-MTBE efforts in California “depend[ed]” on Mountjoy. S. Fitz and D. Morain, *supra*. For his part, Senator Mountjoy has been “using the issue to widen his political

(continued...)

See F. Greve, Knight-Ridder News Service, *Power of Political Giving: Grain magnate reaps favors*, The Denver Post, Jan. 22, 1995, at A-16 (FA 107).

base.” *Id.* According to one lobbyist, at the time he sponsored Senate Bill 521, Senator Mountjoy was “running for Lieutenant Governor” and was “trying to make himself the champion of people who believe there is a conspiracy between government and big business.” *Id.*

212. ADM and ethanol supporters have also sought to undercut the environmental advantages of methanol-based MTBE with a sophisticated program of “health scares.” In a May 1992 *Moneyline* interview with CNN correspondent Lou Dobbs, then-ADM-chairman Dwayne Andreas described methanol as “lethal, it’s poison.” *Moneyline: Inflation Figures Look Promising Say Economists* (CNN television broadcast, Tr. #644, May 12, 1992) (FA 117). ADM and its allies have also misquoted scientists in their effort to discredit MTBE, issuing “unfounded reports . . . that the American Medical Association (AMA) had called for a nationwide MTBE moratorium.” *False MTBE Moratorium Report Wreaks Havoc for Methanol Industry*, New Fuels Report, July 18, 1994 (FA 98). Fuels for the Future, the group that issued the false reports, “is financed by farmers’ groups and companies including Archer-Daniels-Midland Co. of Decatur, Ill., which would benefit from greater use of ethanol, a corn derivative.” Bloomberg Business News and Staff, *Scare Hits Methanex Shares*, Globe & Mail (Toronto), July 12, 1994, at B9 (FA 79).

213. ADM is also alleged to have engaged in criminal activity to pursue its interests in monopolizing the oxygenate market. The U.S. Justice Department is currently investigating ADM and other ethanol producers in connection with a “complex” price-fixing scheme involving Regent International, a California-based ethanol producer (whose CEO, Dick Vind, organized the secret meeting with then-Lieutenant Governor Davis discussed below). *Ethanol Ethics?*, Investor’s Business Daily, May 7, 2002, at A16 (FA 92). The activities of ADM, Regent and other ethanol producers came to the attention of the Federal Trade Commission (and

subsequently the U.S. Justice Department) after U.S. Senator Doug Ose, chairman of the House Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs, turned over numerous incriminating memos from ethanol industry insiders. See D. Samuelsohn, *Ethanol: Industry Executive Rebuts Price-Fixing Allegations*, Greenwire, Vol. 10, No. 9, May 8, 2002 (FA 133). The European Union has initiated its own investigation into the potentially illegal activity. See *European Union Investigating Alleged Ethanol Price-Fixing*, Hart's European Fuels News, Vol. 6, Issue 10, May 15, 2002 (FA 96).

214. ADM is no stranger to such price-fixing investigations. In October 1996, after a four-year criminal investigation into ADM's business practices, the company was convicted of fixing the price of lysine, an animal feed supplement, and citric acid. In a plea-bargained settlement, ADM admitted its guilt and paid a fine of \$100 million, the largest fine in a federal antitrust case at that time. See *Grain Group to Pay \$100m Fines*, Financial Times (London), Oct. 15, 1996, at 1 (FA 105). Separately, the European Commission fined ADM an additional 47.3 million euros for its leading role in this "worldwide" price fixing scheme. Press Release, *European Commission Fines ADM, Ajinomoto, Others in Lysine Cartel*, (June 7, 2000), available at <http://www.eurunion.org/news/press/2000/2000026.htm> (last visited Nov. 1, 2002) (FA 95). The devastating effect of the price-fixing case has caused at least one news publication to refer to ADM as "price-fixer to the world," a play on ADM's advertising campaign, which touts itself as "supermarket to the world." J. Wilson, *Price-fixer to the World*, available at <http://www.bankrate.com/nsc/news/investing/20001221c.asp?prodtype=advice> (last visited Nov. 2, 2002) (FA 147).

215. As a result of the U.S. lysine investigation, three of ADM's senior executives, including Michael Andreas (the son of former ADM chairman Dwayne Andreas), were

convicted of price-fixing and sentenced to prison. On appeal, the U.S. Court of Appeals for the Seventh Circuit not only affirmed the convictions, but, in an extraordinary judicial act, actually *increased* the defendants' prison sentences and condemned ADM's corporate culture:

The facts involved in this case reflect an inexplicable lack of business ethics and an atmosphere of general lawlessness that infected the very heart of one of America's leading corporate citizens. Top executives at ADM and its Asian co-conspirators throughout the early 1990s spied on each other, fabricated aliases and front organizations to hide their activities, hired prostitutes to gather information from competitors, lied, cheated, embezzled, extorted and obstructed justice.

United States v. Andreas, 216 F.3d 645, 650 (7th Cir. 2000).

2. ADM And Its Partners In The Domestic Ethanol Industry Played An Important Role In Securing The Protectionist California Ban On Ethanol's Competitors

216. When, in the mid-1990s, MTBE was first discovered in the groundwater around California's leaking gasoline USTs, Pete Wilson was governor of California, and Gray Davis was the State's lieutenant governor. As noted, Wilson was opposed to legislation favoring ethanol. *See* Section V(E), above. But Wilson's term was coming to an end; he was not running for reelection; and his Lieutenant Governor, Davis, was campaigning hard to replace him. Widely criticized for lack of charisma, Davis nevertheless demonstrated a prodigious capacity for fundraising that quickly earned him a reputation for being accessible to anyone with an open checkbook. That reputation fit well with ADM's preferred methods of expanding its ethanol investments.

a) ADM Introduces Itself To Gray Davis

217. According to the L.A. Times, "ADM wasn't a major campaign donor in California until last year [1998]," coinciding precisely with the time when California was considering a possible MTBE ban. *See* D. Morain, *supra*, (FA 119). However, "[ADM's]

money apparently talks — and gets favors in return.” *Ethanol Ethics?*, Investor’s Business Daily, May 7, 2002 (FA 92).

218. Governor Davis’ dealings with ADM appear to be part of his broader practice of affording favorable access and regulatory treatment to large campaign contributors. As one journalist has explained:

During the first year of his governorship, Davis pulled in a record \$14 million from a wide variety of special interest groups, averaging more than \$38,000 a day, or \$1,600 an hour.

* * * *

[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. The most obvious example involved health care company regulation, with Davis insisting on a final version that the companies could tolerate, but that health consumer advocates found wanting.

* * * *

Lobbyists believe that the surest way to get Davis’ attention is to stage a fund-raising event. And Davis political aides, lobbyists say privately, make it clear that the minimum required for a personal appearance by the governor is \$100,000, four times his threshold as a candidate in 1998.

D. Walters, *Is It all Simply A Coincidence?*, Sacramento Bee, June 23, 2000 (FA 143). As a result of this pattern, “[m]any articles have been written about Gray Davis referring to him as a ‘coin-operated Governor.’” C. Wade, *Gray Davis: The After 5 Governor*, American Partisan, Aug. 30, 2002, available at <http://www.american-partisan.com/cols/wade.htm> (last visited Nov. 3, 2002) (FA 142).

219. More recently, there has been a series of campaign contributions and corresponding actions that has called Governor Davis’ motivations into question. See M.

Sappenfield, *Governor Tests the Boundaries of Fundraising Zeal*, Christian Science Monitor, May 20, 2002 (FA 134). For instance, the California “state prison guards’ union donated \$251,000 to Governor Davis in March, weeks after he gave them a 34 percent pay raise and chose to shut down five private prisons, which had been hailed as successes but which the union opposed.” *Id.*

220. In 1999, Governor Davis vetoed a bill that would have preserved the tax break for the insurance industry, worth millions of dollars, arguing that it was “neither fair nor in keeping with sound taxation principles.” *Pay-to-Play; Davis Guilty of Brazen Buckracking*, San Diego Union-Tribune, May 17, 2002, at B10 (FA 128). “But after receiving more than \$250,000 in campaign contributions from the Fireman’s Fund Insurance Companies, the governor reversed himself. He now is supporting the insurance industry’s case before the Franchise Tax Board, arguing that it is a matter of fairness.” *Id.*

221. Precisely the same pattern surrounds ADM’s contributions.

b) The Secret Meeting And The Subsequent Denials

222. On June 2, 1998 (after S.B. 521 had been enacted but before the UC Report was completed), ADM made a \$5,000 contribution to the Gray Davis California gubernatorial campaign. A month later, Dick Vind, the President and CEO of two California-based ethanol companies, Regent International and Western Ethanol, arranged for then-Lieutenant Governor Gray Davis and John Burton, the President *Pro Tempore* of the California State Senate, to meet secretly with officials from ADM on August 4, 1998 at ADM Headquarters in Decatur, Illinois. *See* Letter from Dick Vind to Linda Yipp, Office of Sen. John Burton (July 16, 1998) (FA 57); Letter from Dick Vind to Marty Andreas (July 16, 1998) (FA 58); *see also* Phone Messages from Sen. John Burton to Dick Vind (July 15, 1998) (FA 165). An itinerary, reproduced below, shows

that ADM actually planned two separate meetings with California officials that day. See Draft Itinerary for Aug. 4, 1998 Meeting at ADM Headquarters (“Draft Itinerary”) (FA 151).

