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 DRAFT AMENDED CLAIM

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February 12, 2001

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I. INTRODUCTION

A. The Reason for the Amendment

Methanex Corporation ("Methanex") seeks to amend its NAFTA claim in order to allege intentional discrimination[1] by the State of California to favor and protect the U.S. ethanol industry, and to ban a product – methanol-based methyl tertiary-butyl ether ("MTBE") – that has been repeatedly and stridently identified in the United States as "foreign." Ethanol, also an oxygenate like MTBE, is the chief competitor of MTBE and the primary beneficiary of the California MTBE ban.

Methanex's decision to amend is the result of information it discovered in the fall of 2000 indicating that Archer-Daniels-Midland ("ADM"), the principal U.S. producer of ethanol, misled and improperly influenced the State of California with respect to MTBE. Specifically, Methanex discovered that – during the middle of his 1998 California gubernatorial campaign, and during a time when the future of all oxygenates in California was under active review – now-Governor Gray Davis met secretly with top executives of ADM. On August 4, 1998, after receiving an initial $5,000 campaign contribution from ADM, he traveled to Decatur, Illinois, where ADM is headquartered, on a private plane owned by ADM, in order to confer with executives of ADM.

ADM has a reputation for seeking to create and control markets by influencing the political decision-makers who affect them; to that end, ADM makes large political contributions to both political parties in order to ensure that its interests are furthered. ADM is single-minded in pursuit of its corporate objectives, and its corporate behavior has been harshly condemned by the U.S. Court of Appeals for the Seventh Circuit in a case involving another of ADM's products: "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).

Two weeks after the secret meeting at ADM's headquarters in Decatur, ADM made a $100,000 contribution to the Davis campaign, and it made another $55,000 in contributions over the next four months. Seven months after his initial meeting with ADM officials, the Governor issued the executive order banning MTBE and indicating that ethanol would be the preferred replacement. Shortly thereafter, ADM made yet another $50,000 contribution to the Governor.[2] Once the MTBE ban was announced, ADM moved into the California oxygenate market: it began selling its U.S. ethanol, and it has been reported that it will build an ethanol plant there.

As set forth in previous submissions, these new allegations fully justify Methanex's request to amend its claim.

B. Summary of Amendments

The amended claim describes the actions of the U.S. ethanol industry and its political allies to expand ethanol's protected status, and in particular their attempts to create a public perception that MTBE and methanol are dangerous foreign products whose use should be restricted. The amended claim shows that there are much better alternatives to the California

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[1] As used herein, the term "intentional discrimination" has its usual and customary legal meaning. In this context, intentional discrimination means an intent to discriminate against imports of methanol and MTBE, to the benefit of the domestic ethanol industry.

[2] Methanex is not alleging that Governor Davis or ADM in any way violated U.S. or California campaign contribution statutes or other relevant laws. The issue, however, is not whether Governor Davis' and ADM's actions were legal in the United States, but whether they were so unfair, inequitable, and discriminatory that they violate NAFTA and international law.

MTBE ban, such as fixing the leaking gasoline tanks, and that these alternatives, on balance, protect the environment better than the MTBE ban (which does not, in fact, protect the environment).

The amended claim asserts that the California measures violate the anti-discrimination provisions of NAFTA Article 1102. It also asserts that because of the U.S. ethanol industry's improper influence, the California measures were arbitrary, unreasonable, and not in good faith, and that the MTBE ban was not the least trade-restrictive method of solving the water contamination problem. As such, the California measures violate Article 1105. The amended claim continues to include the allegations in the original claim that the California measures violate NAFTA Article 1105 and NAFTA Article 1110.

As the amended claim makes clear, California's decision to ban MTBE was an arbitrary rush to judgment that was not based on a reasoned analysis of the evidence, nor on a reasoned assessment of the risks, costs, and benefits of the ban and its alternatives. Nonetheless, California's decision, caused by the U.S. ethanol industry's lobbying, precipitated efforts to impose similar bans throughout the U.S. In contrast, European regulatory authorities, who are not subject to any ethanol industry influence or pressure, have reached a much different judgment. After re-examining MTBE in light of the California ban, these authorities have concluded that MTBE is not a danger to the environment, that it is not a carcinogen, and that there is no reason to ban its use. Had California not been improperly influenced by the U.S. ethanol industry, it would have reached the same conclusion.

II. THE PARTIES

The Claimant, Methanex, is a company originally incorporated under the laws of Alberta and now continuing under the Canadian *Business Corporations Act*. Methanex is the largest producer and marketer of methanol in the world, with production facilities located in Canada, the

United States, New Zealand, Chile, and Trinidad. Methanex's headquarters are in Vancouver, British Columbia, Canada.

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

Methanex Fortier, Inc. ("Methanex Fortier") is a company incorporated under the laws of the State of Delaware. Methanex owns, indirectly, 100% of the shares of Methanex Fortier.

The Respondent United States of America is the governmental body that, under the provisions of the North American Free Trade Agreement ("NAFTA"), has responsibility for responding to arbitration claims arising from actions taken by the federal and state governments of the United States.

III. FACTUAL BACKGROUND

A. The U.S. Oxygenate Market

1. The Business of Methanex and Its Investments

Methanex's sole business is the production, transportation, and marketing of methanol. Methanol is a liquid petrochemical made from feedstocks containing carbon and hydrogen. As of 2000, Methanex owned production facilities around the world with an annual capacity of approximately 7.0 million tons of methanol. In 2000, Methanex marketed in excess of 6.8 million tons of methanol throughout the world, approximately 6.0 million tons of which were produced in Methanex facilities. Methanex's sales represented approximately 24% of the world market in methanol. Approximately one-third of methanol produced by Methanex is for the fuel sector, principally for use in methanol-based MTBE.

Methanex ships methanol directly from its wholly owned Canadian plants into the United States for consumption by U.S. customers. When the Methanex Fortier plant was open, many shipments for U.S. consumption originated there. Other shipments for U.S. consumption originate at other Methanex production facilities around the world. Methanex U.S. markets methanol throughout North America, and it maintains some inventory in the U.S. For legal reasons, all shipments by Methanex and its subsidiaries in or to the United States are booked through Methanex U.S.

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 as defined in NAFTA. In 1998, Methanex U.S. booked sales of 797,412 tons of methanol in the U.S. Approximately 40% of Methanex U.S.' 1998 methanol sales in the U.S. were to third parties that use methanol for the production of MTBE, including approximately 132,000 tons shipped to California refineries for MTBE production. Some of these U.S. sales were shipped from Methanex's Canadian plants directly to U.S. customers.

Due to market conditions, Methanex's U.S. methanol production facility, Methanex Fortier, temporarily shut down its operations in early 1999 and continues to be idle. As a result of the California measures detailed herein, together with similar measures taken and threatened elsewhere in the United States, the recent tendency toward oversupply in the methanol industry will continue and worsen, further extending the closure of one of Methanex's principal U.S. investments.

2. MTBE As an Oxygenate Under the Clean Air Act

The chief uses of methanol-based MTBE are as an oxygenate and as a source of octane for gasoline. In 1990, the U.S. Congress enacted Clean Air Act Amendments ("CAAA"), setting new air-quality standards and limitations on motor vehicle emissions in areas of the country which suffered significant air pollution, principally larger metropolitan centers. In particular, the

CAAA required the addition of oxygenates to gasoline (reformulated gasoline ("RFG"), in order to reduce pollution.

The CAAA required a minimum 2% oxygen by weight standard in RFG. To meet the oxygenate requirements, petroleum refiners are permitted to blend into gasoline a number of oxygenates, including (1) MTBE; (2) ethanol; (3) ethyl tertiary-butyl ether ("ETBE"); or (4) tertiary amyl methyl ether ("TAME").

The former head of the United States Environmental Protection Agency ("EPA"), Carol Browner, called the RFG program "the most successful air pollution reduction program since the phase-out of lead in gasoline,"[3] and MTBE is at the heart of the RFG program. In 1997, the California Environmental Protection Agency concluded:

> 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 the unique combination of price and supply, gasoline blending, and transportation properties . . . . Last year, the Cleaner Burning Gasoline program was largely responsible for the 18 percent improvement in ozone levels in Southern California and the 10 percent improvement in ozone levels in the Bay Area and Sacramento.

California E.P.A. Briefing Paper on MTBE, April 24, 1997 at 1, 4, 7. ("Cal.EPA MTBE Paper").

Most authorities do not consider MTBE to be a carcinogen. A European Commission Working Group concluded that "the suspicion that MTBE can cause cancer was not sufficiently founded by the available data." *Draft Summary Record, Meeting of the Commission Working*

[3] *MTBE Imports Affect U.S. Energy Security*, 145 Cong. Rec. S4105 (Apr. 22, 1999) (testimony of Sen. Thomas Daschle) (quotation omitted).

Group on the Classification & Labeling of Dangerous Substances, ECB Ispra, Nov. 15-17, 2000, No. ECBI/76/00, Jan. 8, 2001, at 22. Similarly, "The World Health Organization found that MTBE is not classifiable as a human carcinogen and California's Proposition-65 regulations do not list MTBE as a human carcinogen, developmental toxic, or reproductive toxin. Additionally, the National Toxicology Program did not list MTBE as a carcinogen in its Ninth report to the U.S. Congress." J. Ferguson, *California's MTBE Contaminated Water: An Illustration of the Need for An Environmental Interpretative Note on Article 1110 of NAFTA*, 11 Colo. J. Int'l Envtl. L. & Pol'y 499, 509 (2000) (footnotes omitted).

MTBE is not a risk to human health. According to the California EPA, numerous studies have been conducted by organizations such as Yale University, the Center for Disease Control, the U.S. EPA, and various state health agencies. *See* Cal.EPA MTBE Paper, at 9-10. But "there is no evidence that MTBE at ambient concentrations causes acute health effects." *Id.* In fact, MTBE has actually been extensively used as a medicine for humans. *See* European Union *MTBE Risk Assessment*, CAS-No. 1634-04.4, Draft, Jan. 20, 2001, at 19.

In short, MTBE is a safe, effective, and economical component of gasoline, and an extraordinarily valuable element in the most successful air pollution reduction program of recent years.

3. Ethanol and the U.S. Ethanol Industry

a. Ethanol is A Heavily Subsidized and Protected U.S. Product

Ethanol is a fuel and an oxygenate that directly competes with MTBE. It is usually manufactured from various biomass feedstocks, primarily corn. Because ethanol is so expensive to produce, 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 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." [4] Mark Ivey and Ronald Grover, *Alcohol Fuels Move Off the Backburner*, Business Week, June 29, 1987 at 100. In a May 22, 1990 article, the Washington Post noted: "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." *A Kinder, Fitter President*, The Washington Post, May 22, 1990, at Z11.

The U.S. ethanol industry cannot survive without U.S. government assistance. "According 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, *Tax Policy - Effects of the Alcohol Fuels Tax Incentives*, Mar. 13, 1997.[5]

The purpose of the subsidies is simply to protect the U.S. ethanol and farming industries: "[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). The U.S. ethanol industry is heavily protected from foreign competition. On May 14, 1998, Iowa Senator Charles Grassley wrote a letter to President Clinton, stating that he "was absolutely stunned" to learn that Vice President Gore had agreed to allow 4 billion liters of Brazilian ethanol into the United States by the end of 1999. Letter from Senator Grassley to President Clinton, May 14, 1998. Senator

[4] The subsidy per gallon has since been reduced to 54¢ per gallon.

[5] The United States General Accounting Office ("GAO") is an investigative arm of Congress that examines the use of public funds.

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.