Tuesday, August 4, 1998

Draft

9:00 AM Depart Chicago Meigs Airport – Signature Flight Support
5821 South Central Avenue - 773/767-4400
John Burton, Dick Vind, Bob Dineen

9:45 AM Arrive ADM Hangar – Decatur - ADM Security will meet and take directly on tour

11:00 AM Group arrives Media Room - Introductions – Show ADM tour tape
 Attending:
 Dwayne Andreas, Chairman
 Allen Andreas, President & CEO
 Marty Andreas, Sr. Vice President
 Roger Listenberger, Western Marketing Mgr., Fuel Ethanol
 Rick Reising, Sr. Vice President
 John Burton, President Pro-Tempore of California State Senate
 Dick Vind, Chairman, CEO – Regent International
 Bob Dineen, Legislative Director - Renewable Fuels Association

11:30 AM Lunch

12:30 PM Lunch concludes – security will return Mr. Vind and Mr. Burton to ADM Hangar

12:45 PM Guests depart ADM Hangar

1:30 PM Arrive Chicago Meigs

Contact for Gray Davis: Mark Vargas 310/201-0344 – (ADM Security will coordinate arrival)

6:15 PM Plane departs Meigs with passengers: Dick Vind, Gray Davis, Dan Weinstein, John Farkas, and CHP Officer (name to come)

7:00 PM Plane arrives ADM Hangar
Illinois State Highway Patrol will meet plane and escort to Decatur Country Club

7:15 PM Dinner at Country Club – Board Room
 Attending:
 Dwayne Andreas, Chairman
 Allen Andreas, President & CEO
 Marty Andreas, Sr. Vice President
 Roger Listenberger, Western Marketing Manager – Fuel Ethanol
 Rick Reising, Sr. Vice President
 Bob Dineen, Legislative Director – Renewable Fuels Association
 Dick Vind, Chairman/CEO – Regent International
 Gray Davis, Lt. Governor - California
 Dan Weinstein, Labor Relations
 John Farkas, Special Assistant/Body Guard

9:00 PM Group departs Country Club

9:15 PM Group departs ADM Hangar

10:00 PM Plane arrives Midway Airport, Signature Flight Support - 5821 South Central Ave.
Telephone: 773-767-4400

7/30/98 3:17 PM Lisa Royal 217/424-5434

AUG 04 '98 18:13 PAGE 02

The first meeting was scheduled in the morning, with Senator Burton, and the second meeting in the afternoon with then-Lieutenant Governor Davis. ADM flew both Lieutenant Governor Davis

and Senator Burton to and from the meeting aboard ADM's corporate jet. *See* Letter from Dick Vind to Linda Yipp (July 16, 1998) (FA 57); *see also* Draft Itinerary (FA 151).⁹

223. It is apparent from ADM's itinerary and the meetings' scheduled participants that there was only one issue on the agenda for the meetings: ethanol. With the exception of the California officials involved, all scheduled participants were the same at both meetings. Those participants were either senior ADM executives or persons whose sole responsibility was ethanol. The ADM senior executives slated to attend the meetings were Dwayne Andreas, Chairman; Allen Andreas, President and CEO; Marty Andreas, Sr., Senior Vice-President; and Rick Reising, Senior Vice-President and former General Counsel.

224. Significantly, two of Marty Andreas' primary responsibilities are ethanol and political giving. He is on the Board of Directors of the Renewable Fuels Association, of which Bob Dinneen is now president. *See* RFA, *available at* <http://www.ethanolrfa.org/about.shtml> (identifying RFA as "The Voice of The Ethanol Industry" and listing the company's directors) (FA 177). In addition, Marty Andreas "served as President of the Corn Division from 1975 to 1986 prior to being appointed to his current position, where he oversees marketing for ADM. Mr. Andreas pays particular attention to the sweeteners and *ethanol* product lines." *See* Philadelphia Society for Promoting Agriculture, *Martin L. Andreas, Biographical Sketch*, *available at* <http://www.pspaonline.com/andreas.html> (last visited Nov. 1, 2002) (emphasis added) (FA 174). In his capacity as senior vice president, Marty Andreas also oversees the company's political contributions. *See* ADM's Independent Expenditure Committee & Major

⁹ The itinerary is the same document that Methanex counsel referred to as an agenda in the July 2001 hearing. While probably better characterized as an itinerary, the agenda for the meetings — ethanol in California — is obvious from the identity of the scheduled participants.

Donor Committee Campaign Statements (Jan. 1, 1998-Dec. 31, 1998) (naming Martin L. Andreas as the “responsible officer”) (FA 158); *see also* D. Morain, *supra*, at A1 (FA 119).

225. The scheduled participants whose sole responsibility was ethanol were Roger Listenberger, ADM’s Western Marketing Manager for Fuel Ethanol; Bob Dinneen, Legislative Director for the Renewable Fuels Association, a well-known ethanol proponent funded by ADM; and Dick Vind, the chairman and CEO of both Regent International and Western Ethanol, two California-based companies whose sole business is to produce and distribute ethanol. *See* Regent International, *available at* <http://www.regentinternational.com> (last visited Nov. 1, 2002) (describing Regent’s and Western Ethanol’s businesses) (FA 175); *see also* RFA, *available at* <http://www.ethanolrfa.org/about.shtml> (last visited Nov. 1, 2002) (describing the mission and objectives of the RFA) (FA 177).

226. The significance of these scheduled participants becomes even more clear when it is understood that ADM’s business operations are very diversified. According to the company’s website, “[w]hat started as a small linseed company has grown into a major food supplier to the entire world.” ADM, *ADM Food For A Growing World*, *available at* <http://www.admworld.com/products/food.htm> (last visited Nov. 1, 2002) (FA 168). ADM’s Wheat Processing division, for instance, includes the milling of wheat, oats, rice, barley, corn, and sorghum “to produce more than 400 ingredients, primarily for the baking and food industries.” *Id. at* <http://www.admworld.com/products/milling> (FA 170). Its Grain Merchandising division acts as a commodities broker for all manner of crops. *Id. at* <http://www.admworld.com/grain/grainmerch.htm> (FA 169). “Additionally, even though [ADM is] primarily an agricultural company, [it has] an impressive global transportation business

consisting of trucks, railcars and barges.” *Id. at*

<http://www.admworld.com/products/addingvalue.htm> (FA 167).

227. Yet no one scheduled to attend the secret meetings had any line responsibility for any of these other sectors 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 the meetings with Davis and Burton. Rather, the meetings’ scheduled participants were solely from the ethanol division’s top spokesmen, executives and managers.

228. Further, at least two of the meetings’ scheduled participants were known to have condemned methanol — not MTBE, but methanol — as a “foreign” product competing with home-grown ethanol. Dwayne Andreas had previously remarked in a national television appearance 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.” *Moneyline, supra* (FA 117). And in a letter from Mr. Vind’s company, Regent International, to the Los Angeles County Metropolitan Transportation Authority (the “LACMTA”), the company demanded that the “MTA’s procurement office immediately stop the current practice of purchasing *foreign produced methanol*.” Letter from Regent International to Ted Hope, LACMTA (Apr. 7, 1998) (emphasis added) (FA 63). Here it bears noting that some of that “foreign produced methanol” was supplied by Methanex. Mr. Vind had thus already complained to California officials about Methanex’s “foreign” methanol competing with ethanol.

229. ADM’s efforts to influence Davis did not end with the secret meeting in Decatur. Two weeks after that meeting, on August 19, 1998, gubernatorial hopeful Davis received a

contribution of \$100,000 from ADM. And within the next four months (both before and after his election), the Governor received still another \$55,000 in contributions from ADM. Seven months after his initial meeting with ADM officials, four months after his election, and only two months after assuming office, the Governor issued the Executive Order banning methanol-based MTBE in California. Following the Executive Order — and long after the California gubernatorial election — ADM made another \$50,000 contribution to the Governor, bringing the total of its monetary contributions from June 2, 1998 through September 24, 1999 to \$210,000. *See* ADM’s Independent Expenditure Committee & Major Donor Committee Campaign Statements (Jan. 1, 1998-Dec. 31, 1998) (FA 158). This put ADM in the top echelon of Davis contributors.

230. The secret meeting did not become public knowledge until early 2001 because the participants concealed its existence. The official campaign documents identify Davis’ trip to Chicago on August 5th and 6th, but conspicuously fail to disclose the 180-mile side trip to ADM headquarters in Decatur on the evening of August 4th. *See* Gray Davis’ California Form 490 Schedule E (July 1, 1998-Sept. 30, 1998) (“Form 490 Schedule E”) (FA 157). In fact, Lieutenant Governor Davis’ August 1998 trip to Illinois was reported on campaign finance filings as a meeting in Chicago with “labor representatives” — a studied effort to hide from public scrutiny the additional “side trip” to ADM headquarters in Decatur. *See* Form 490 Schedule E (FA 157).

231. Once the meeting became public in early 2001, ADM publicly misrepresented its nature. In ADM’s first public response concerning the meeting, a “top official of ADM” categorically stated: “[W]e don’t hold secret meetings.” *Canadian Methanol Producer Alleges Deal Between California Governor and Ethanol Giant ADM*, Inside EPA.com, Mar. 7, 2001,

available at http://www.insideepa.com/secure/features/today_feature.asp (FA 86). But this was an obvious untruth — ADM has always relied on secret meetings to do its business, such as the secret meetings that ADM held to fix the price of lysine, meetings that were videotaped by the U.S. Federal Bureau of Investigation. See Evidence Room from Kurt Eichenwald's *The Informant*, available at <http://www.randomhouse.com/features/informant/evidence.html> (last visited Nov. 1, 2002) (FA 171).