The U.S. ethanol industry has a powerful political lobby that is constantly seeking legislation and other measures granting ethanol higher subsidies and better protection from competition by other fuels and oxygenates. Despite the fact that "[e]thanol is not the cleanest of alternative fuels, . . . it does have the best-organized lobbying machine behind it." *You Say Ethanol, I Say Methanol*, The Washington Times, Dec. 16, 1993, Commentary, at A20. The Washington Times, commenting on the ethanol industry's lobbying power, stated: "[E]nvironmental regulation is not necessarily about improving the environment. Big businesses have big stakes in how rules and regulations get written, and they are willing to call in all their political chits to pressure regulators and ultimately the politicians who control them." *Id.* Other critics have concluded that "the ethanol industry is trying to win through political muscle what it hasn't been able to prove through clean air studies." Tim Landis and Judith Barra Austin, *Commercial News*, Gannett News Service, Sept. 23, 1993.

Campaign contributions are a central element of the ethanol industry's lobbying program. "Ethanol producers must heavily bankroll politicians because their product would otherwise vanish overnight from the nation's gas pumps." John Bovard, *Corporate Welfare Fueled by Political Contributions*, Business and Society Review, June 22, 1995, No. 94, at 22. According to a report by Common Cause, a U.S. "public interest" group, the tax subsidy "escaped its latest brush with death largely on the bountiful political giving by ADM the nation's largest ethanol producer." Ben White, *ADM's Largess Preserved Ethanol Break, Study Says: Common Cause Cites Firm's Political Giving*, The Washington Post, June 11, 1998, A21.

b. Ethanol Is Not A Superior Oxygenate

Despite its protected political status, using ethanol as a gasoline oxygenate may be environmentally harmful, and is not energy-efficient:

> United States data do not clearly support ethanol as a clean-burning fuel. The environmental case for ethanol is further eroded when the environmental effects of its production are considered. Corn is an energy-intensive crop to grow and transform into alcohol. Vogel notes that the production of ethanol may actually consume more energy than it generates, making it an energy-inefficient choice.

J. Soloway, *supra*, at 93 (citing David Vogel, *Trouble for Us and Trouble for Them: Social Regulations as Trade Barriers, in Comparative Disadvantages? Social Regulations and the Global Economy* 111-13 (Pietro S. Nivola, ed., 1997)). Further,

> Vogel notes that ethanol is not clearly more environmentally friendly than its alternatives. One study undertaken by the National Academy of Sciences in the United States found that "while [ethanol blends] would reduce carbon monoxide emissions by 25 percent, *hydrocarbons would increase by as much as 50 percent and nitrogen oxide by 15 percent" and that "[e]thanol may also contribute to ozone pollution (smog) because it evaporates relatively quickly*." The study concluded that "using ethanol as a blending agent in gasoline . . . *would not achieve significant air-quality benefits and, in fact, would likely to be [sic] detrimental*."

Id. at 72; *see also* J. Lieber, *Rats in the Grain The Dirty Tricks and Trials of Archer Daniels Midland* 98 (Four Walls Eight Windows 2000) (noting that numerous governmental agencies had questioned the use of ethanol, including the Department of Energy, which "saw no environmental benefit" from ethanol).[6]

Moreover, ethanol may be harmful to human health. Utah Senator Robert Bennett has stated that "because ethanol is highly soluble, it takes the most toxic parts of gasoline, including cancer-causing benzene, and spreads it in water." S. Rep. No. 106-426, at 92 (2000) (Minority Views of Sen. Robert F. Bennett, Dissenting Views on S. 2962, The Federal Reformulated Fuels Act of 2000). Janet Williams, director of communications for the American Lung Association, has stated: "The economic studies [of ethanol] are all one-sided arguments purporting to show how good this is for corn growers," but the studies do not mention, "the increased cost of smog control resulting from ethanol-based fuels and the health threats to the health of the one in 10 urban residents who have respiratory problems." Landis & Austin, *supra*.

And ethanol is, in contrast to MTBE, a carcinogen. "[B]ecause ethanol has been listed as a carcinogen by the World Health Organization, the State of California, and the National Toxics Program, it is of greater public health concern than MTBE." S. Rep. No. 106-426, at 92 (Minority Views of Senator Robert F. Bennett, Dissenting Views on S. 2962, The Federal Reformulated Fuels Act of 2000). The UC Report identified increased cancer rates as a likely consequence of substituting ethanol for MTBE. UC Report Vol. I, An Integral Cost-Benefit Analysis of Gasoline Formulations Meeting California Phase II Reformulated Gasoline Requirements *found in* Risk Assessment, Exposure Assessment, Water Treatment Cost-Benefit Analysis, Nov. 1998, at 8-9.

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[6] *Cf*. B.D. McNutt & Thom White, *No Free Lunch – Understanding ALL Impacts of an MTBE Ban*, Presented at Clean Fuels 2001 Conference, Jan. 30-Feb. 1, 2001, at 18 (noting that in 2001, an analysis prepared by a U.S. Department of Energy employee concluded that an MTBE ban would result in "increased refinery fuel/power/pollutant emissions.")

c. Archer-Daniels-Midland Is The Primary Beneficiary Of Ethanol Subsidies

ADM produces more than 70% of U.S. ethanol, and thus "is the largest beneficiary" of the federal tax subsidies for ethanol. *Ethanol Not Doing Job*, Chicago Daily Herald, June 25, 2000, at 16. John Bovard, a political analyst for the CATO Institute, described ADM as "the most prominent recipient of corporate welfare in recent U.S. history." Bovard, *supra*, at 22. And James Lieber, in his book *Rats in the Grain*, stated that "about 43 percent of ADM's profits came from subsidized products," and that "ADM had become the number one recipient of corporate welfare" in the 1990s. Lieber, *supra*, at 99. Indeed, "[e]ach dollar of ADM profit from ethanol costs taxpayers thirty dollars" as a result of the subsidy. *Id.* at 96.

4. Because Ethanol Cannot Compete With MTBE in the Free Market, ADM Has Led A Public Attack On Methanol and MTBE

For most purposes, ADM *is* the U.S. ethanol industry. ADM has been described as "the agri-business Goliath which dominates the domestic ethanol industry." *Ethanol's Benefits are Suspect, Fail to Withstand Close Scrutiny*, The Oil Daily, July 20, 1987, at 8. "There's no industry in the world that's so dominated by one company." Michael J. Weiss, *The High Octane Ethanol Lobby*, The New York Times, Apr. 1, 1990, § 6, (Business World Magazine), at 19 (quotation omitted).

ADM is the primary force that drives the ethanol industry's political and lobbying machine. ADM is "a potent lobbying force, [whose] advocates on Capitol Hill include a dozen or more powerful Midwestern representatives and senators." *See* Ivey and Grover, *supra*, Business Week, June 29, 1987 at 100. One reason why the ethanol industry "enjoys the support of Midwestern lawmakers" is because it "has a powerful backer in Dwayne Andreas, whose Archer-Daniels-Midland, an Illinois-based agribusiness giant, dominates the industry." *A Kinder, Fitter President*, *supra*.

ADM has launched a systematic political attack on both MTBE and methanol, and the purpose of this lobbying campaign is simple: remove MTBE from the market so that ethanol can take its place.[7] To this end, ADM has for years advanced two consistent themes: (1) methanol and MTBE are foreign products, and any increased use of MTBE increases U.S. reliance on energy imports; and (2) methanol and MTBE are health hazards.

a. MTBE and Methanol Have Been Characterized as "Foreign" Products

Representatives of ADM have long stressed the "foreign" origins of methanol. In an interview with Lou Dobbs on *Moneyline* on May 12, 1992, 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 the Middle East versus Middle West.

Moneyline: *Inflation Figures Look Promising Say Economists* (CNN television broadcast, Transcript # 644, May 12, 1992). Dwayne Andreas has publicly declared: "This is the Midwest versus the Middle East." *See* Bovard, *supra*, at 22. On other occasions, Andreas has been quoted as declaring: "It's corn farmers vs. the oil companies." David Greising and Peter Hong, *Big Stink on the Farm*, Business Week, July 20, 1992, No. 3275, at 31 (quotation omitted).

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

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[7] *See, e.g.*, Testimony of Eric Vaugh, President & CEO of the Renewable Fuels Association, an ethanol organization funded by ADM, before the Senate Agriculture, Nutrition & Forrestry Committee, July 20, 2000, at 6, *available at* http://www.ethanolfra.org/0720tst.html. ("The Renewable Fuels Association is currently working with the Senate Environment and Public Works Committee on a . . . comprehensive legislative package to reduce the use of MTBE and increase the use of ethanol across the country.").

methanol will necessarily be produced from offshore gas . . . ." Andrew Wood, *Renewed Fuss Over Renewable Fuel*, Chemical Week, Feb. 14, 1990, at 56 (quotation omitted). 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 MTBE as a non-U.S. product, describing MTBE as the "oil companies' oxygenate," which is made from methanol, a "mostly imported" product. Raymond G. Friend, *Politics and Ethanol*, Oil & Gas Journal, Nov. 13, 1995, at 12. A Fuels for the Future news release,[8] dated May 16, 1994, described methanol as a "petroleum-based product imported mainly from the Middle East" and noted that MTBE was "produced in oil refineries from the chemical feedstock methanol." Fuels for the Future Press Release, May 16, 1994 at 1.

The Renewable Fuels Association ("RFA"), an organization supporting ethanol and funded by ADM, has repeatedly emphasized that "MTBE is primarily imported from the Middle East while ethanol is grown right here in . . . the United States from corn, a renewable, environmental friendly commodity." RFA, Ethanol vs. MTBE In Reformulated Gasoline (Speaking Points) (Feb. 11, 1998). Eric Vaughn, the President and CEO of the RFA, stated in testimony before a U.S. Senate committee that ethanol production "[n]ot only . . . help[s] America's farmers and our rural communities, it increases energy independence and security, and improves our environment. Today, we are more reliant than ever before on OPEC and rogue nations to supply our insatiable and growing appetite for oil." Testimony of Eric Vaughn before

[8] "Fuels for the Future 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." The Globe & Mail, (Toronto) July 12, 1994.

the Senate Agriculture, Nutrition and Forestry Committee, July 20, 2000, at 1, *available at* http://www.ethanolfra.org/0720tst.html.

Similarly, on April 18, 1997, Mr. Vaughn claimed: "More than 70 percent of MTBE imports in 1996 were from the Middle East and other OPEC countries, reflecting a growing dependence on OPEC." *See Energy: U.S. Depending More on Middle East For MTBE Supplies*, OPECNA News Service, Apr. 18, 1997 (quotation omitted). Bob Dineen, Legislative Director of the RFA, testified before the U.S. International Trade Commission ("ITC") that "[i]n the absence of such precipitous MTBE import level, the domestic ethanol industry would have been able to double in size – creating more domestic jobs, providing increased rural economic development and further enhancing our balance of trade." 145 Cong. Rec., S4105, 4106.

The ADM campaign to focus attention on the foreign sources of methanol and MTBE has succeeded, for numerous officials at all levels of the U.S. government have characterized methanol as a predominantly non-U.S. substance, and believe that the use of MTBE will increase reliance on imports. In contrast, ethanol is regularly described as a domestic U.S. product whose increased use will protect national security.

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. Jim Nussle, *Help Fuel Independence*, USA Today, June 19, 1997, editorial page. In support of extending tax subsidies, which were scheduled to end in 2000, Mr. 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.* The Alcohol Fuels Caucus has noted: "The use of ethanol also lessens our dependence on foreign nations for our oil supply, which improves national security . . . . Using ethanol decreases the demand for imported oil and methyl tertiary butyl ether (MTBE) by 98,000 barrels a day." *Congressional Alcohol Fuels Caucus Members Ask President to Include Ethanol Program Extension in Budget Message*, PR NewsWire, Jan. 29, 1998 (quotation omitted).

Senator Charles Grassley has attacked methanol-based MTBE as a foreign product. During a debate in the Senate on the ethanol tax credit, Senator Grassley urged his fellow colleagues to "join us . . . in defending one of our Nation's bright spots in our long battle to reduce our dependence upon foreign energy." 144 Cong. Rec. S1754 (March 11, 1998). In an effort to rally support, Senator Grassley stated:

> A few months ago, four of our nation's top national security experts wrote to congressional leaders calling for increased support for ethanol. They warned, and I quote:
>
> > ''The domestic ethanol industry provides fuels that reduce imports . . . We implore Congress of the United States to continue and indeed strengthen tax incentives for the ethanol industry.
> >
> > To do otherwise would threaten America's national and economic security, weaken its plans to improve the environment and relinquish U.S. world-wide leadership in the biofuels area."
>
> This letter was signed by: General Lee Butler USAF (Ret.) Former Commander, Strategic Air Command, Desert Storm; R. James Woolsey, Former Director of the CIA; Robert McFarland, Former National Security Advisor to the President; and Admiral Thomas Moorer USN (Ret.), Former Chairman, Joint Chiefs of Staff.
>
> Mr. President, by using ethanol, Americans reduce by 98,000 barrels a day, the amount of oil and MTBE that must be imported.

144 Cong. Rec. S1755 (statement of Sen. Grassley).

In 1992, Senator Thomas Daschle introduced 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." *See* Derek J. Caney, *Ethanol Capacity to be Put on Hold*, Chemical Marketing Reporter, Mar. 16, 1992, Vol. 241, No. 11, at 3. Similarly, former Senator 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* Douglas Frantz, *Dole and Ethanol Industry Count on Each Other*, The New York Times, Apr. 16, 1996, at A1.

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. S6670-02, S6690 (daily ed. June 27, 1997) (statement of Sen. Johnson). Speaking in support of ethanol at another hearing on the ethanol tax credit, former Senator Carol Mosely-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. Mosley-Braun).

On April 22, 1999, Senator Daschle noted that one of the objectives of Congress in enacting the reformulated gasoline program was to stimulate investment in domestic ethanol plants, and added:

> A major impediment to full realization of the potential of the RFG program has been the importation of massive volumes of MTBE, much of it subsidized by the Saudi Arabian government, into the United States. Domestic ethanol and MTBE producers have been harmed, and American plants have not been built, largely due to the influx of subsidized product from offshore that makes potential investors unwilling to commit capital to U.S. ethanol and ether plants.

145 Cong. Rec. S4105 (statement of Sen. Daschle).

The U.S. Department of Energy has criticized the increasing use of MTBE and methanol. In March, 1997, the Department criticized a draft GAO report (GGD-97-41, March 6, 1997) for failing to "note that if MTBE were to replace ethanol as an oxygenate, the additional MTBE would likely come almost entirely from foreign sources . . . [which] could reduce U.S. energy security by increasing the percentage of oxygenates that is imported." GAO Report, *supra*. Another report for the U.S. Department of Energy also criticized the increase in imports of MTBE and of methanol used in the production of domestic MTBE, stating that a "rapidly growing part of the trade deficit in energy resources is the import of [MTBE]." *See* Energetics Incorporated, *Fuel Ethanol "Special Studies," Trade Deficit Analysis: Petroleum and Fuel Ethanol*, at 1, *available at* http://rredc.nrel.gov/biomass/doe/rbep/ethanol/five.html (visited Nov. 2, 2000).

Numerous state governors have emphasized the Midwest v. 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." Judith Barra Austin, *Edgar: EPA Plan Would Threaten Future of Ethanol*, Gannett News Service, Apr. 29, 1992. Similarly, the goal of the Governors Ethanol Coalition ("GEC"), a 24-member group of United States Governors, is to "increase the use of ethanol based fuels, to decrease the nation's dependence on imported energy sources, improve the environment[,] and stimulate the national economy." GEC, *The Coalition's Goals*, *at* http://www.ethanol-gec.org/coalgoal.htm (visited Jan. 11, 2000).

California State Senator Tom Hayden has repeated ADM's themes. During a special appearance at a California Assembly Natural Resources Committee hearing on the use of ethanol as an alternative to MTBE, Senator Hayden stated: "I've always wished for a source of fuel from the Midwest, not the Middle East." Mary Moore, *Safety of gasoline additives debated at SM meeting*, The Outlook, Nov. 22, 1997, A6 (quotation omitted).

"Public interest" groups – the same interests that oppose the WTO and "globalization" – 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. Citizen Action went on to criticize the United States' increasing dependence on imported methanol:

> Because of the CAAA [Clean Air Act Amendments], the demand for MTBE and methanol have 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 foreign countries (primarily because of access to very low cost natural gas resources), the United States is importing an increasing amount of methanol
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> . . . .
>
> 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.

These statements, by organizations and public officials supported by ADM, reflect the great success of ADM's efforts to paint methanol and MTBE as undesirable "foreign" products. It would be extraordinary if ADM, during its secret meeting with Governor Davis, did not emphasize to him what it has stated publicly on numerous occasions – that methanol and MTBE are "foreign" products, and that banning MTBE would be a patriotic step to reduce U.S. independence on foreign fuels.

b. Methanol and MTBE Have Been Portrayed As Dangerous, Environmentally Unsafe Products

ADM and ethanol supporters have also sought to undercut the environmental advantages of MTBE with a sophisticated program of "health scares." In the May 1992 *Moneyline* interview with Lou Dobbs, Dwayne Andreas said: "Ethanol, as I have said, is pure grain alcohol . . . This other product, methanol, is what - to describe it - it used to be called wood alcohol. Now it's made out of - it's gas, or coal." When Dobbs interjected that it was "[p]otentially lethal," Andreas responded: "yes, it's lethal, it's poison. . . ." *Moneyline*, *supra*.

ADM and its allies have misquoted scientists in an effort to discredit MTBE, issuing "unfounded reports . . . that the American Medical Association (AMA) had called for a nationwide MTBE moratorium":

> Reports of the so-called moratorium were generated by a press release sent to major news organizations by a Washington, D.C.-based ethanol information group called Fuels for the Future. The press release, which trumpeted the moratorium in its lead paragraph, was the basis for stories on two major Wall Street news services. Fuels for the Future, however, painted a misleading picture of the AMA's action . . . Knight-Ridder and Bloomberg officials complained that the Fuels for the Future press release looked as if it were issued by the AMA.

False MTBE Moratorium Report Wreaks Havoc for Methanol Industry, New Fuels Report (July 18, 1994).

ADM and its allies also mounted an advertising campaign "proclaiming the virtues of ethanol and warning darkly of risks from competing alternatives such as methanol." Peter H. Stone, *The Big Harvest*, The National Journal, July 30, 1994, Vol. 26, No. 31, at 1790. It has been reported that complaints about MTBE "triggered about $2 million worth of studies, none of which established a significant link between MTBE and either health or engine troubles." Mark Emond, *What Changes Are Coming for RFG? Reformulated Gasoline*, National Petroleum News, Mar. 1998, No. 3, Vol. 90, at 36.

5. Political Contributions and Lobbying Are the Foundation of ADM's Business Strategy

ADM does not believe in a free market system. In 1995, 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. John Bovard of the CATO Institute, a political think-tank, has said that "ADM champions political control over markets . . . . [Dwayne] Andreas has exerted his influence in Washington [D.C.] to ensure that the U.S. form of 'socialism' resembles 1930's Italian corporate statism: the government plunders the citizenry for the benefit of politically connected corporations." *Id.* "Political contributions have long been a central part of [former ADM chairman Dwayne] Andreas' modus operandi." Stone, *supra*, at 1790.

ADM's contributions are not motivated by any principled 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." Ann McBride, *Where Soft Money Hits Taxpayers Hard*, The Palm Beach Post, July 26, 1998, at 1E.

ADM's lobbying and political contributions have been the prime mover in creating the heavily protected ethanol industry:

> ADM has used big money over the years to ingratiate themselves and protect the ethanol subsidy. Over a 10-year period ADM gave $2.2 million of soft money to the Republicans and $1 million soft money to the Democrats. ADM also gave direct political action committee contributions to congressional candidates over 10 years: $700,000 to Democrats and $500,000 to Republicans.[9]

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[9] 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 has 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).

Ethanol Not Doing Job, Chicago Daily Herald, June 25, 2000, at 16. In return, according to the CATO Institute's John Bovard, ADM has "reaped billion-dollar windfalls from taxpayers and consumers." Bovard, *supra*, at 22.

Public officials have repeatedly and explicitly adopted ADM's program, supporting a ban on MTBE in order to increase U.S. ethanol production. For example, Lamar Alexander, a 1996 presidential candidate,

> called for a federal ban on MTBE on June 22 and challenged his fellow presidential candidates to do the same. Urging them to "stop giving lip service to ethanol," Alexander pledged to make ethanol a key campaign issue. Alexander said the government should ban MTBE, an oil-based fuel additive believed to contaminate groundwater, and promote the use of corn-based ethanol – a move he said would protect the environment and boost corn prices.

MTBE: *Alexander Calls for Ban on Additive*, Nat'l J.'s Daily Energy Briefing, June 25, 1999.

Political manipulation is not the only tactic ADM has engaged in to control the market. It routinely uses other organizations to disguise its support while advancing its views. For example, an ADM consultant, Bob O'Rourke, 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 he "felt ethanol was in jeopardy." *MTBE Public Relations War Gets New Twist in New Jersey*, Octane Week, Aug. 5, 1996, Vol. 11, No. 32. "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

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See Frank Greve, Knight-Ridder News Service, *Power of political giving: Grain magnate reaps favors*, The Denver Post, Jan. 22, 1995, at A-16.

public-relations consultant who works for the ethanol industry." Nancy Phillips, *Man linked to ethanol firm aided group that opposed rival method*, The Philadelphia Inquirer, July 30, 1996.

ADM has even engaged in criminal activity to pursue its interests. In October 1996, after a four-year criminal investigation into ADM's business practices, ADM 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*, The Financial Times (London), Oct. 15, 1996, at 1. As a result of that investigation, three of ADM's senior executives, including Michael Andreas, Dwayne Andreas' son, were convicted of price-fixing and sentenced to prison. On appeal, on June 26, 2000, the U.S. Court of Appeals for the Seventh Circuit not only affirmed the convictions, but, in an extraordinary act, it 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 at 650.

B. California's Drinking Water Problem: Leaking Underground Storage Tanks and Recreational Watercraft

California's drinking water problem is principally caused by leaking underground storage tanks ("UST"), and the obvious and reasonable solution is not to ban MTBE, but to stop the leaks. Stopping the leaks will not only keep out MTBE, but will keep the water safe from all hazardous substances associated with gasoline, such as ethanol, benzene, toluene, xylene, and ethylbenzene.

There is no doubt that the primary cause of MTBE in drinking water is leaking tanks. The United States EPA Blue Ribbon Panel Report noted that "[u]nderground storage tanks represent the largest population of potential point sources of gasoline releases to ground water." *Achieving Clean Air and Clean Water: The Report of the Blue Ribbon Panel on Oxygenates in Gasoline*, Sept. 15, 1999, at 49 (citation omitted). The University of California Report ("UC Report"), relied upon by Governor Davis in his initial action to ban MTBE (discussed in detail below), noted that "[b]ecause the [leaking underground fuel tanks] are so numerous and handle such a large volume of product, they clearly pose the most serious threat to groundwater." UC Report, Vol. I, Summary & Recommendations, at 31.

Fixing the leaking tanks would largely eliminate the MTBE problem. According to calculations in the UC Report, upgrading underground storage tanks would reduce gasoline leaks into groundwater by up to 97%. *See id.*, Vol. IV, *Leaking Underground Storage Tanks (USTs) as Point Sources of MTBE to Groundwater and Related MTBE-UST Compatibility Issues*, at 2. Similarly, the California EPA concluded in 1997 that "[u]pon completion of the [tank upgrades] program, the leaking gasoline components, including MTBE, into soil and ground water should be minimal." Cal.EPA MTBE Paper, at 17.

Leaking tanks are already illegal under U.S. and California law. The express purpose of the California Underground Storage Tank Regulations ("UST Regulations") is "to protect waters of the state from discharges of hazardous substances [defined to include gasoline] from underground storage tanks." Cal. Code Reg., tit. 23, § 2620.