232. Five days after that categorical (and false) denial, ADM was forced to acknowledge that it had in fact met with Governor Davis. Even then, it issued an even more preposterous denial, claiming that the meeting was only a “get acquainted session” related to ADM’s “extensive food business in California.” *ADM Denies Methanex Charge on California Campaign Cash*, Reuters English News Service, Mar. 12, 2001 (FA 77). But the itinerary and the list of scheduled participants conclusively proves that the purpose of the secret meeting was ethanol, not ADM’s “extensive food business.” A Wall Street Journal article reached the same conclusion, noting that the attendance list was dominated by ethanol executives, with no indication that any “food business” executives were in attendance. J. Carlton, *Methanex Questions Davis-ADM Meeting in Gas-Additive Case*, Wall Street Journal, Mar. 30, 2001, at B5 (FA 88).

c) What Conclusions Can Be Drawn From The Facts And Circumstances Of The Secret Meeting?

233. It is undisputed that the secret meeting actually took place, and taken together, the available evidence supports several important inferences. *First*, the purpose of the meeting was ethanol. No one involved in ADM’s “extensive food business” in California was scheduled to attend the secret meeting; indeed, if this had been a “food” meeting, one would be left to wonder why Regent’s Mr. Vind — an ethanol executive — set up and, together with Bob Dinneen, the

ethanol industry's spokesman, planned to participate in this "food" meeting. Similarly, the ADM senior vice president in charge of ethanol was scheduled to attend the meeting, none of his counterparts from ADM's "extensive food business" was to be on hand to meet Senator Burton or Lieutenant Governor Davis. Only ethanol was on the agenda. *See Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 158 (1970) (holding that a jury may permissibly infer a conspiracy (to discriminate on racial grounds) between a policeman and a restaurant from the mere fact that the policeman was present in the restaurant); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 263 (1986) (Brennan, J., dissenting) (same).

234. *Second*, the purpose of the meeting was to promote ethanol by influencing Lieutenant Governor Davis to discriminate against ADM's competitors — methanol and MTBE. The timing of the meeting makes such an inference obvious, for only by banning MTBE and methanol would ADM and Regent achieve their objectives.

235. *Third*, ADM and Regent promoted ethanol using their well-worn rhetoric characterizing it as a domestic product, such as describing ethanol as "from the Midwest not the Middle East." This is ADM's standard argument, and it is extremely unlikely that it was not repeated here.

236. *Fourth*, ADM and Regent promoted ethanol by characterizing MTBE and methanol as foreign products. The letter from Regent International to the LACMTA and Andreas' previous public statements compels the conclusion that the participants knew that most methanol consumed in California was "foreign" and that they voluntarily characterized it as such. Characterizing methanol and MTBE as "foreign" is also part of ADM's standard rhetoric, and it would have even greater force in a state such as California, which had no methanol

industry. Hurting “foreign” methanol would not hurt any of Lieutenant Governor Davis’ constituents.

237. *Finally*, the parties wanted to keep the meeting secret because they were afraid of the appearances it would create. They were understandably afraid that public knowledge of the meeting would create the appearance that the ethanol industry had obtained improper influence over, or at least improper access to, Lieutenant Governor Davis.

238. To reach any different conclusions, one would have to ignore a wealth of evidence, all of which points to the conclusion that ADM’s protectionist, anti-foreign rhetoric and campaign contributions had an important — and improper — influence over the enactment of California’s protectionist measures. *See, e.g., Wash. State Apple*, 432 U.S. at 352 (noting evidence that state official wanted to consult with local apple producers who “were mainly responsible for this legislation being passed,” before considering an exemption to the labeling requirement and concluding that this evidence indicates that the labeling requirement’s “discriminatory impact on interstate commerce was not an unintended byproduct”).¹⁰

F. Discriminatory Intent Can Be Inferred From Analogous Cases In Which States Have Disguised Economic Protectionism As Environmental Regulation

239. The Tribunal’s decision should be informed by the fact that state and national governments commonly — albeit improperly — use health and environmental regulations to disguise trade and investment restrictions that favor or protect domestic industries, while

¹⁰ The secret meeting between ADM ethanol officials and Governor Davis, in combination with ADM’s consistent strategy of using political influence to secure competitive advantages across the United States, provides a key link to understanding the improper intent motivating the California measures. Because of the efforts of the participants to keep the details of this meeting secret, there is little to no publicly available documentation regarding precisely what was discussed at this meeting. Methanex’s request for witness testimony and additional documentary evidence directly addresses the need for more information about this unquestionably relevant issue.

discriminating against foreign investors, their products, and their domestic investments. Indeed, “[t]here 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 regulation.” J. Soloway, *supra*, at 58.

240. International legal scholars have frequently “acknowledge[d] the danger that environmental regulations may be captured by protectionists who will use them as a ‘guise for erecting barriers to imports.’” 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); *see also* E. Laing, *Equal Access/Non-Discrimination and Legitimate Discrimination in International Economic Law*, 14 *Wis. Int’l L.J.* 246, 327-28 (1996) (“Without strict interpretation of health and safety clauses, alleged health and safety clauses could easily be used as a pretext for illegitimate discrimination.”); A. Sykes, *Product Standards for Internationally Integrated Goods Markets* 1, 16 (1995) (noting that, as tariffs have diminished, a “suspicion arises, in some cases, that announced concerns about health and safety are mere pretense for regulation that is motivated by protectionist ends”).

241. The protectionist pattern for creating disguised trade and investment restrictions includes unlikely alliances:

The classic strategy for securing shelter [from foreign competition] has been the capture of the administration of domestic regulation, including the new generation of environmental regulations, by domestic industry. The industries seeking shelter often form alliances with environmental groups and seek protection through the discriminatory application of national and local environmental regulation, at times in violation of internationally guaranteed national treatment provisions and other trade disciplines.

A. Rugman *et al.*, *Environmental Regulations and Corporate Strategy: A NAFTA Perspective* 1 (1999).

242. These sorts of unlikely alliances have been described as “baptist-bootlegger coalitions.”

In the US prohibition era, Baptists were opposed to alcoholic consumption on moral grounds, while bootleggers actually benefited from prohibition by the production and sale of illegal alcoholic beverages. Similarly, today there is often a coalition formed between domestic environmental groups in favour of environmental regulations on public good grounds and domestic producers who recognize an opportunity to erect entry barriers against rival foreign producers.

Id. at 54-55; *see also* Soloway, *supra*, at 59. Indeed, the existence of such a Baptist-bootlegger coalition is a *prima facie* indication that protectionist concerns have led to disguised discrimination against investments and trade in the form of environmental regulations. *See, e.g.*, Rugman, *supra*, at 53; Soloway, *supra*, at 59, 95.

243. The ethanol industry’s efforts to co-opt environmentalists in its efforts to undermine competitors in the oxygenate market offers a classic example of the Baptist-Bootlegger relationship. As part of the ethanol industry’s efforts to sabotage MTBE in California it lent considerable behind-the-scenes support to a number of MTBE-related class action lawsuits purportedly brought on behalf of private individuals. In but one notable example, Regent International’s Chairman, Dick Vind, offered ethanol’s support to well-known environmental activist Erin Brockovich (the subject of the eponymous film) in her efforts to spearhead one such class action lawsuit. *See* Letter from Dick Vind to Erin Brockovich, Masry & Vititoe (Mar. 19, 1998) (FA 56). In fact, Vind, who arranged and attended the secret meeting between Governor Davis and ADM, personally advised the attorneys handling the case, *see id.*, simultaneously using the litigation as a weapon in the ethanol industry’s anti-MTBE lobbying campaign. *See* Letter from Dick Vind to Ed Harjehausen & Dwayne Andreas (Apr. 24, 1998) (FA 55). Dwayne Andreas, then-Chairman of ADM, was also personally involved in developing

the ethanol industry's "strategies" for using the nominally "private" litigation to eliminate competition in the oxygenate market. *See id.*; *see also* Letter from Dick Vind to Ed Harjehausen (May 28, 1998) (copied to Dwayne Andreas) (FA 53).

244. Disguised protectionism resulting from such "Baptist-bootlegger coalitions" has repeatedly been struck down under GATT and the WTO Agreements, as well as under the U.S.-Canada Free Trade Agreement ("CFTA"). (*See Methanex's Draft Amended Claim at 39-40.*) Rugman discusses nine cases where "it has been found that an environmental regulation was used as an indirect trade barrier," and where "a domestic 'bootlegger' industry can be identified as benefiting from the environmentally based trade barrier placed in the path of its foreign rival." Rugman, *supra*, at 55-67.¹¹ The problem of ostensibly neutral environmental regulations that are actually protectionist in intent or effect is so well-recognized that the GATT Members have enacted international agreements to combat the problem. Both the Agreement on the Application of Sanitary and Phytosanitary Measures ("Sanitary Measures Agreement"), and the Agreement on Technical Barriers to Trade ("Technical Barriers Agreement"), prohibit arbitrary regulations that are a disguised restriction on trade. *See generally* Sanitary Measures Agreement, GATT 1994; Technical Barriers Agreement, GATT 1994.

245. Moreover, two separate NAFTA Chapter 11 Tribunals have already returned awards in favor of investors challenging investment restrictions disguised in the form of environmental regulations or otherwise defended in the name of environmental protection. In the

¹¹ These nine cases are: (1) *Prohibition of Imports of Tuna and Tuna Products from Canada* (GATT decision, 1982); (2) *Measures Affecting Exports of Unprocessed Herring and Salmon* (GATT decision, 1988); (3) *Canada's Landing Requirement for Pacific Coast Salmon and Herring* (CFTA decision, 1989); (4) *Lobsters from Canada* (CFTA decision, 1990); (5) *Ultra-High Temperature Milk (UHT) from Quebec*; (6) *Softwood Lumber* (CFTA decision, 1994); (7) *US State Newspaper Content Requirements*; (8) *Ontario Beer Can Tax* (1993); and (9) *Canadian Ban on Exports of PCBs*. Rugman, *supra*, at 55-67.