California and federal law both established a deadline of December 22, 1998, to remove, replace or upgrade USTs that do not meet state and federal standards. California Auditor Report to the Governor at 9 (Dec. 17, 1998). After January 1, 1999, tank owners that had not upgraded their USTs to acceptable standards were prohibited from receiving petroleum products. *See id.* But according to the California Auditor, as of September 30, 1998, only 18.5% of regulated USTs had been issued upgrade certificates. *See id.*

The California Auditor criticized state officials for failing to take adequate steps to protect California groundwater and for not promptly addressing contamination resulting from leaking USTs. "The State of California has missed opportunities to aggressively address the problem of gasoline contamination [in] our drinking water even though the State has had sufficient evidence that leaking storage tanks and gasoline additives pose a major threat to California's groundwater." Auditor's Report at 15. The Auditor's Report also criticized state officials for failing to properly enforce the UST regulations: "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." *Id.* at 2.

At least one environmental organization, the Environmental Working Group, has similarly condemned California's lax enforcement of UST regulations. Environmental Working Group, *Uncontrolled LUSTS* (2000), *available at* http://www.ewg.org.

> California regulators have failed to order cleanup or take other legally binding enforcement action on more than 90 percent of the thousands of underground fuel storage tanks known to be leaking toxic chemicals into water and soil throughout the state, although many of the leaks were first reported more than 10 years ago . . . . Even when cleanup was ordered, regulators almost never fined even the biggest polluters . . . . no enforcement action was taken in more than 80 percent of the cases. *Id.* at 1.
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> [T]he state's entire regulatory system for underground storage tanks [is] seriously flawed. Not only is enforcement abysmal once leaks are reported, there is virtually no effective monitoring to detect leaks before they threaten water supplies . . . a UC Davis water expert testified that California's efforts to assess toxic threats to groundwater "lag far behind those of other states." *Id.*

> The state continues to respond reactively, waiting for problems instead of heading them off. Gov. Davis has ordered a phaseout by the end of 2002 of the gasoline additive MTBE . . . . But the great majority of leaking tanks, containing an array of known carcinogens and other toxic chemicals that could pose a greater threat than MTBE, go on polluting water and soil without action by the state water board, regional water boards or state health department. *Id.* at 2.
>
> Unless state regulators take aggressive steps to identify and contain all leaks, adopt a comprehensive and reliable monitoring program to catch leaks before they spread to water supplies, act swiftly to order cleanup of contaminated sites, practice rigorous enforcement to deter future contamination, and hold the producers of the contaminants responsible, the threat from California's leaking underground storage tanks will grow worse. *Id.*
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> The lack of enforcement was again blasted in a 1999 report by the [California] Joint Legislative Audit Committee. A private water engineer who has worked on many site cleanups attributed the lax enforcement to the politically-motivated unwillingness of both the Wilson and Davis administrations to crack down on major oil companies. *Id.* at 12.
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> This widespread failure to enforce the law has delayed cleanups, let most violators off the hook, exacerbated groundwater pollution, and worst of all, led to a regulatory environment that has utterly failed to deter polluters . . . . The widespread contamination of California groundwater by MTBE and other chemicals was not accidental but foreseeable and preventable. *Id.* at 15.

A secondary source of MTBE in drinking water is the use on reservoirs of jet-skis and other gasoline-powered boats. Such craft often use inefficient two-stroke marine engines that emit up to 30% of their fuel unburnt in their exhaust. *See* Barbara Barte Osborn, *Truckee Awaits Water Test Results*, Sacramento Bee, June 19, 1999, Metro, at B4. Such gasoline and MTBE contamination can be easily prevented by controlling the use of such engines. A ban on two-stroke engines on Lake Tahoe instituted by the Tahoe Regional Planning Agency in June 1999 resulted in a 95% reduction in the mean levels of MTBE. *Tahoe Gas Pollution Declines Sharply*, The San Francisco Chronicle, Dec. 6, 1999, at A10.

Methanex believes that gasoline and all its components, whether MTBE, ethanol, ETBE, or benzene, should at all times be appropriately contained and controlled. It believes that existing UST laws and regulations should be rigorously enforced, and that all leaking tanks should be cleaned up. However, in situations where leaks have occurred, MTBE could be construed as serving a useful purpose because it gives early warning of leaking tanks. When gasoline containing MTBE is discharged into the environment, some of the MTBE may dissolve into the surrounding groundwater. An MTBE plume in groundwater often travels faster than other gasoline components in the environment, and is more readily apparent as it has a characteristic taste and smell that is detectable at extremely low threshold levels. MTBE in water is thus an early indicator of gasoline leaks.

C. Leaking Gasoline Tanks Presented ADM With An Opportunity to Eliminate Competition from MTBE and Methanol

In the mid-1990's, trace amounts of MTBE began to appear in some sources of California's drinking water. The problem was not widespread. As the California EPA concluded:

> MTBE has not significantly impacted California surface drinking water resources, since when MTBE is present, concentrations are typically five to 10 times below the United States Environmental Protection Agency (U.S. EPA) draft health advisory limits.

Cal.EPA MTBE Paper at 1. The UC Report stated: "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. 4, Impact of MTBE on California Groundwater *found in* Ground & Surface Water, Nov. 1998, at 62.

Despite the generally isolated nature of the problem, ADM saw California's contaminated groundwater as a golden opportunity to eliminate competition. It enabled ADM to use its favorite competitive methods – misleading publicity and massive political contributions –

to eliminate its competition. The plan was simple: exaggerate the problem and, through the use of misinformation and hundreds of thousands of dollars of campaign contributions, influence state officials,[10] particularly the soon-to-be-governor, to eliminate MTBE as an oxygenate competitor. As a result of ADM's years of publicly characterizing MTBE and methanol as dangerous foreign products, California officials were already receptive to ADM's tactics.

California's response to the problem of gasoline leakage was to enact legislation which, rather than address the lack of UST regulatory enforcement, set in motion a process to ban the use of MTBE in gasoline. Put another way, rather than cure the *problem* of leaking USTs, California took punitive action against one of the *symptoms* of leaking USTs, the easily-identifiable MTBE. On February 24, 1997, Bill 521 was introduced in the California Senate, and an amended version was passed on October 9, 1997. Bill 521 called for the appropriation of $500,000 to the University of California to conduct a "thorough and objective" and "academically sound" study and assessment of the human health and environmental risks and benefits, if any, associated with the use of MTBE. Bill 521 also required a comparative study of the risks and benefits of MTBE's competitors – ethanol, ETBE, and TAME.

On June 2, 1998 (after Senate Bill 521 had been enacted but before the UC study was finished), ADM made a $5,000 contribution to the Gray Davis California gubernatorial campaign. Two months later, on August 4, 1998, in the middle of his California campaign, the soon-to-be Governor left California and went to Chicago, and then on to Decatur, Illinois, where

[10] In addition to the contributions to the Governor Davis, ADM has made significant contributions to a number of other state officials important to MTBE policies, including the President of the California Senate and the current state Attorney General.

ADM's headquarters are located, to meet secretly with officials of ADM. Governor Davis flew to and from the meeting on ADM's corporate plane.[11]

Two weeks after the meeting, on August 19, 1998, the Governor received a contribution of $100,000 from ADM. Within the next four months, the Governor received another $55,000 in contributions from ADM. Seven months after his initial meeting with ADM officials, the Governor issued the executive order banning MTBE. 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. This put ADM in the top 1% of Davis' contributors – in a state where, at the time, ADM evidently had minimal business interests.

In addition, the Governor received campaign contributions from ADM allies, including Regent International, a California-based ethanol company. Regent International and its Chairman and CEO, Richard Vind, contributed over $7,000 to the Governor's gubernatorial campaign.

On November 12, 1998, the UC Report was completed and submitted to the Governor. Six weeks later, on December 24, 1998, peer reviews were completed. Public hearings were conducted on February 19, 23, 24, 1999. The public was also permitted until March 17, 1999, to submit written comments on the use of MTBE.

The UC Report failed in significant ways to meet the requirements specified in Senate Bill 521. Particularly, the Report: (1) failed to do a proper risk characterization and failed to complete the mandated comparison of the risks of MTBE use with the risks posed by other oxygenates having a similar chemical environmental behavior; (2) was substantially

[11] Searches of public record sources have revealed no references to Governor Davis'

underfunded, used an extraordinarily limited database, and relied on broad assumptions to determine the scope of the MTBE issue; (3) contained a badly flawed exposure assessment and cost/benefit analysis; and (4) failed to adequately discuss alternative solutions and remediation, and in particular the costs and benefits of rapidly repairing the leaking gasoline tanks. As a result, the UC Report reached unfounded conclusions and offered unjustifiable recommendations.

After receiving the UC Report, Bill 521 required the Governor to issue a certification stating one of two conclusions: (1) on balance there was no significant risk, or (2) on balance there was significant risk to human health or the environment in using MTBE in gasoline. If he found significant risk to health or to the environment, the Governor was to take "appropriate action." On March 25, 1999, the Governor issued Executive Order D-5-99, in which he concluded "while MTBE has provided California with clean air benefits, because of leaking underground fuel storage tanks MTBE poses an environmental threat to groundwater and drinking water . . . . [O]n balance, there is a significant risk to the environment from using MTBE in gasoline in California." Exec. Order at Preamble. Thus, the Executive Order did not conclude that MTBE posed any threat to human health, but only "to the environment."

Governor Davis decided that the "appropriate action" was to ban MTBE in California after 2002. "The California Energy Commission (CEC), in consultation with the California Air Resources Board, *shall develop* a timetable by July 1, 1999 for the removal of MTBE from gasoline at the earliest possible date, but not later than December 31, 2002." Exec. Order D-5-99 4 (emphasis added). In addition, the Governor's Executive Order requires that all gasoline

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meeting in Decatur, other than an "in kind" contribution of airfare.

containing MTBE be labeled at the gasoline pump; this labeling requirement does not apply to any other oxygenate, such as ethanol. *Id.* 7.

Finally, the California Governor's Executive Order on its face discriminates in favor of the U.S. ethanol industry. In addition to banning MTBE, the order simultaneously began the process of developing an ethanol industry based in California: "The California Energy Commission (CEC) shall evaluate by December 31, 1999 and report to the Governor and the Secretary for Environmental Protection the potential for development of a California waste-based or other biomass ethanol industry. CEC shall evaluate what steps, if any, would be appropriate to foster waste-based or other biomass ethanol development in California should ethanol be found to be an acceptable substitute for MTBE." *Id.* 11.[12]

On December 16, 1999, regulations implementing the Governor's labeling requirement went into effect. *See* Cal. Code Regs. tit. 13, § 2273. These regulations require that gasoline pumps containing MTBE be labeled as follows: "Contains MTBE. The State of California has determined that the use of this chemical presents a significant risk to the environment." *Id.* § 2273(a)(1) (quotation omitted).

Likewise, on September 2, 2000, regulations adopted by the California Air Resources Board ("CARB") pursuant to the Governor's Executive Order went into effect. See Cal. Code Regs. tit. 13, § 2260, *et seq.* ("CaRFG3 Regulations"). These regulations implement the Executive Order by prohibiting the use of MTBE in California gasoline and facilitating the removal of MTBE prior to Dec. 31, 2002. *See* CaRFG3 § 2261(b)(3) (providing for "Early

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[12] Still more evidence that the bans on MTBE are generally intended to discriminate in favor of the protected ethanol industry is the approval last fall by the U.S. Senate Environment and Public Works Committee of a bill that both bans MTBE and explicitly promotes the use of ethanol. Senate Bill 2962 "would require oil refiners to use a certain amount of ethanol and

Compliance with the CaRFG Phase 3 Standards Before December 31, 2002"). These regulations also "prohibit, as of December 31, 2002, the use of any gasoline oxygenate *other than ethanol* unless the California Environmental Policy Council determined, based on an environmental assessment, that the use of that oxygenate would not present a significant risk to public health or the environment." (U.S. Statement of Defense, 95 (emphasis added).)[13]

Once the California ban on MTBE was in place, ADM announced that it would distribute ethanol and build an ethanol facility in California. ADM press release, June 5, 2000; *see also* James Pilcher, *Ethanol industry's future iffy*, Cincinnati Enquirer, July 22, 2000.

Thus, ADM's effort to eliminate its foreign competition and increase its own market share in California, and California's effort to foster an indigenous ethanol industry, have both succeeded. Moreover, the California ban on MTBE has triggered actions in many other U.S. states that have a similar effect of harming MTBE and methanol to the benefit of the U.S. domestic ethanol industry. See, *infra*, Section V. ADM has succeeded in eliminating a competitor that is both less expensive and better for the environment, and replacing it with a domestic product that, if it competed solely on its own merits, would be rapidly eliminated from the marketplace.

D. European Evaluations of MTBE

Other government authorities that have examined the MTBE issue have reached conclusions starkly different from those of California. Those authorities, which include agencies

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other renewable substitutes for gasoline." *Browner Urges Congress to Approve Comprehensive Phaseout of Fuel Additive*, Daily Environment Report, Sept. 11, 2000.

[13] *See* Cal. Envtl. Protection Agency, Air Resources Board, Public Hearing to Consider Amendments to the California Reformulated Gasoline Regulations ("CARB Public Hearing") (Dec. 9, 1999), at 2 (noting that "[t]he originally proposed regulatory language inadvertently failed to reflect staff's intent . . . that the prohibition apply to alcohols other than ethanol . . .").

in Germany and the European Commission, have determined that it is not appropriate or environmentally beneficial to ban MTBE.

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). The German EPA ultimately reached the following conclusions: (1) "MTBE is an important component for the production of gasoline. The use of MTBE leads to a reduction of HC and CO emissions, and benzene and aromatics in gasoline without any loss of quality"; (2) "There 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"; (3) "About 94 % of all gasoline sold in Germany contains MTBE at much lower concentrations than in California"; (4) "Based on the minimum requirements for underground storage tanks (USTs) as well as the relevant regulations, leakage from tanks and pipes is clearly less frequent in Germany than in California"; (5) "Germany [in contrast with the U.S.] has almost completed its nationwide UST renewal and cleanup program"; (6) "The evidence points to the fact that the use of MTBE must be prioritized over the use of benzene and aromatics in gasoline"; and (7) "The German EPA recommended MTBE as a substitution for benzene and aromatics." *Id.*

The European Commission has recently reached 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 Draft Summary Record, supra*, at 20. The EC Working Group did not classify MTBE as a carcinogen, noting that "the suspicion that MTBE can cause cancer was not sufficiently founded by the available data." *Id.* The European Union also has conducted a thorough and extensive risk assessment of MTBE, but did not recommend that it be banned. *See Risk Assessment, MTBE, supra*. Thus, MTBE will continue to be used throughout Europe to reduce air pollution.

IV. THE U.S. MEASURES THAT VIOLATE NAFTA ARTICLES 1102, 1105 AND 1110

California Executive Order D-5-99, which enacted the California ban on MTBE, and the CARB CaRFG3 Regulations, which implemented the ban, are "measures" within the meaning of NAFTA Article 201. These measures have been adopted and maintained by the United States in violation of NAFTA Chapter 11.

California Executive Order D-5-99 ¶ 7, which requires that gasoline pumps containing MTBE be labeled, and the regulations implementing that requirement, as found in California Code of Regulations, tit. 13, § 2273, are also "measures" within the meaning of NAFTA Article 201. These measures have been adopted and maintained by the United States in violation of NAFTA Chapter 11.

California Executive Order D-5-99 ¶ 11, which sets in place a program to develop a California-based ethanol production industry, is a "measure" within the meaning of NAFTA Article 201. This measure has been adopted and maintained by the United States in violation of NAFTA Chapter 11.

V. DAMAGES

The California ban on MTBE has substantially damaged Methanex, its U.S. investments, and its shareholders.

The California 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. In essence, California has 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 will also contribute to the extended closure 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.

The California measures have reduced and will continue to reduce the demand for methanol. MTBE represents approximately 30% of the world demand for methanol, and California MTBE usage alone represents approximately 6% 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. Methanex and its U.S. investments have suffered and will continue to suffer severe losses as a result.

Finally, the state of California is extremely influential when it comes to environmental matters in the United States. Thus, its decision to ban MTBE on environmental grounds established a flawed precedent that has triggered a "ripple effect" that is now being felt across the United States (and indeed, as the European experience seems to illustrate, caused questions about MTBE throughout the world). To the extent that the MTBE bans and restrictions in other U.S. states can be traced to the California measures at issue here, they constitute additional harms to Methanex, its investments, and its shareholders.

The Executive Order caused immediate damage to Methanex, its investments, and its shareholders, and excellent evidence of that damage was the direct and immediate drop in Methanex's market value. The Toronto Stock Exchange ("TSE") is the principal market for

Methanex shares. The day after the issuance of the California Governor's 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 20% less than the average share price in the ten preceding days. That represented a loss in Methanex's market value of approximately C$180,000,000 – a loss that was directly caused by the California measures. This loss was suffered by Methanex, its investments and its shareholders.

Methanex's share price has never recovered from the California measures. Methanex's share price has 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 still tracks the methanol price, it has since traded at a significant discount to the pre-1999 historical correlation.[14]

If the California measures had not been implemented, Methanex would, based on the 1996-99 historic methanol price correlation, be trading at a price of approximately US$10-12. Methanex has thus suffered a permanent drop in market valuation of approximately $1 billion, which is compelling evidence of the permanent damage inflicted by the California measures and subsequent measures in other states. The $1 billion in damages was suffered by both Methanex and its shareholders.

Accordingly, Methanex claims: (a) damages of approximately $1 billion 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,

[14] In mid-1998, Methanex's price was 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.

expert and attorney fees and disbursements, plus any Canadian Goods and Services tax payable thereon; and (c) applicable interest.

VI. LEGAL ARGUMENT

A. Environmental Regulations Are Often Used to Discriminate Against Foreigners Or Foreign Products in Violation of International Law

Nations often improperly use health and environmental regulations to disguise trade and investment restrictions that favor or protect domestic industries or discriminate against foreign investors, their products, and their domestic investments. As one recent commentator has noted, "[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, *Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy*, 8 Minn. J. Global Trade 55, 58 (1999). Even environmentalists acknowledge "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, printed in Fair Trade and Harmonization: Prerequisites for Free Trade?*, Vol. 2, 59, 60 (J. Bhadwati & R. Hudec, eds. 1996).[15]

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,

[15] S*ee 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) (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").

> 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).

Commentators refer to such an unlikely alliance as a "'baptist-bootlegger' coalition:"

> In the US prohibition era, Baptists were opposed to alcoholic consumption on moral grounds, while bootleggers actually benefitted 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* 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* Rugman, *supra*, at 53; Soloway, *supra*, at 59, 95.

Disguised protectionism resulting from "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 ("FTA"), the predecessor to NAFTA. Rugman discusses nine cases[16] where "it has been found that an environmental regulation was used as an indirect trade barrier,"

[16] These 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* (FTA decision, 1989); (4) *Lobster's from Canada* (FTA decision, 1990); (5) *Ultra-High Temperature Milk (UHT) from Quebec*, (6) *Softwood Lumber* (FTA decision, 1994); (7) *US State Newspaper Content Requirements*; (8) *Ontario Beer Can Tax* (1993); (9) *Canadian Ban on Exports of PCBs*. Rugman, *supra*, at 55-67.

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.

Two NAFTA Chapter 11 cases have involved such disguised trade and investment restrictions in the form of environmental regulations. In *S.D. Myers v. Canada* (Partial Award Nov. 13, 2000), the NAFTA Tribunal ruled against Canada’s PCB export ban under NAFTA Articles 1102 and 1105. It found that (1) “the Interim Order and the Final Order favoured Canadian nationals over non-nationals,” (2) “intended primarily to protect the Canadian PCB disposal industry from U.S. competition,” and prevented (3) “SDMI and its investment . . . from carrying out the business they planned to undertake.” *Id.* ¶¶ 193-94. Importantly, the Tribunal also found that “there was no legitimate environmental reason for introducing the ban.” *Id.* ¶ 195.

The NAFTA Chapter 11 claim of *Ethyl Corp. v. Canada* (Award on Jurisdiction June 24, 1998) involved facts very similar to those here. *Ethyl* grew out of a Canadian ban on international and interprovincial trade of a gasoline additive, methylcyclopentadienyl manganese tricarbonyl (“MMT”). *See* Soloway, *supra* at 55.[17] The U.S. Claimant, Ethyl Corp., considered the ban – which purported to be based on environmental concerns – as nothing more than a protectionist ploy intended to discriminate against Ethyl and its Canadian investment and to

[17] The “baptists” behind the Canadian MMT ban were environmentalists and the “bootleggers” were Canadian auto-makers. “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.” *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 June 12, 1998), at 7.

favor Canadian investors. *See id.* at 85.[18] 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.* Canada's Agreement on Internal Trade is a municipal, federal analog to an international trade agreement. The AIT is meant to ensure that Canada's internal trade is as free as possible, and that it is not encumbered by unjustifiable barriers. *See AIT 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 at 3 (June 12, 1998) (quoting AIT Article 100 ("Objectives")). Alberta's AIT suit alleged that "'the cross-border ban [was] a blatant example of Ottawa favouring the Ontario-based car makers over the refineries.'" Soloway, *supra* at 79.

The AIT panel concluded that the Canadian MMT ban was improper, finding it to be "inconsistent with AIT, because it created an obstacle to trade not justified by the legitimate objectives test." *Id.* at 83 (citations omitted). The evidence before the Canadian AIT panel showed that "MMT, while noxious in large amounts, did not appear to be dangerous in small quantities." *AIT Report*, *supra*, at 13 (dissenting opinion).[19] Following the decision of the

[18] In a striking parallel to the facts here, it appears that the Canadian ethanol industry may also have been a cause of 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.*

[19] *Cf.* S. Ganguly, *The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health,* 38 Colum. J. Transnat'l L. 113, 154-55 (1999) (noting that a

Canadian AIT panel, 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." Soloway, *supra*, at 84. As part of the NAFTA settlement, "[t]he Canadian government announced that there was no evidence that MMT was harmful to human health in low amounts." *Id.*

The problem of ostensibly neutral health regulation that is actually protectionist in intent or effect is so well-recognized that the Members of GATT 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.[20]

There is thus no doubt that nations often use regulations not for their purported purpose of protecting the environment or health, but to favor domestic industries over foreign competition. It is equally clear that international tribunals regularly conclude that such measures violate international law.

B. NAFTA Article 1102 and International Law Prohibit Regulatory Measures That Discriminate Against Foreign Investors or Their Investments

Article 1102, commonly referred to as the "national treatment" provision, requires NAFTA signatories to accord to NAFTA investors and their investments "treatment no less favorable than it accords, in like circumstances" to its own investors and their investments "with

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U.S. court addressing a similar MMT ban by the U.S. EPA found that "the EPA . . . had not found definite proof of . . . danger [from MMT] at the levels that humans would normally encounter").

[20] Sanitary Measures Agreement, GATT 1994, Annex IA ("Multilateral Agreements on Trade in Goods"); Technical Barriers Agreement, GATT 1994, Annex IA ("Multilateral Agreements on Trade in Goods").

respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

Simply stated, Article 1102 stands for the proposition that a Party cannot discriminate in favor of its own nationals, or against foreigners *because* they are foreign. International law – which is incorporated into NAFTA by Article 1131(1) – similarly ensures that a State may not exercise its powers to discriminate against foreign investors or to benefit domestic industry.[21]

This precept is firmly embedded in international law. The "non-discrimination [principle] in international law" prevents the State from making a distinction that "has no objective and reasonable justification, or pursues no legitimate aim," or that lacks "a reasonable relationship of proportionality between that aim and the means employed to attain it." A. Bayefsky, *The Principle of Equality or Non-Discrimination in International Law*, 11 Human Rts. L. J. 1, 34 (1990). The non-discrimination principle is so widely-accepted that Dr. Mann has written: "The rule against discrimination . . . involves a principle that does not seem to have been challenged in any country or at any time." F.A. Mann, *Studies in International Law* 476 (1973).