S.D. Myers case, a U.S. company wanted to export hazardous chemical compounds known as PCBs from Canada for treatment and disposal in the United States. The company challenged Canada's PCB export ban, which was purportedly enacted for environmental reasons, on the ground that the ban was, in reality, disguised discrimination in violation of NAFTA Article 1102. *S.D. Myers* (Partial Award) ¶ 130.

246. The *S.D. Myers* Tribunal agreed, relying on many facts that are remarkably parallel to the facts of this case. *First*, the foreign investor was more cost-effective than its Canadian competitors, while also providing equal if not greater environmental benefits. *See id.* ¶¶ 112, 191, 192 n.32. Here, methanol-based MTBE's economic and technical advantages made it the oxygenate of choice in both the U.S. and California markets, while simultaneously providing significant environmental benefits.

247. *Second*, the Canadian authorities had been approached by members of the domestic industry, seeking the very protectionist actions ultimately enacted. The Tribunal noted that the "Canadian PCB disposal industry started a vigorous lobbying campaign" to close the market. *Id.* ¶ 122; *see also id.* (describing letter from *S.D. Myers*' chief Canadian competitor to Canadian Minister of the Environment, seeking a "commitment to assist the Canadian hazardous waste industry" by continuing the ban on the export of PCBs). This persistence mirrors the efforts of the U.S. domestic ethanol industry, which has lobbied every level of U.S. federal and state government, maligning "foreign" methanol and MTBE, while calling for its replacement by domestic ethanol.

248. *Third*, there was no scientific basis for the environmental regulations. The initial Canadian Order claimed that its purpose was "to ensure that Canadian PCB Wastes are managed in an environmentally sound manner in CANADA and to prevent any *possible* significant danger

to the environment or to human life or health.” *Id.* ¶ 123 (citing PCB Waste Export Regulations, Interim Order, Explanatory Note) (emphasis added). The subsequent final order omitted the fact that the danger was only “possible.” *Id.* ¶ 125. Two years later, however, Canada lifted the prohibition, allowing PCB exports as long as proper safeguards were in place. *Id.* ¶¶ 127, 298. The tribunal made note that this implicitly acknowledged that if Canada had wanted to maintain a “safe environment,” as it claimed, it could have “kept the Canadian border open, but put in place safeguards.” *Id.* ¶ 298. Here, as noted above, California’s assessment of the “risks” of MTBE is scientifically unsupported and unsupportable. Moreover, just as in *S.D. Myers*, California has now delayed the MTBE ban by another year, and there is evidence that groundwater contamination detection has decreased significantly with the enforcement of California and federal gasoline UST laws. Thus, in *S.D. Myers*, the subsequent events revealed the emptiness of the alleged fears, and thus the discriminatory intent behind the measure.

249. *Fourth*, Canada ignored less-protectionist alternatives that could have addressed Canada’s claimed environmental concerns. The *S.D. Myers* tribunal noted that a NAFTA side agreement, the North American Agreement on Environmental Cooperation, recognized the NAFTA Parties’ objective to “avoid creating distortions to trade” (art. 1), and that this objective meant that “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.” *Id.* ¶¶ 220-21. Here, even if the claimed risks of increased MTBE detection levels were scientifically sound, California could have simply enforced its existing gasoline UST laws to prevent leaks, rather than racing to ban the foreign product from the market. *See* Section V(D), above.

250. *Finally*, the effect of the Canadian regulation was to disproportionately benefit the domestic industry. As the *S.D. Myers* tribunal noted, in determining intent, it is important to take into account “whether the practical effect of the measure is to create a disproportionate benefit for nationals over non nationals.” *Id.* ¶¶ 252-54. The negative effect of the Canadian measures in *S.D. Myers* fell disproportionately on U.S. investors, while the benefits flowed to Canadian companies that found their uncompetitive business suddenly guaranteed a virtual monopoly over PCB disposal. *See id.* ¶ 251. Here too, the harm of the California measures falls disproportionately on foreign investors and their investments, while all of the benefit flows to the U.S. domestic ethanol industry.

251. In the second case, *Metalclad Corp. v. United Mexican States*, Case No. ARB(AF)/97/1 ¶¶ 28-64 (Aug. 30, 2000), the 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. Because the *Metalclad* tribunal found Mexico liable for breaches of NAFTA Chapter 11 on other grounds, it did not need to decide whether the decree was legitimate. *Id.* ¶¶ 89-101, 105-12. Nevertheless, the tribunal noted that if it had reached the issue, it would have to “consider the motivation [and] intent of the adoption of the Ecological Decree,” and concluded that “the implementation of the Ecological Decree would, in and of itself, constitute an act tantamount to expropriation.” *Id.* ¶ 111. *Metalclad* is thus another example of a state violating its investment protection obligations under the pretext of environmental regulation.

252. And in a third Chapter 11 case, *Ethyl v. Canada*, the facts of which are particularly analogous to the facts of this case, Canada settled with the claimant rather than

continue to defend an “environmental” regulation that it ultimately acknowledged was unsupported by the evidence. *See Soloway, supra*, at 84 (reporting the outcome of the *Ethyl* case).

253. *Ethyl* grew out of a Canadian ban on international and interprovincial trade of a gasoline additive, methylcyclopentadienyl manganese tricarbonyl (“MMT”). *See id.* at 55. The U.S. Claimant, Ethyl Corp., considered the ban — which was purportedly based on environmental concerns — as nothing more than a protectionist ploy intended to discriminate against Ethyl and its Canadian investment and to favor Canadian investors. *See id.* at 85. The “baptists” behind the Canadian MMT ban were environmentalists and the “bootleggers” were Canadian automakers: “It is clear . . . that it was the automobile manufacturers who were the driving force behind the elimination of MMT. They claimed that the on-board monitoring equipment in new vehicles would be impaired by the use of MMT-enhanced gasoline.” 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) (“*AIT Report*”).

254. In a striking parallel to the facts here, it appears that the Canadian ethanol industry may have influenced the MMT ban. “[S]upporters of an MMT ban cite[d] reasons other than legitimate environmental concerns,” such as “provid[ing] ‘shelter’ for a domestic infant [ethanol] industry competing with a mature United States industry.” *Soloway, supra*, at 71. According to Soloway, “[t]his brings into question the motivations of the Canadian Government in passing Bill C-29, as it appears to be responding to the strong agriculture lobby pressing for protection and assistance.” *Id.*

255. Ethyl challenged the MMT ban both in Canadian domestic courts and at the international level by bringing a NAFTA Chapter 11 action. *See id.* at 75. The Government of Alberta, with the support of the Governments of Quebec, Nova Scotia, and Saskatchewan, brought a separate action challenging the ban under Canada’s Agreement on Internal Trade (“AIT”). *See id.* The AIT is a municipal analog to an international trade agreement, meant to ensure that Canada’s internal, inter-province trade is as free as possible, and that it is not encumbered by unjustifiable barriers. *See AIT Report, supra*, at 3 (quoting AIT Article 100 (“Objective”)).

256. The AIT panel concluded that the Canadian MMT ban was improper, finding it to be “inconsistent with the AIT, because it created an obstacle to trade . . . not justified by the legitimate objectives test.” Soloway, *supra*, at 83. Following that decision, a settlement was reached in the NAFTA case: “the Canadian government agreed to repeal the ban on MMT and pay Ethyl \$19.3 million (Canadian) in costs and lost profits.” *Id.* at 84. As part of the NAFTA settlement, “[t]he Canadian government” publicly acknowledged “that there was no evidence that MMT was harmful to human health in low amounts.” *Id.*

257. The facts of this case, are even more stark. California has banned not just one effective gasoline additive, but *all oxygenates* that could compete with domestic ethanol. It has done so even though MTBE has proven to be an environmentally beneficial product. It has done so even though ethanol poses its own environmental hazards. Moreover, ethanol is a known carcinogen, a point recently confirmed by an expert witness testifying on behalf of the state of California. *See* Deposition Transcript of Dr. Bernard Goldstein, at 66-67 (*South Tahoe Pub. Util. Dist. v. Atl. Richfield Co.* (Cal. Super. Ct., Dec. 13, 2000) (confirming that “[e]thanol is

recognized as a human carcinogen”) (FA 150).¹² In addition, the use of ethanol in gasoline markedly increases both the tailpipe and evaporative emissions of other dangerous chemicals, such as acetaldehyde. See UC Report, Vol. II, *An Evaluation of the Scientific Peer-Reviewed Research & Literature*, at 147, 153 (FA 37).

258. By contrast, the International Agency for Research on Cancer (“IARC”) of the World Health Organization, the Federal National Toxicology Program (“NTP”) of the National Institute for Environmental Health Sciences (“NIEHS”), and the California Proposition 65 Scientific Advisory Panel Carcinogen Identification Committee have all declined to list MTBE as a carcinogen. 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) (FA 24); 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) (FA 29); Press Release, Cal. EPA, *Prop. 65 Scientific Review Panels Conclude 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) (FA 83); 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 Committee have “all determined not to list MTBE as a human carcinogen”) (FA 27). Moreover, the European Union published a study in December 2001, concluding that MTBE was not harmful to human health, the atmosphere or

¹² Although ethanol is a known carcinogen, it is not known what percentage of the

the environment. European Comm'n, *Recommendation of 7 November 2001*, Official Journal of the European Communities, 2001/838/EC, at L319/42-44 (Dec. 4, 2001) (FA 22).