The principle of non-discrimination requires that a State's actions be both facially neutral and neutral in fact and in application. As the International Court of Justice stated:

> [T]he prohibition against discrimination, in order to be effective, must ensure the *absence of discrimination in fact as well as in law*. A measure which in terms is of general application, but in fact is directed against Polish nationals and other persons of Polish origin

[21] Thus, the United States argued in *Case Concerning Elettronica Sicula S.p.A. (ELSI)* (U.S. v. Italy), 1989 I.C.J. 15 (Judgment July 20, 1989), that the principle of non-discrimination prohibited either discrimination in favor of Italian interests, or against U.S. investors: "'The basic aim of the [investment] provisions [is] to safeguard the investor against the nonbusiness hazards of foreign operations, . . . [such as] . . . special favors to State-owned businesses, . . . and other discriminations against foreign capital.'" I.C.J.: *Pleadings, Oral Arguments, Documents, Case Concerning Elettronica Sicula S.p.A. (ELSI)* (U.S. v. Italy), Vol. I, at 76 (Mem. of U.S.) (quoting the Remarks of Harold F. Linder, Deputy Assistant Secretary for State of Economic Affairs (Ann. 86, at 394)).

> or speech, constitutes a violation of the prohibition. . . . Whether a measure is or is not in fact directed against these persons is a question to be decided on the merits of each particular case. No hard and fast rules can be laid down.

Advisory Opinion Concerning the Treatment of Polish Nationals and Other Persons of Polish Origin or Speech in the Danzig Territory No. 44, 1932 P.C.I.J. (ser. A/B) No. 44, at 4, 28; *see also Advisory Opinion Concerning German Settlers in Poland* No. 6, 1923 P.C.I.J. (ser. B) No. 6, at 6, 24 ("There must be equality in fact as well as ostensible legal equality in the sense of the absence of discrimination in the words of the law."). With regard to discriminatory regulations in the trade and investment arena, it has been said that:

> The principle of effective equality of opportunity (not outcome) lies at the heart of the National Treatment principle, and exceptions to it should require a demonstration that policy measures that have a substantial disparate impact on foreign trade (a) *genuinely* serve some *legitimate* (non-trade related) domestic policy objective and are *not merely a disguised form of discrimination* (the sham principle) and (b) are not an *unjustified* means of attaining those objectives (the least trade restrictive or proportionality principle). Thus, the policy objective should be genuine and the means of attaining it *proportionate*.

M. Trebilcock & R. Howse, *Trade Liberalization and Regulatory Diversity: Reconciling Competitive Markets with Competitive Politics*, 6 Eur. J. L. & Econ. 5, 31-32 (1998) (emphases added).

In *S.D. Myers v. Canada*, a NAFTA investment Tribunal concluded that discriminatory environmental regulations violated the investment protections of the requirements of Chapter 11. S.D. Myers, Inc. ("SDMI"), a United States corporation specializing in PCB remediation, challenged a Canadian export ban on PCBs to the United States as a violation of NAFTA Chapter 11. *See id.* ¶ 129-43. SDMI claimed that "the PCB Waste Export Interim Order and Final Order constituted disguised discrimination aimed at SDMI and its investment in Canada contrary to Article 1102." *Id.* ¶ 130. The Tribunal agreed, finding that "the Interim Order and the Final Order favoured Canadian nationals over non-nationals," and that "the practical effect of the Orders was that SDMI and its investment were prevented from carrying out the business they planned to undertake, which was a clear disadvantage in comparison to its Canadian competitors." *Id.* ¶ 193. The Tribunal found that the measures were "intended primarily to protect the Canadian PCB disposal industry from U.S. competition." *Id.* ¶ 194. Moreover, the Tribunal concluded that "there was no legitimate environmental reason for introducing the ban." *Id.* ¶ 195.

In applying Article 1102 to the facts before it, the *S.D. Myers* Tribunal first noted that Article 1102 "refer[s] to treatment that is accorded to a Party's own nationals 'in like circumstances,'" and determined that this "like circumstances" phrase, in the "overall legal context in which [it] appears," "invites an examination of whether a non-national investor complaining of less favourable treatment is in the same 'sector' as the national investor," and that "'sector' has a wide connotation that includes the concepts of 'economic sector' and 'business sector.'" *S.D. Myers*, *supra* ¶¶ 243-50. The Tribunal found that the "like circumstances" requirement was "clear[ly]" satisfied: "It was precisely because SDMI was in a position to take business away from its Canadian competitors that Chem-Security and Cintec lobbied the Minister of the Environment to ban exports when the U.S. authorities opened the border." *Id.* 251.

Next, the *S.D. Myers* Tribunal outlined "factors [that] should be taken into account" when "assessing whether a measure is contrary to a national treatment norm": (1) "whether the practical effect of the measure is to create a disproportionate benefit for nationals over non-nationals;" and (2) "whether the measure, on its face, appears to favour its nationals over non-nationals who are protected by the relevant treaty." *Id.* 252. These factors "must be explored in the context of all the facts . . . ." *Id.* 253. The Tribunal felt that while "[i]ntent is important, . . . protectionist intent is not necessarily decisive on its own," because "[t]he word 'treatment' suggests that practical impact is [also] required to produce a breach of Article 1102 . . . ." *Id.* 254.

The *S.D. Myers* Tribunal held 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. This . . . is consistent with the language of the case law arising out of the WTO family of agreements." *Id.* ¶ 221.

Based on this analysis, the Tribunal concluded that Article 1102 had been breached:

> CANADA was concerned to ensure the economic strength of the Canadian industry, in part, because it wanted to maintain the ability to process PCBs within Canada in the future. This was a legitimate goal, consistent with the policy objectives of the Basel Convention. There were a number of legitimate ways by which CANADA could have achieved it, but preventing SDMI from exporting PCBs for processing in the USA by the use of the Interim Order and the Final Order was not one of them. The indirect motive was understandable, but the method contravened CANADA's international commitments under the NAFTA. CANADA's right to source all government requirements and to grant subsidies to the Canadian industry are but two examples of legitimate alternative measures. The fact that the matter was addressed subsequently and the border re-opened also shows that CANADA was not constrained in its ability to deal effectively with the situation.

Id. ¶¶ 255-56.

Similar to *S.D. Myers*, California's decision to ban MTBE improperly discriminated in favor of the U.S. ethanol industry and against non-U.S. products and investments, and therefore violated NAFTA Article 1102 and international law. The decision was motivated primarily by a desire to protect the domestic ethanol industry by eliminating one of ethanol's chief competitors, the "foreign" methanol product, MTBE, from the California oxygenate market. The effect was to severely damage Methanex and its U.S. investments by handing their market share directly to the U.S. ethanol industry.

The discriminatory purpose can be seen on the face of the Executive Order, which not only banned MTBE, but also sought to establish an ethanol industry in California: "The California Energy Commission (CEC) shall evaluate by December 31, 1999 and report to the Governor and the Secretary for Environmental Protection the potential for development of a California waste-based or other biomass ethanol industry. CEC shall evaluate what steps, if any, would be appropriate to foster waste-based or other biomass ethanol development in California. . . ." Exec. Order D-5-99 ¶ 11. Moreover, the subsequent regulations that implemented the MTBE ban specifically name ethanol as *the* replacement product. *See* Cal. Code Regs. tit. 13, § 2262.6(c). Finally, California requires gasoline containing MTBE to be so labeled at the pump; this requirement does not apply to other oxygenates, such as ethanol. *See* Exec. Order D-5-99 7; Cal. Code Regs., tit. 13, § 2273. And, as noted in the Cincinnati Enquirer, *supra*, "ADM, in fact, . . . [has] announced it would be opening an ethanol plant in California. . . ." Pilcher, *supra*.

The California actions replacing MTBE with ethanol reflect the protectionist attitude found across the United States that dependence on the "foreign" methanol product would harm the American economy, whereas reliance on the "domestic" ethanol product would not only aid American farmers but would boost the U.S. economy generally. Such discrimination violates NAFTA Article 1102 and international law.

C. NAFTA Article 1105 and International Law Require that Fair and Equitable Treatment Be Accorded to Foreign Investments

Article 1105 of NAFTA provides that "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."

The concept of "fair and equitable treatment" goes well beyond a mere prohibition on arbitrary and discriminatory measures. *See* F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 Brit. Y.B. Int'l L. 241, 243 (1981) ("unfair and inequitable treatment is a much wider conception" than the prohibition against "arbitrary, discriminatory or abusive treatment" under "customary international law"); K. Vandevelde, *United States Investment Treaties*: *Policy and Practice* 76 (1992) ("fair and equitable treatment" is a standard that provides "a baseline of protection" even where other international protections are inapplicable). By its very terms, Article 1105 imposes an obligation on States to treat foreign investments fairly and equitably, and the NAFTA Tribunal in *Metalclad Corp. v. Mexico* applied this requirement in accordance with its ordinary meaning. That Tribunal held that Mexico breached Article 1105 because "Metalclad was not treated fairly or equitably under the NAFTA." *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 Award (Aug. 30, 2000) at 20.

"International law" includes both customary international law and treaty law, to the extent that treaties reflect general acceptance of particular principles. "International law is made in two principal ways – by the practice of states ("customary law") and by purposeful agreement among states (. . . *i.e.*, law by convention, by agreement) . . . In our day treaties have become the principle vehicle for making law for the international system." Restatement (Third) of Foreign Relations Law, Introductory Note, at 18. International law "includes law contained in widely accepted multilateral agreements." *Id*., § 101, cmt. d. GATT and WTO agreement, which are multilateral and widely accepted, contain principles of international law that, as discussed below, are applicable to this action.

In the circumstances presented here, Article 1105's requirement that investments be treated fairly, equitably, and in accordance with international law encompasses at least four principles of international law: (1) the principle that a decision-maker purportedly acting independently and in the public interest must not be biased by pecuniary considerations; (2) the principle that state officials must act reasonably and in good faith; (3) the principle of non-discrimination; and (4) the principle that an ostensibly legitimate measure taken by a State must not be a disguised form of protection, but instead must be the least trade-restrictive of the reasonably available alternatives.

1. Article 1105 Requires State Officials to Act Without a Pecuniary or Personal Interest In the Public Decision-Making Process

It is common to all legal systems that a person sitting in a decision-making capacity must be independent and without a personal or pecuniary interest in the matter, so as to enable him to act in good faith. For example, in *Regina v. Gough*, A.C. 646 (H.L. 1993), the British House of Lords, in an opinion written by Lord Goff of Chievely, stated with regard to judicial decision-makers:

> [T]here are certain cases in which it has been considered that the circumstances are such that they must inevitably shake public confidence in the integrity of the administration of justice if the decision is to be allowed to stand. . . . These cases arise where a person sitting in a judicial capacity has a pecuniary interest in the outcome of the proceedings. In such a case . . . 'any direct pecuniary interest, however small, in the subject of inquiry, does disqualify a person from acting as a judge in the matter.'

Id. at 661.

This requirement of independence and freedom from pecuniary interest is not limited to judicial officials, but applies to any public official sitting in a decision-making capacity. As the High Court of Australia stated:

> It [the requirement that jurors act without bias] is certainly no less important than that of the judge sitting alone in a civil trial, *a commissioner determining an industrial dispute or a member of a statutory tribunal inquiring into conduct in an industry which it supervises*. The public is entitled to expect that issues tried by juries as well as judges and *other public office holders* should be decided by a tribunal free of prejudice and without bias.

Webb v. The Queen, [1994] 181 C.L.R. 41, 53 (emphasis added). Similarly, Lord Goff noted the case of *Metropolitan Properties Co. (F.G.C.) Ltd. V. Lannon* [1969] 1 Q.B. 577:

> The case was concerned with a decision by a rent assessment committee, when determining fair rents for a block of flats in London. The rent so determined was substantially below the rent suggested eve n by the expert called by the tenants. The landlord sought to quash the decision on the ground that the chairman of the committee was a solicitor who had been concerned with advising tenants of flats in another comparable block of flats. The Court of Appeal, allowing the appeal from a Divisional Court held that the facts were such as to give rise to an appearance of bias on the part of the chairman, and on that ground they quashed the decision of the committee, even though there was no actual bias on his part.

Regina, A.C. at 665-66.

When a state official acting in an ostensibly neutral fashion discriminates in favor of a protected domestic industry that has given the official substantial political contributions, his actions are not independent, but instead improperly influenced by political and pecuniary considerations. Consequently, they violate international law because they are unfair, inequitable, and not in accord with the duty of independence. *Cf. BP Exploration Co. (Libya) Ltd. v. Gov't. of the Libyan Arab Republic*, (Award Oct. 10, 1973), *reprinted in* 53 I.L.R. 297, 329 (1979) ("the taking by the Respondent of the property, rights, and interests of the Claimant clearly violates public international law as it was made for purely extraneous political reasons and was arbitrary and discriminatory in character."); I.C.J.: Pleadings, Oral Argument, Documents Case Concerning Elettronica Sicula S.p.A. (*U.S. v. Italy*), at 384 (Reply of U.S.) ("even if the Respondent's actions were reasonably related to the goal stated, requisitioning a plant for political reasons is not a legally permissible goal under the Treaty"); *id.*, Vol. I, at 76 ("'The basic aim of the [investment] provisions [is] to safeguard the investor against . . . special favors to State-owned businesses'"); *id.* at 78 n.6 (citing *Sieur Beauge*, Conseil d'Etat, 4 July 1924, *Recueil Sirey*, at 641, which annulled a "mayor's order requiring ocean bathers to change clothes in local bath-houses [because it was] motivated by financial interest of the village").

It is no defense that the political contributions of the protected domestic industry and the actions of the state official are entirely legal under domestic law. Acts that are legal under municipal law have often been found to violate international law. "What is a breach of a treaty may be lawful in the municipal law and what is unlawful in the municipal law may be wholly innocent of violation of a treaty provision." ¶ 70, 1989 I.C.J. 15, (Judgment July 20).

It must be emphasized again that Methanex is not asserting that the acts of Governor Davis or ADM in any way violated U.S. law. Nonetheless, Governor Davis' decision to ban MTBE was palpably unfair and inequitable because the misinformation and political contributions he received from ADM misled and improperly affected his decision about the leaking tanks and MTBE. Governor Davis lacked the fairness and independence required of neutral decision-makers under international law.

It is no secret that a very substantial segment of Americans recognize that political contributions can unfairly and improperly influence the decision-making process of elected officials. For example, in a March 6, 2000 address, Yale Law Professor George L. Priest stated, "the central organizing thought of the reform tradition [of U.S. campaign finance] is that money

– whether in the form of a contribution to a campaign or an expenditure on behalf of a candidate – corrupts the electoral system." G. Priest, *Buying Democracy: A New Look at Campaign Finance "Reform,"* Eleventh Annual Bradley Lecture Series, American Enterprise Institute, Mar. 6, 2000, at 2, *available at* http://www.aei.org/bradley/b1030600.htm (visited Jan. 11, 2001). Professor Priest further stated: "[A] campaign contribution or a campaign expenditure may affect the actual substance of decisions made by public officials." *Id.*

Many prominent U.S. officials share this concern. Former Senator Bill Bradley recently stated: "I don't think mistakes are just made at the edges. The entire process, even when conducted strictly within the law, invites corruption and erodes the confidence that the decisions made in our democracy are based on our representative[s'] honest judgment and deliberation about the best policies and the interests and opinions of all their constituents." Sen. Bill Bradley (Op Ed, L.A. Times, Feb. 1997), *available at* http://www.citizen.org/congress/reform/3_28_97/quotes.html (visited Jan. 11, 2001). Senator Ernest Hollings has stated: "[T]he massive amount of money spent is astonishing and serves only to cement the commonly held belief that our elections are no more than auctions and that ou[r] politicians are for sale." Sen. Ernest Hollings (Roll Call, Jan. 9, 1997, at 28), *available at* http://www.citizen.org/congress/reform/3_28_97/quotes.html (visited Jan. 11, 2001). Senator Robert Byrd has said: "Money! It is money! Money! Money! Not ideas, nor principles, but money that reigns supreme in American politics." Sen. Robert C. Byrd (N.Y. Times, 3/20/97, at A26), *available at* http://www.citizen.org/congress/reform/3_28_97/quotes.html (visited January 11, 2001). Numerous "public interest" groups take the same position. "All the special interest money in the system amounts to legalized bribery." Public Citizen, *Message Themes on*

Campaign Finance Reform, available at
http://www.citizen.org/congress/reform/3_28_97/message.html (visited Jan. 8, 2001).

The California MTBE ban is in truth a disguised trade and investment restriction intended to achieve the improper goal of protecting and advantaging a domestic industry through sham environmental regulations. It is fair to conclude that ADM promoted the ban on MTBE at its secret meeting with Governor Davis; it is fair to conclude that the meeting led to ADM's massive campaign contributions immediately thereafter; and it is fair to conclude that the MTBE measures were, at least in part, the result of the Governor's political debt to ADM, and of his desire to favor and protect ADM, establish a California-based ethanol industry, and penalize producers of MTBE and methanol, the "dangerous" and "foreign" MTBE feedstock.[22] As such, the ban violates international law and NAFTA Article 1105.

2. The "Fair and Equitable Treatment" Requirement of Article 1105 Also Requires States to Act Reasonably and In Good Faith

By its terms, NAFTA's provision for "fair and equitable treatment" requires that investments receive treatment that is consistent with principles of equity. *See* G. Schwarzenberger, *The Abs-Shawcross Draft Convention on Investments Abroad,* 14 Current Legal Probs. 213, 217, 220 (1961) ("fair and equitable treatment" standard combines "the minimum standard with the standard of equitable treatment.").

International principles of equity include the well-recognized requirements of reasonableness and good faith. As the *S.D. Myers* Tribunal recently concluded, "Article 1105 imports into the NAFTA the international law requirements of due process, economic rights, obligations of good faith and natural justice." *S.D. Myers*, *supra*, 134. The ICJ has repeatedly

[22] This same discriminating motive must also be attributed to the Governor's decision to place a discriminatory labeling requirement on MTBE, but not on any other oxygenate.

found that under international law, the power of a government official *"must be exercised reasonably and in good faith*." *Case Concerning Rights of Nationals of the United States of America in Morocco*, 1952 I.C.J. 176, 212 (emphasis added).

Commentators agree that under the abuse of rights doctrine, officials must act responsibly, not arbitrarily:

> [A]lthough a State may have a strict right to act in a particular way, it must not exercise this right in such a manner as to constitute an abuse of it; it must exercise its rights in good faith and with a sense of responsibility; it must have bona fide reasons for what it does, and not act arbitrarily or capriciously.

Sir Gerald Fitzmaurice, *The Law and Procedures of the International Court of Justice* 12-13, Vol. 1 (1986).

The United States has long argued that arbitrary government acts violate international law.

> Article I [of the relevant FCN Treaty] prohibits 'arbitrary' measures as distinct from, and in addition to, 'discriminatory measures.' The prohibition of 'arbitrary' measures conveys above all the commitment of the respective Governments not to injure the investments and related interests of foreign investors by the unreasonable or unfair exercise of governmental authority. Following standard dictionary definitions, an 'arbitrary' act may be one which is characterized by absolute power or an abuse of discretion. 'Arbitrary actions' include those which are not based on fair and adequate reasons (including sufficient legal justification), but rather arise from the unreasonable or capricious exercise of authority. The terms, 'oppressive' and 'unreasonable' are thus synonyms of 'arbitrary.'

I.C.J. Pleadings, *(ELSI)*, *supra*, Vol. I, at 76-77 (Mem. of U.S.) (footnote omitted).

Similarly, government regulatory actions must be reasonable. *See* A. Sykes, *Prudent Standards for Internationally Integrated Goods Markets* 16 (1995) ("there seems little disagreement that national governments are entitled to promulgate *reasonable* safety and health regulations to protect their citizens." (emphasis in original)). Reasonableness is particularly important when dealing with allegations of discrimination. *See, e.g.*, I. Brownlie, *Principles of Public International Law* at 531 (5th ed. 1998) ("The concept of discrimination calls for more sophisticated treatment in order to identify *unreasonable* (or material) discrimination as distinct from the different treatment of non-comparable situations." (emphasis added)); *Restatement (Third) of Foreign Relations Law* § 712, cmt. f ("Discrimination implies unreasonable distinction"); A.F.M. Maniruzzaman, *Resolving International Sanitary and Phytosanitary Disputes in the WTO: Lessons and Future Directions*, 8 J. Transnat'l L. & Pol'y 57, 69 (1998) 69 ("*Unreasonable*, arbitrary, or invidious distinctions are undoubtedly prohibited by international law, and are actionable." (emphasis added)).

It is a violation of the reasonableness requirement for a local government to defy national or federal standards and block a foreign investor from operating or benefitting from his investments. In *Metalclad*, the Claimant had received both permission and encouragement for its Mexican investment from the Mexican federal authorities. *See Metalclad*, ¶¶ 78-80, 85-89. However, the state and municipal governments took action to prevent Metalclad from operating its investment. *See id.* ¶¶ 86, 90-96. The Tribunal held that the local action violated the Article 1105 requirement of fair and equitable treatment. *See id.* ¶¶ 97, 99-101.

California's MTBE measures were arbitrary, unreasonable, and lacking in good faith. The decision to ban MTBE was unreasonable because there were better alternatives for solving the problem of MTBE in drinking water. Because the contamination problem was caused by leaking USTs and recreational watercraft on drinking-water reservoirs, the logical solution was – and is – to address the causes of the problem, not the symptom, which is the presence of MTBE. Governor Davis could have ordered a serious effort to complete the upgrading of all existing tanks, to fix those that were leaking, and to extend regulatory jurisdiction over all USTs in the state. As noted above at [p.25 65], such measures can eliminate up to 97% of UST leaks. Similarly, Governor Davis could have prohibited environmentally-unfriendly marine engines on drinking-water reservoirs, which would have virtually eliminated all forms of gasoline contamination, including MTBE. When such engines were banned on Lake Tahoe, California, MTBE pollution dropped by 95%. *Tahoe Gas Pollution Declines Sharply*, *supra*.

By taking these alternative measures, Governor Davis could have directly addressed the sources of MTBE infiltration of drinking water without banning MTBE. Importantly, these alternative measures have the pronounced benefit of stopping the release of other gasoline components, such as benzene, which pose serious health and environmental risks. These alternative measures would also allow refiners to continue to use MTBE as an oxygenate to reduce air pollution. These alternative measures were thus an environmentally *superior* solution.

Given the existence of much more logical and effective alternatives, and given the extensive evidence of a pervasive U.S. program to protect the U.S. ethanol industry, it is fair to conclude that California was not acting in good faith when it banned MTBE.

The California measures were also arbitrary and unreasonable because the U.S. federal government had already, after exhaustive study, approved and encouraged the use of MTBE. As was the case in *Metalclad*, where the federal authorities gave their approval, it is not reasonable to allow local authorities to arbitrarily block a foreign investor from operating or benefitting from his investment where the federal authorities have not rescinded their sanction.

Finally, it must be a violation of the duty of good faith and principles of natural justice for any official purporting to act independently in a decision-making function for the protection of public health or the environment to accept political campaign contributions from a party that stands to benefit greatly from the official's decision.