259. California has banned MTBE, and all other competitors to ethanol, even though simply correcting the root problem — California's leaking gasoline USTs — would have, and in fact has, addressed not only any concerns related to MTBE, but also the much broader concerns raised by the many gasoline components that the challenged measures continue to allow to leak into its environment. It may thus be inferred that California and the ethanol industry used the detection of MTBE in the state's groundwater as a pretext for securing support among environmentalists for protecting domestic ethanol against its "foreign" competitors.

G. California's Intent To Harm Foreign Methanol Producers Is Further Evidenced By The United States' Nationalistic Bias Against The "Foreign" Methanol/MTBE Industry

1. Intent To Harm Foreign Methanol Products Can Be Inferred From The Fact That Such Harm Was Probable and Foreseeable

260. The inference of protectionism is made even stronger here by the fact that the adverse impact on foreign investors was not only probable and foreseeable, but actually foreseen, by the United States. Tribunals reviewing anti-competitive conduct uniformly hold that intent to cause anti-competitive consequences can be inferred from the fact that an "action [is] undertaken with knowledge of its probable consequences." *United States Gypsum*, 438 U.S. at 444. In this case, both California and the United States *actually and expressly foresaw* that mandating the use of ethanol would have an adverse impact on methanol and MTBE.

261. As discussed above, when the President *Pro Tempore* of the California Senate told representatives of Methanex and the methanol industry they were "[out of luck]" on "the

(continued...)

population would be affected at concentration levels likely to be present in drinking water.

MTBE issue,” he expressly advised them to “sell Methanex stock short.” *See* Section VI(A), above (quoting Wright Aff. ¶ 13) (Ex. B).

262. Indeed, the United States has in the past touted the discriminatory impact that favoring ethanol would have on foreign methanol and MTBE producers as one of the primary benefits of such favoritism. In 1993, the EPA proposed a requirement that thirty percent of the oxygenate content for U.S. reformulated gasoline be reserved for “renewable oxygenates” such as ethanol. *See* Regulation of Fuels & Fuel Additives: Renewable Oxygenate Requirement for Reformulated Gasoline, 58 Fed. Reg. 68,343 (proposed Dec. 27, 1993) (codified at 40 C.F.R. § 80). In so doing, the EPA made the now-familiar protectionist argument that “the use of domestic, renewable ethanol would clearly reduce high value energy imports relative to imported *methanol or MTBE*.” *Id.* at 68,345 (emphasis added). “Money now spent on imported oil or *oxygenates* could instead be spent for renewable fuels made from feed stocks currently grown or processed in the United States. This would keep capital in the U.S., provide domestic jobs, strengthen our national security, and support a wide variety of American agricultural and fuel industries.” *Id.* at 68,344 (emphasis added). Several members of Congress enthusiastically supported the program because it would provide “a significant new market for ethanol.” Regulation of Fuels & Fuel Additives: Renewable Oxygenate Requirement for Reformulated Gasoline, 59 Fed. Reg. 39,258, 39,262 (Aug. 2, 1994).

263. The EPA recognized the obvious economic impact of its proposal to expand the ethanol market by government fiat: “The revenues and net incomes of both corn farmers and ethanol producers should rise significantly, due to higher corn and ethanol demand and prices, respectively.” 58 Fed. Reg. at 68,350. It also saw the necessary corollary, that competing methanol producers would be harmed: “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.” *Id.* (emphasis added). The United States considered these damages to be among “[t]he primary economic impacts of this proposal.” *Id.*¹³

264. Because the harm to foreign methanol producers from an MTBE ban was probable, foreseeable, and foreseen, it is logical to infer that that harm was, as a matter of law, intended by California.¹⁴

2. Anti-Foreign Bias Against Methanol And MTBE Pervades National Politics In The United States

265. Methanol has long been a popular target of nationalistic attacks in the United States. It is widely treated as indistinct from MTBE and from imported oil generally, and is condemned as a “foreign” threat to American security and economic independence. Spurred on by the domestic ethanol industry, and the politicians that support it, this anti-foreign rhetoric has become a fixture of political discourse at all levels of governmental policy-making concerning ethanol. After all, “foreign” interests are under-represented in the U.S. political process, making such nationalistic biases an attractive strategy for elected politicians to gain votes and curry favor

¹³ Opponents challenged the EPA proposal, arguing that it was bad environmental policy, “politically motivate[d,] and simply designed to funnel hundreds of millions of dollars to Archer Daniels Midland Co., the primary maker of ethanol.” F. Swoboda and D. Southerland, *Court Bars EPA from Mandating Ethanol Use*, *The Washington Post*, Sept. 14, 1994, at A8 (FA 140); *see also* A. Gottschalk, *Federal Court Ruling Clouds the Outlook for Ethanol Interests*, *J. Com.*, Sept. 19, 1994, at 5B (FA 103). The U.S. Court of Appeals for the D.C. Circuit ultimately invalidated the proposal because the EPA had no statutory authority to promulgate such a rule if, as the EPA itself conceded, the “use of ethanol might possibly make air quality *worse*.” *Am. Petrol. Inst. v. EPA*, 52 F.3d 1113, 1119 (D.C. Cir. 1995) (emphasis added).

¹⁴ As noted, the probability of such damage, by itself, is sufficient to infer that the measures at issue were based on improper protectionist intent. Methanex possesses some such evidence but has sought additional evidence relating to this issue, *e.g.*, evidence related to the California measures, such as background documents relating to S.B. 521 and the UC Report, that would further inform the Tribunal on this important issue.

with major contributors. As a result, the anti-foreign bias against methanol here is raw and blatant.

266. At the national level, elected politicians and appointed officials alike regularly conjure images of methanol as “foreign” in their attempt to justify a range of measures intended to protect the economically uncompetitive domestic ethanol industry. For example, Representative Jim Nussle, a member of the House Ways and Means Committee and co-chairman of the Congressional Alcohol Fuels Caucus, has claimed: “[M]ethanol is derived from oil and other petroleum-based products Increased use of MTBE translates into even more dependence on foreign energy supplies.” Rep. J. Nussle, *Help Fuel Independence*, USA Today, June 19, 1997, at 12A (FA 125). In support of extending ethanol’s tax subsidies to counter that threat, subsidies that had been scheduled to end in 2000, Representative Nussle wrote: “We should not destroy an incentive to produce a clean-burning, renewable fuel source produced in America’s cornfields when that would make us even more dependent on foreign oil.” *Id.* As Nussle’s statements vividly illustrate, protecting domestic ethanol and penalizing “foreign” methanol are simply opposite sides of the same discriminatory coin.

267. In 1992, at the start of the oxygenate debate, Senator Thomas Daschle emphasized the punitive approach, introducing a tax package that would have “put a 50 cent per-gallon-duty on imported methanol, which [would have] translate[d] to a 17-cent-[per-gallon] hike in MTBE price.” D.J. Caney, *Ethanol Capacity to be Put on Hold*, Chemical Marketing Report, Mar. 16, 1992, at 3 (FA 87). Conversely, former Senator (and then Presidential candidate) Bob Dole pushed through a Senate bill that imposed tariffs on ethanol imported from Brazil, and he later fought for a reversal of a Customs Service ruling that would have allowed ethanol to be imported

from Brazil duty-free. See D. Frantz, *Dole and Ethanol Industry Count on Each Other*, N.Y. Times, Apr. 16, 1996, at A1 (FA 99).

268. During a debate on the ethanol tax credit, former Senator Bennett Johnson claimed:

Ethanol improves the U.S. trade balance. Ethanol competes with MTBE, a methanol-derived oxygenate, as an octane - oxygenate - additive. Imports of MTBE have risen from just 30 million gallons in 1992 to more than 700 million gallons last year, or about 25 percent of domestic consumption. By displacing the demand for MTBE that would be necessary without ethanol, the U.S. trade imbalance is reduced by approximately \$1.3 billion annually [Ethanol] reduces our dependance [sic] on foreign oil.”

143 Cong. Rec. S6690 (daily ed. June 27, 1997) (statement of Sen. Johnson).

269. Speaking in support of ethanol at another hearing on the ethanol tax credit, former Illinois Senator Carol Moseley-Braun stated: “Ethanol flows not from oil wells in the Middle East, but from grain elevators in the Middle West, using American farmers, and creating American jobs Isn’t it the responsibility of Congress to foster an economic climate that creates jobs and strengthens domestic industry?” 144 Cong. Rec. S1754 (Mar. 11, 1998) (statement of Sen. Moseley-Braun).

270. And joining together in a 1998 letter successfully urging the Senate to “extend the Federal tax exemption for ethanol until the year 2007,” three Cabinet-level officials wrote:

Continued public support for the ethanol program is vital to continuing the economic and environmental contributions ethanols [sic] is making to our country. Ethanol is a clean-burning, *made-in-America fuel* that has created thousands of jobs and provided a multi-billion dollar boost to rural communities and family farmers *The more we produce and use domestically-produced fuel, the less reliant our nation is on oil from foreign countries.*

Letter from U.S. Treasury Secretary Robert E. Rubin, U.S. Agriculture Secretary Dan Glickman and U.S. Transportation Secretary Rodney E. Slater to U.S. Senator William V. Roth, Jr. (Apr.

28, 1998) (emphasis added) (FA 68). These and many similar statements by national leaders helped set the anti-methanol, anti-MTBE tone of California's concurrent consideration of proposals to replace "foreign MTBE" with domestically produced ethanol.

271. "Public interest" groups have also stressed that methanol and MTBE are foreign products. One group, Citizen Action, has claimed: "[M]ost of the methanol consumed in the United States is either imported or manufactured by foreign-owned companies." *Reformulated Gasoline Price Hikes: Did Foreign Methanol Producers Manipulate the Market To Earn Windfall Profits?* (attached to Citizen Action Press Release of July 18, 1995), at 3 (FA 32). Citizen Action went on to criticize the United States' increasing dependence on imported methanol:

Because of the CAAA, the demand for MTBE and methanol have [sic] increased substantially leading to the re-opening of mothballed, and the construction of new, methanol plants, both in the United States and abroad. Because methanol can be produced cheaply in many foreign countries (primarily because of access to very low cost natural gas resources), the United States is importing an increasing amount of methanol.

* * * *

As the United States seeks to reduce pollution from gasoline by shifting to cleaner-burning fuels and fuel components, there are concerns that oil import dependence may be exchanged for foreign methanol import dependence.

Id. at 4-5, 24.

272. Methanex itself has not escaped these nationalistic attacks. For example, Citizen Action has accused "*foreign-owned Methanex*" of leading methanol producers in "creating market panic and driving prices above anticipated competitively-determined levels." *See id.* at 3 (emphasis added); *see also id.* (referring to "*foreign-owned Methanex*" as the world's leading methanol producer) (emphasis added).

3. The Nationalistic Bias Has Been Spurred On By ADM And Others In The Domestic Ethanol Industry

273. 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.

Moneyline, supra. Elsewhere, Dwayne Andreas has similarly declared: “This is the Midwest versus the Middle East.” *See* Bovard, *supra*, at 23 (FA 81). On other occasions, Andreas has been quoted as declaring: “[I]t’s corn farmers vs. the oil companies.” D. Greising and P. Hong, *Big Stink on the Farm*, *Business Week*, July 20, 1992, at 31 (quotation omitted) (FA 106).

274. In a February 14, 1990 *Chemical Week* article, Martin Andreas, then Senior Vice-President of ADM, stated: “MTBE has a major drawback in that any increased demand for methanol will necessarily be produced from offshore gas” A. Wood, *Renewed Fuss Over Renewable Fuel*, *Chemical Week*, Feb. 14, 1990, at 56 (quotation omitted) (FA 148). Martin Andreas also asserted that “[s]ome analysts predict the U.S. methanol dependency could exceed that for imported oil.” *Id.* (quotation omitted). 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. R.G. Friend, *Politics and Ethanol*, *Oil & Gas J.*, Nov. 13, 1995, at 12 (FA 100). Similarly, a May 16, 1994 news release by Fuels for the Future, a group funded by ADM, described methanol as a “petroleum-based product imported mainly from the Middle East.” Press Release, Fuels for the Future, *Methanol Dangers Are Cited as U.S. Incidents Increase; Pipeline Spills at School*, at 1

(May 16, 1994) (FA 116); *see also* Press Release, RFA, *OPEC Meeting Highlights Need for Increased Use of Ethanol*, (Mar. 27, 2000), available at <http://www.ethanolrfa.org/pr32700.html> (trumpeting “domestically produced ethanol” as the solution to “America’s dependence on foreign oil and MTBE”) (emphasis added) (FA 127); Press Release, RFA, *10-Year Anniversary of Iraq Invasion Of Kuwait Highlights American Dependence On Foreign Oil, Need For Ethanol*, (Aug. 2, 2000), available at <http://www.ethanolrfa.org/pr080200.html> (similar) (FA 76).

275. In short, the domestic ethanol industry never misses the opportunity to portray methanol and methanol-based MTBE as “foreign” products, and ethanol as the homegrown answer to growing dependence on energy imports. And leading that industry is ADM, led in turn by the same executives who secretly met with Governor Davis before the California measures came into existence.

4. The Same Bias Pervades State-Level Policy Making As Well

276. As the California measures demonstrate, the ethanol lobby’s campaign to shut out foreign competitors is not limited to the national level: It is being waged at the state level as well, where numerous governors emphasize nationalistic themes and the Midwest-versus-Mideast metaphor. For example, Illinois Governor Jim Edgar has testified before Congress: “I would much rather be dependent on a corn farmer from the Midwest than an oil baron from the Mideast for my fuel.” J.B. Austin, *Edgar: EPA Plan Would Threaten Future of Ethanol*, Gannett News Service, Apr. 29, 1992 (FA 78).

277. Edgar is also one of twenty-seven Midwestern and other governors who have joined together to form the GEC. According to its mission statement:

It is the Coalition’s goal to increase the use of ethanol based fuels, to decrease the nation’s dependence on *imported* energy resources, improve the environment and stimulate the national economy. This

will be accomplished through a coordinated set of activities designed to educate and demonstrate to the public the benefits of ethanol use; to encourage ethanol fuel production and use through research and market development efforts; and to make investments in infrastructure to support expansion of the ethanol market. The Coalition supports the production of ethanol from corn or other *domestic*, renewable resources using sustainable agricultural methods and encourages its use in environmentally acceptable applications.

GEC, *The Coalition's Goals*, available at <http://www.ethanol-gec.org/aboutus/goals.htm> (last visited Nov. 1, 2002) (emphasis added) (FA 173).

278. It is, of course, no surprise that the ethanol lobby would find strong support in the U.S. Midwest, where most of the U.S. ethanol supply is produced. But the ethanol lobby's nationalistic bias infects state and local-level decisionmaking across the United States. California is no exception to that rule. Tom Hayden, the California state senator who sponsored one of the MTBE-related laws during the run-up to its ultimate ban, admitted during a state legislative hearing: "I've always wished for a source of fuel from the Midwest, not the Middle East." M. Moore, *Safety of gasoline additives debated at SM hearing*, *The Outlook*, Nov. 22, 1997, at A6 (FA 118).

279. The same nationalistic biases are also evident at the local level of California decision-making. As discussed above, one letter to the Los Angeles County Metropolitan Transit Authority from Regent International — ADM's alleged co-conspirator in the current U.S. and European ethanol price-fixing investigations — demanded "that the MTA's procurement office immediately stop the current practice of purchasing *foreign produced methanol* to supply the MTA's alcohol bus fleet." Letter from Regent International to Ted Hope, LACMTA (Apr. 7, 1998) (emphasis added) (FA 63). But the political pressure to replace "foreign" methanol and methanol-based MTBE in California with domestic ethanol came both from within and without the State.

280. From all of 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 decisionmaking processes at every level. *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.¹⁵

VII. CAUSES OF ACTION

281. The causes of action in this case arise under Chapter 11 of NAFTA. Section A of Chapter 11, entitled “Investment,” imposes on signatory Parties various obligations regarding foreign investors and their investments. Section A includes Articles 1102, 1105, and 1110, the substantive provisions directly at issue in this case. Section B of Chapter 11, entitled “Settlement of Disputes between a Party and an Investor of Another Party,” creates private rights of action to enforce Section A. Section B includes Articles 1116 and 1117, which create the causes of action alleged here.

282. In pertinent part, Article 1116 provides that an “investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under” Section A “and that the investor has incurred loss or damage by reason of, or arising out of, that breach.” Methanex satisfies all of the elements for a claim under Article 1116.

¹⁵ Methanex has discussed a wide variety of evidence demonstrating the United States’ bias against methanol and MTBE as “foreign” products and how such a bias led to the measures at issue. Even more evidence should be obtained, however, such as that evidence requested by Methanex concerning ADM and other ethanol producers’ involvement in the California decisionmaking process. This will allow the Tribunal to better understand the relationship between this bias and the resulting California measures as well as the role of the domestic ethanol industry in creating and nurturing this culture of bias in that State.

283. *First*, Methanex is an investor of Canada, which is a NAFTA signatory, and of no other state. Methanex's investments in the United States include Methanex U.S., Methanex Fortier, and the market shares, goodwill, and operations of Methanex, Methanex U.S., and Methanex Fortier.

284. *Second*, as explained at length above, the United States, and the federal states for which the United States is responsible, have breached, and continue to breach, their obligations under NAFTA Articles 1102, 1105, and 1110.

285. *Third*, as explained above and below, Methanex suffered grave damages as a result of those breaches, both directly and through its United States investments.

286. In pertinent part, Article 1117 provides that an "investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the other Party has breached an obligation under" Section A "and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach." Methanex satisfies all the elements for a claim under Article 1117.

287. *First*, as noted above, Methanex is a Canadian investor.

288. *Second*, Methanex U.S. is a United States enterprise that is a juridical person indirectly owned and controlled by Methanex. Methanex Fortier is also a United States enterprise that is a juridical person indirectly owned and controlled by Methanex.

289. *Third*, as noted above, the United States, and the federal states for which the United States is responsible, have breached, and continue to breach, their obligations under NAFTA Articles 1102, 1105, and 1110.

290. *Fourth*, as explained above and below, Methanex U.S. and Methanex Fortier suffered grave damages as a result of those breaches.

A. The California Measures Violate Article 1102

291. “The national treatment standard is perhaps the single most important standard of treatment enshrined in international investment agreements.” United Nations Conference on Trade and Development, *National Treatment*, at 1 (1999). The United Nations has clearly described the substance of the standard: “[F]oreign and domestic investors should be subject to the same competitive conditions on the host country market, and therefore no government measure should unduly favour domestic investors.” *Id.* at 8; *see also Japan — Taxes on Alcoholic Beverages*, Appellate Body Report, at *10 (stating that the national-treatment obligation in GATT Article III requires Members “to provide equality of competitive conditions” for imported and domestic products).

292. In the United States’ own words, the promise of national treatment is to provide “equality of competitive opportunity” — “a level playing field . . . for foreign and domestic” investors and their investments. U.S. Dep’t of the Treasury, *National Treatment Study 1994*, at 13 (1994). This principle is “the cornerstone” of the United States’ “belief that everyone benefits from” open markets. *National Treatment in Policy and Practice in the United States and Abroad: Hearing Before the House Subcomm. on Financial Institutions Supervision, Regulation and Insurance and the International Competitiveness of United States Financial Institutions Task Force of the Comm. on Banking, Finance & Urban Affairs*, 101st Cong. 3 (1990) (testimony of David Mulford, Undersecretary of the Treasury for International Affairs) (FA 73).

1. If Improper Intent Is The Limiting Principle Under Article 1101, Then The Operative Intent For Purposes Of Article 1102 Must Be Intent To Deny National Treatment (“Discriminatory Intent”), Not Intent To Otherwise Harm Foreign Investors Or Their Investments

293. The Tribunal has decided that, as a matter of “common sense,” not all investments adversely affected by a government measure are entitled to bring NAFTA claims. (Aug. 7, 2002 Award ¶¶ 137-39.) It thus concluded that Article 1101 must act as the “gatekeeper” for Chapter 11 claims. (*Id.* ¶ 139.) Methanex does not seek to relitigate that decision. However, it is equally a matter of common sense that the “gatekeeper” function of Article 1101 cannot reduce or narrow the substantive protections established in Chapter 11 itself. In particular, with respect to NAFTA violations that are intentional in nature, such as discrimination or a denial of national treatment, the relevant “gatekeeping” intent should be an intent to deny NAFTA’s substantive protections. Put differently, if a credible claim of discrimination in violation of Article 1102 is stated, and if a particular claimant is within the class of enterprises protected by Article 1102, that should be sufficient to establish a “legally significant connection” for purposes of Article 1101.

294. Article 1102(3), which governs Methanex’s claim, guarantees the investors of each Party that they and their investments in the territory of another Party will receive national treatment (*i.e.*, the equivalent of the best treatment accorded to domestic investors and their investments). It provides:

The treatment accorded by a Party under paragraphs 1 and 2 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 Pope & Talbot II* ¶ 42 (Apr. 10, 2001) (concluding that, like Article 1102(3), Articles 1102(1) and (2) also entitle foreign investors “to treatment equivalent to the ‘best’ treatment accorded to domestic investors or investments in like circumstances”).

295. Article 1101 thus does not require an Article 1102(3) claimant to allege, much less prove, something beyond an intent to deny national treatment to foreign investors and their investments. If an Article 1102 claimant shows that a particular measure has in fact denied it the best possible treatment, it need not show and should not be required under Article 1101 to show, that, in addition, the measure was motivated by a specific intent to harm a particular foreign investor or its investment. If a claimant is required to make such an additional showing, Article 1101 would become too narrow a gateway, because it would go beyond a “common sense” restriction of the class of investors that can bring claims against a particular breach of Chapter 11, and would instead disregard and, indeed, eliminate much of the substantive protection that Chapter 11 expressly guarantees.

296. As shown above, California and the United States plainly intended to deny foreign methanol producers, including Methanex, the best treatment it has accorded to domestic ethanol investors, thus violating Article 1102.

2. Article 1102 Expressly Limits The Class Of Investors And Investments Entitled To Protection To Those In “Like Circumstances”

297. Not all foreign investors injured by the discriminatory effects of a given measure have standing to maintain an Article 1102 claim. By that Article’s express terms, its national-treatment guarantee is limited to that class of foreign investors or investments in “like circumstances” with the more favorably treated domestic investor or investment. By definition, then, a measure that discriminates in favor of a domestic investor or investment “relates,” and

thus has a “legally significant connection,” *only* to foreign investors or investments that are in “like circumstances” with the favored domestic investor or investment.

298. As demonstrated below, Methanex and its investments are in “like circumstances” with the U.S. domestic ethanol industry. Accordingly, the California measures at issue in this case, which undeniably discriminate in favor of the U.S. ethanol industry to the competitive disadvantage of foreign methanol investors like Methanex, are measures “relating to” Methanex and its U.S. investments.

3. The Critical Test For “Likeness” is Competition

299. The relevant inquiry under Article 1102 is whether two investors or their investments are in “like circumstances”; Article 1102 obviously does not require that the investments be identical or produce identical products. If the investments are “like,” then they are entitled to national treatment.

300. NAFTA Chapter 11’s national treatment guarantee does not exist in a vacuum. As Sir Robert Jennings points out in his attached expert opinion, Chapter 11 itself directs the Tribunal to apply relevant rules of international law. (Jennings Op. at 7) (citing Article 1131) (Ex. C). As Sir Robert further observes, the GATT has long included a similar national treatment guarantee, and the GATT/WTO decisions on national treatment and “likeness” provide particularly relevant and “indeed very useful” precedents in determining national treatment and “likeness” under NAFTA Article 1102. (*See id.* at 10.) It is thus no surprise that the NAFTA Chapter 11 Tribunal in the *S.D. Myers* case found guidance in the decisions of the “WTO dispute resolution panels, and its appellate body,” when interpreting the meaning of “like circumstances” in NAFTA Article 1102. *S.D. Myers* (Partial Award) ¶ 244.

301. As the *S.D. Myers* Tribunal recognized, and Professor Ehlermann confirms in his attached expert opinion, the most accurate and widely recognized test of “likeness” is

competition. *See id.* ¶ 251 (focusing on competition between the U.S. claimant and Canadian investors and their investments); (Ehlermann Op. ¶ 24) (“[T]he term ‘like products’ is concerned with competitive relationships between and among products”) (Ex. D). Numerous other authorities confirm the point as well. *See, e.g., European Communities — Measures Affecting Asbestos and Asbestos-Containing Products*, Appellate Body Report, WT/DS135/AB/R ¶ 99 (Mar. 12, 2001) (stating that “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”); M. Bronckers & N. McNelis, *Rethinking the ‘Like Product’ Definition in GATT 1994*, in *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* 345, 347 (T. Cottier & P. Mavroidis eds., 2000) (“[w]hat counts in defining ‘like’ or ‘directly competitive or substitutable products’ is competition in the marketplace, which is determined from the consumer’s perspective.”); R. Hudec, *‘Like Product’: The Differences in Meaning in GATT Articles I and III*, in *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law*, *supra*, at 101, 104-05 (national treatment’s anti-protectionist goal is achieved if “like” is defined in terms of “competitiveness”).

302. The most obvious test for competition between foreign and domestic investors (or their investments) is whether they are in a position to take business away from each other. *See S.D. Myers* (Partial Award) ¶ 251 (“it is clear that” foreign and domestic investors are in like circumstances when each is “in a position to attract customers that might otherwise have gone to” the other); *see also Japan — Taxes on Alcoholic Beverages II*, Appellate Body Report, at *15 (affirming that cross-price elasticity of demand is relevant to determining direct competition); *Chile — Taxes on Alcoholic Beverages*, Panel Report, WT/DC87/R ¶ 7.31 (“Overlap in end-use determines to a great extent direct competitiveness or substitutability.”).

303. In short, if two or more investors or their investments compete for the same business, they are in “like circumstances.”

4. Methanex Is In “Like Circumstances” With Protected Domestic Ethanol Producers, But Has Not Received National Treatment

304. Methanol and ethanol are both oxygenates under U.S. law. Methanex and other methanol producers are in “like circumstances” with U.S. domestic ethanol producers because they both produce the same product — oxygenates used in manufacturing reformulated gasoline — and because they both compete directly for customers in the oxygenate market. As noted, integrated oil refiners have a binary choice: Buy methanol or buy ethanol. Merchant ether-oxygenate producers have the same binary choice: Buy methanol or buy ethanol. And other oxygenate consumers, such as gasoline-blending plants, have a similar choice between buying methanol-based MTBE or ethanol-based ETBE on the one hand, or buying an alcohol oxygenate (ethanol or methanol) on the other. It is thus a zero-sum game — each additional sale of ethanol results in a direct loss in sales for methanol. Indeed the United States has itself recognized this obvious consequence of this binary competition: The U.S. EPA concluded that “the use of domestic, renewable ethanol would clearly reduce high value energy imports *relative to imported methanol or MTBE.*” 58 Fed. Reg. at 68,345 (emphasis added).

305. Moreover, as Dr. Ehlermann’s expert opinion makes clear, application of the highly similar GATT/WTO “like products” test also leads to the conclusion that ethanol and methanol are “like.” Two factors to the “like products” test are particularly important. *First*, “[m]ethanol and ethanol are capable of serving the same or similar end uses.” (Ehlermann Op. ¶ 56) (Ex. D). Both are capable of serving as oxygenates in their own right, while both can and do serve as the oxygenate component in their respective derivative ethers, MTBE and ETBE. *Second*, oxygenate “consumers perceive and have treated” methanol and ethanol “as alternative

means of performing particular functions in order to satisfy a particular want or demand,” (*id.*) that is, to be used as an oxygenate in manufacturing reformulated gasoline.

306. There is no doubt that Methanex and its investments do not receive the same treatment as ethanol in California (or, indeed, the United States). California has banned MTBE and methanol from the oxygenate market and has instead, by legal fiat, given ethanol a complete monopoly. Such disparate treatment is the antithesis of the “equality of competitive opportunity” championed by the United States.

307. *Finally*, as set forth above, the spurious “environmental” concerns cited by California do not justify such discrimination. MTBE and methanol present no risk to the environment. The infrequent presence of trace amounts of MTBE in drinking water has been largely remedied by fixing the cause of the problem — California’s leaking underground gasoline storage tanks. Consequently, California and the United States have violated Article 1102 by denying to Methanex and its investments, without adequate justification, the same treatment they grant to U.S. ethanol producers.

5. The Fact That A Measure May Also Discriminate Against *Some* “Like” Domestic Investors And Investments Does Not Excuse An Article 1102 Violation

308. The fact that the California measures may have discriminated against some U.S. domestic methanol investors and their investments does not excuse an Article 1102 violation.

Again, the express language of Article 1102(3), makes this clear:

The treatment accorded by a Party under paragraphs 1 and 2 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 Pope & Talbot II* ¶ 42. Accordingly, under NAFTA’s plain language, Methanex and other Canadian or Mexican investors and investments are entitled to the best, not the worst, treatment accorded to like domestic investors and their investments.

309. Were the rule otherwise, Article 1102 would not be honored according to its explicit terms, and would be nothing more than a resurrection of the Calvo Doctrine — an agreement among the Parties that each may discriminate against, or otherwise mistreat, the others’ investors so long as it similarly mistreats at least some of its own investors as well. That, of course, is an absurd proposition, and contradicts the well-established rule that a measure is not saved from “running afoul” of a national treatment obligation “merely because there are domestic products” that are also affected by the discrimination. *Chile — Taxes on Alcoholic Beverages*, Panel Report, WT/DC87/R ¶ 7.158; *see also United States — Measures Affecting Alcoholic and Malt Beverages*, BISD 39S/206 ¶ 5.17 (1992) (same); *Korea — Measures Affecting Imports of Fresh, Chilled And Frozen Beef*, Panel Report, WT/DS161/R, WT/DS169/R ¶¶ 6.29, 6.30 (July 13, 2000); *United States — Standards For Reformulated And Conventional Gasoline*, Panel Report, WT/D52/R ¶¶ 6.29, 6.30 (adopted May 20, 1996).

310. EC trade law, too, is to the same effect. *See, e.g., E.C. Comm’n v. France*, [1980] ECR 347 ¶ 41 (“[T]he fact that another domestic product . . . is similar [sic] placed at a disadvantage does not rule out the protective nature of the system as regards the treatment for [competitive domestic and imported products].”).

311. The rule is exactly the same under the U.S. Constitution’s Dormant Commerce Clause. As the U.S. Supreme Court has repeatedly held, it is “immaterial” that a measure discriminates against *some* in-state producers as well as producers from outside the state. *Dean Milk Co.*, 340 U.S. at 354 n.4; *see also C&A Carbone, Inc.*, 511 U.S. at 391 (“The ordinance is

no less discriminatory because [some] in-state or in-town processors are also covered.”); *Fort Gratiot Sanitary Landfill, Inc.*, 504 U.S. at 361 (similar) (citing *Minnesota v. Barber*, 136 U.S. 313 (1890)).

312. In sum, the United States cannot avoid liability for breaching its Article 1102 obligations merely because that breach has damaged both foreign and domestic investments.

B. The California Measures Violate Article 1105

313. 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.” NAFTA Article 1105(1). As demonstrated above, the California measures were intended to discriminate against foreign investors and their investments, and intentional discrimination is, by definition, unfair and inequitable.

314. Accordingly, this is not a case in which the Tribunal must “second-guess government decision-making.” *S.D. Myers* (Partial Award) ¶ 261. Nor is it a case in which the United States has simply “made mistakes . . . misjudged the facts, [or] proceeded on the basis of a misguided economic or sociological theory.” *Id.*

315. Instead, this is a straightforward case of raw economic protectionism. On such facts, the United States’ breach of Article 1102 “establishes a breach of Article 1105 as well.” *Id.* ¶ 266.

C. The California Measures Violate Article 1110

316. NAFTA Article 1110 provides, in pertinent part: “No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment . . . except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation”

317. The California measures fail each of those requirements. *First*, a substantial portion of Methanex’s investments, including its share of the California and larger U.S. oxygenate market were taken by facially discriminatory measures and handed over to the domestic ethanol industry. Such a taking is at a minimum “tantamount . . . to expropriation” under the plain language of Article 1110.

318. *Second*, these measures were not intended to serve a “public purpose” as is required by Article 1110(a), but rather were primarily a mechanism for seizing Methanex’s, Methanex U.S.’ and Methanex Fortier’s share of the California oxygenate market and handing it directly to the domestic ethanol industry.

319. *Third*, the discriminatory nature of the measures fail to meet the requirement of Article 1110(c) that they comply with “due process of law and Article 1105(1).”

320. *Finally*, Methanex has not been compensated for the harms it has suffered as a result of these measures.

VIII. SUMMARY OF METHANEX’S DAMAGES

321. The California measures have substantially damaged Methanex, its U.S. investments, and its shareholders. Under NAFTA Chapter 11, the Tribunal may award, *inter alia*, “monetary damages and any applicable interest,” Article 1135(1), to compensate an investor and its investment for “loss or damage by reason of, or arising out of, that breach” of Chapter 11, Section A. *See* Article 1116(1); Article 1117(1).

322. Methanex and its U.S. investments have sustained losses and damages by reason of, or arising out of, the California measures. *Inter alia*, those measures have deprived and will continue to deprive Methanex and Methanex U.S. of a substantial portion of their customer base, goodwill, and market for methanol in California. California has essentially taken part of the U.S. methanol business of Methanex and Methanex U.S. and handed it directly to its competitor, the

U.S. domestic ethanol industry. The California measures have also contributed to the continued idling of the Methanex Fortier plant, Methanex's other U.S. investment. The measures have reduced the return to Methanex, Methanex U.S., and Methanex Fortier on capital investments they have made in developing and serving the U.S. MTBE market, increased their cost of capital, and reduced the value of their investments.

323. Additionally, the California measures have reduced and will continue to reduce the demand for methanol — both in its own right and as the key component of MTBE. MTBE represents approximately thirty percent of the world demand for methanol, and California MTBE usage alone represents approximately six percent of the *world* demand for methanol. Because methanol is a commodity, with a substantially uniform global price, the California measures will continue to cause substantial downward pressure on the global methanol price, reducing the price below what it otherwise would be in the absence of the measures. Methanex and its U.S. investments have suffered and will continue to suffer severe losses by reason of, or arising out of, these measures.

324. Finally, the State of California is extremely influential when it comes to environmental matters in the United States — in part owing to its disproportionate size; in part because of a tradition of addressing environmental issues in that state. In fact, California itself “recognize[d] that if MTBE were to be phased out of use in California, the rest of the United States could follow suit.” CEC, *Supply and Cost Report 1999*, at 30 (FA 9). Thus, its decision to ban methanol-based MTBE on environmental grounds established a flawed precedent that has triggered a “ripple effect” both in the marketplace and in the decisions of other governmental bodies. That effect is now being felt across the United States (and indeed, as subsequent events in Europe seem to illustrate, it has also caused questions about MTBE throughout the world).

See, e.g., European Chemicals Bureau, *European Union Risk Assessment Report, tert-butyl methyl ether* (“MTBE”), at 101-08, 246-47 (Final Report 2002) (FA 20); International Fuel Quality Center Special Report: *German EPA Position Paper on MTBE* (1999) (FA 25). To the extent that the MTBE bans and restrictions in other U.S. states — and indeed in other countries — can be traced to the California measures at issue here, they constitute additional harms to Methanex, its investments, and its shareholders, incurred by reason of, or arising out of, the California measures.

325. The immediate damage to Methanex, its investments, and its shareholders caused by the Executive Order is evidenced most obviously by the direct and immediate drop in Methanex’s market value that followed issuance of that Order. The Toronto Stock Exchange (“TSE”) is the principal market for Methanex shares. The day after the issuance of the Executive Order, the trading volume in Methanex shares on the TSE was *nine times* the average of the preceding four days, and the price of Methanex’s shares began to drop sharply. The average share price in the ten days after the Order was almost twenty percent less than the average share price in the ten preceding days. That represented a loss in Methanex’s market value of approximately CN\$180,000,000 — a loss that was directly caused by the California measures. This loss was suffered by Methanex, its investments and its shareholders.

326. Methanex’s share price and capitalization have never recovered from the damage inflicted by the California measures. Methanex’s share price and capitalization have historically tracked the price of its only product — methanol. The nature of that historical correlation was permanently altered by California’s MTBE ban, for while the Methanex share price and

capitalization still track the methanol price, they have since traded at a significant discount to the pre-1999 historical correlation.¹⁶

327. Accordingly, Methanex claims: (a) damages of approximately \$970 million suffered by itself, its investments, and its shareholders as a result of the United States' breach of Articles 1102, 1105 and 1110 of NAFTA; (b) its costs of this arbitration including, without limitation, expert and attorneys' fees and disbursements, plus any Canadian Goods and Services tax payable thereon; and (c) applicable interest.

IX. CONSENT AND WAIVER

328. Pursuant to NAFTA Article 1121, Methanex, Methanex U.S., and Methanex Fortier (as the investor and enterprises) have fully consented to this arbitration and waived their right to initiate or continue proceedings elsewhere. (Ex. F.)

¹⁶ In mid-1998, Methanex's price was briefly elevated due to rumors that it was an acquisition candidate. When those rumors ceased, Methanex's share price dropped to a level consistent with the historic correlation.

X. CONCLUSION AND REQUEST FOR RELIEF

329. Accordingly, Claimant respectfully requests that the Tribunal find that the United States has breached its obligations under NAFTA, and award Claimant all damages that are just and appropriate, together with interest, the claimant's costs of litigation, and attorneys' fees.

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