3. Discriminatory Measures Are, by Definition, "Unfair" and "Inequitable" and Violate NAFTA Article 1105

Just as discriminatory measures violate Article 1102, discussed above in Section V(B), they also violate Article 1105 because they are inherently "unfair" and "inequitable."[23] The requirement of "fair and equitable treatment," as is found in Article 1105, encompasses a complaint that "the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interests." P. Muchlinski, *Multinational Enterprises and the Law* 625 (1995). This is so because "the concept [of fair and equitable treatment] connotes the principle of non-discrimination and proportionality in the treatment of foreign investors." *Id.* The NAFTA Tribunal in *S.D. Myers*, *supra*, held that discriminatory treatment violates Article 1105: "on the facts of this particular case the breach of Article 1102 [through the enactment of discriminatory regulations] essentially establishes a breach of Article 1105 as well." *Id.* ¶ 266.

As noted above in Section VI(B), the California measures at issue were discriminatory in both intent and effect. These measures were intended to favor the domestic U.S. ethanol industry and protect it from foreign competition, including Methanex and its U.S. investments. In effect, California took part of the market share of Methanex and its U.S. investments and handed it directly to ethanol, one of its principal competitors. Accordingly, because the California measures are discriminatory, they violate NAFTA Article 1105's requirement of fair and equitable treatment.

[23] Discriminatory measures are also in violation of the international minimum standard of treatment, which is incorporated into NAFTA by Article 1105.

4. Regulatory Measures That Are Disguised Restrictions on Trade and Investment And That Are Not The Least Trade-Restrictive Approach Violate Article 1105

Any violation of an international principle intended for the protection of trade or investment is also a violation of the NAFTA Article 1105 requirement that state measures be fair, equitable, and in accordance with international law. As Dr. Bryan Schwartz stated in his *S.D. Myers* separate opinion: "The interpretation and application of Article 1105 *must*, I tend to think, also take into account the letter or spirit of widely, though not universally, accepted international agreements like those in the WTO system and those typical of BITs." *S.D. Myers, supra* (separate opinion of Dr. Schwartz), 234 (emphasis added). The *S.D. Myers* Tribunal reached the same conclusion: "In some cases, the breach of a rule of international law by a host Party may not be decisive in determining that a foreign investor has been denied 'fair and equitable treatment,' but the fact that a host Party has breached a rule of international law that is specifically designed to protect investors will tend to weigh heavily in favour of finding a breach of Article 1105." *Id.* 264 (emphasis added; original emphasis deleted). Consequently, to the extent that state measures that violate other principles of international law also affect NAFTA investors or their investments adversely, they violate Article 1105 as well.

The principle of international law most applicable to this case is the widely-accepted WTO/GATT rule that regulatory measures are only acceptable if they meet certain conditions. Such measures are legal if: (1) they are intended to achieve a legitimate objective, (2) they are the least trade-restrictive alternative that can achieve the legitimate objective, and (3) they do not constitute a disguised restriction on international trade. These requirements are found in at least two multilateral treaties (1) the WTO Agreement on Technical Barriers to Trade ("Technical Barriers Agreement"); and (2) the WTO Agreement on Sanitary and Phytosanitary Measures ("Sanitary Measures Agreement").

a. The Technical Barriers Agreement

The Technical Barriers Agreement governs technical barriers to or regulations on trade, and is designed to prevent the adoption of protectionist measures. "Technical regulation" is defined in Annex I to the Technical Barriers Agreement as a "[d]ocument which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labeling requirements as they apply to a product, process or production method." Accordingly a "technical regulation" is a measure that defines the technical specifications that one or more given products must meet before they can be sold. *See European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS/135/R, Sept. 18, 2000, 8.43; 2000 WL 1449942 (WTO).

The Technical Barriers Agreement allows Members to adopt technical regulations so long as such regulations are not "prepared, adopted or applied with a view to or with the effect of creating *unnecessary obstacles* to international trade." Article 2.2 (emphasis added). Specifically, "technical regulations shall not be *more trade-restrictive than necessary* to fulfil a legitimate objective, taking account of the risks non-fulfillment would create." *Id.* (emphasis added). Such legitimate objectives include "national security requirements," "prevention of deceptive practices," and "protection of human health or safety, animal or plant life or health, or the environment." *Id.* Relevant considerations for assessing such risks include "available scientific and technical information, related processing technology or intended end-uses of products." *Id.*

Hence, the first requirement for fulfilling the obligations of the Technical Barriers Agreement is the presence of a legitimate objective. After a legitimate objective has been identified, it can be determined whether the technical regulation creates an unnecessary obstacle to trade.

The California ban on MTBE is within the scope of the Technical Barriers Agreement because it is a technical regulation that sets “product characteristics” for reformulated gasoline (*i.e.*, that MTBE may not be used as a component of reformulated gasoline). The requirement that pumps containing MTBE be labeled is, by definition, a “marking or labeling requirement[].” *See* Annex 1, *supra*.

The stated objective of the Governor’s executive order and the implementing regulations was to keep MTBE out of drinking water. Methanex fully agrees that this was a legitimate objective and thus consistent with the Agreement.

However, the California ban on MTBE violated the Technical Barriers Agreement because (1) in comparison to alternative remedies, the ban will actually increase the environmental risks, especially the risk of higher air pollution; (2) the ban created unnecessary obstacles to international trade; and (3) the ban was more trade restrictive than necessary to solve the problem of MTBE in drinking water.

As discussed above, there were two obvious alternative measures available to the State of California that would allow it to control the release of gasoline without banning MTBE and affecting foreign trade and investment – fixing the leaking tanks and banning dirty marine engines. In addition, substituting ethanol for MTBE could lead to greater environmental risks: increased air pollution, increased cancer risks and, if the leaking tanks are not fixed, increased penetration of carcinogens such as ethanol and benzene into California’s drinking water. Because alternative measures were available to California to solve the MTBE problem, because these measures were less trade restrictive, and because using ethanol could increase the environmental damage, the Technical Barriers Agreement prohibits the continued application of the more trade restrictive measures adopted by California. By allowing California to ban MTBE, the United States is violating the Technical Barriers Agreement.

The labeling measure is also clearly intended to discriminate against MTBE as a "foreign" competitor of ethanol. The labels are not intended to provide consumers with necessary information, or to prevent "deceptive practices." If this were the case, the label would include more information on the chemical make-up of the gasoline in the pump (particularly as a number of the components in gasoline pose serious health risks). Rather, by identifying only the presence of MTBE – and not the presence of any other oxygenates or other harmful components – the labels simply give consumers the ability to *choose away* from MTBE. As "technical regulations," the labeling measures must be no more trade restrictive than necessary to achieve a "legitimate objective" of protecting the environment. In view of the illegitimate objective of the labeling measure, the considerations discussed above with respect to the ban will apply equally to this measure as well.

b. The Sanitary Measures Agreement

The WTO Sanitary Measures Agreement governs sanitary and phytosanitary measures, and has three principal requirements. First, the measures must not be arbitrary, unjustified, or discriminatory. Article 2.3 of the Sanitary Measures Agreement mandates that WTO Members must "ensure that their sanitary and phytosanitary measures do not arbitrarily or unjustifiably discriminate between Members where identical or similar conditions prevail, including between their own territory and that of other Members." Article 2.2 requires that such measures be "applied only to the extent necessary to protect human, animal or plant life or health," and that they be "based on scientific principles" and "not maintained without sufficient scientific evidence."

Second, "[s]anitary and phytosanitary measures shall not be applied in a manner which would constitute a disguised restriction on international trade." Article 2.3.

Third, sanitary measures are improper if there is a reasonably available alternative that is less trade restrictive. Article 5.6 provides that when WTO Members establish sanitary and phytosanitary measures "to achieve the appropriate level of . . . protection," they "shall ensure that such measures *are not more trade-restrictive than required* to achieve [that] level of . . . protection, taking into account technical and economic feasibility." (Emphasis added). Footnote 3 explicates this article by providing that "a measure is not more trade-restrictive than required *unless there is another measure, reasonably available* taking into account technical and economic feasibility, that achieves the appropriate level of sanitary or phytosanitary protection and is *significantly less restrictive to trade*." Sanitary Measures Agreement, Article 5.6 n.3 (emphasis added). The Sanitary Measures Agreement requires States to take into account what alternative measures are available. As one commentator noted, "in the Japan Food Quarantine decision, Japan's SPS measure violated the SPS Agreement because its risk assessment did not take into account what alternative SPS measures might be applied." K. Kennedy, *Resolving Int'l Sanitary and Phytosanitary Disputes in the WTO: Lessons and Future Directions*, 55 Food & Drug L.J. 81, 99-100 (2000).

The WTO Appellate Body has determined that a measure falling within the Sanitary Measures Agreement does not meet the minimum requirements of Article 5.6 if there is an alternative measure that is: (1) reasonably available taking into account technical and economic feasibility; (2) capable of achieving the Member's appropriate level of sanitary or phytosanitary protection; and (3) significantly less restrictive to trade than the contested measure. *See*

Australia – Measures Affecting Importation of Salmon, WT/DS18/AB/R, ¶ 194; 1998 WL 731009 (WTO).

The WTO has not hesitated to find that purported health measures violate the Sanitary Measures Agreement. As one commentator noted with regard to *Australia-Measures Affecting Importation of Salmon*: "The Appellate Body . . . upheld the panel's finding that Australia's import prohibition was arbitrary, unjustifiable, and a disguised restriction on international trade. While herring and ornamental fin-fish presented an equal or greater risk of the introduction and spread of disease that could threaten domestic stocks, the Australian import ban was limited strictly to salmon. This fact gave rise to a strong inference that the import ban was intended and designed to protect the domestic salmon aquaculture industry from import competition." Kennedy, *supra*, at 97.

As an initial matter, it should be noted that the California ban on MTBE does not fall within the Sanitary Measures Agreement because it was explicitly taken to protect the environment, not health. The Executive Order found that "MTBE poses an *environmental* threat to groundwater and drinking water" and that "on balance, there is significant risk to the *environment* from using MTBE in gasoline in California" (emphases added). This express identification of the objective as the environment, rather than health, takes the MTBE measures outside the scope of the Sanitary Measures Agreement.

However, if the California measures *were* covered by the Sanitary Measures Agreement, they would fail to meet its requirements. The California MTBE measures violate Articles 2.2 and 2.3 because, as discussed above, they are excessive, not based on sufficient scientific evidence, and arbitrary.

The California MTBE measures violate Article 2.3 of the Sanitary Measures Agreement because they are a disguised restriction on foreign trade and foreign investment. As discussed above, California imposed the MTBE ban in order to favor the U.S. ethanol industry and penalize its foreign competitors. As such, the MTBE measures violate Article 2.3.

The California MTBE measures violate Article 5.6 of the Sanitary Measures Agreement because there is a reasonable alternative that is less trade-restrictive. First, as noted above, better alternatives to the MTBE ban are reasonably available to correct the leaking gasoline problem. These alternatives are clearly economically and technically feasible because, for the most part, the regulatory and administrative structures are in place but they simply have not been enforced. Second, these alternatives would not only achieve the appropriate level of protection, but would protect public health better than the MTBE ban because they would control the release of all gasoline components, many of which pose a serious health and environmental risk. Finally, the alternative measures are significantly less trade restrictive because they permit the continued use of imported MTBE or MTBE produced from imported methanol, as opposed to the current ban. Accordingly, the MTBE measures are not legitimate sanitary or phytosanitary measures that are consistent with U.S. obligations under the Sanitary Measures Agreement.

The foregoing arguments apply equally to the labeling measure.

Because the California measures violate the Technical Barriers Agreement and the Sanitary Measures Agreement, they are unfair and inequitable, and thus a violation of NAFTA Article 1105.[24]

[24] Indeed, viewed in context, the entire U.S. ethanol program (of which the California measures are a small part) violates many other GATT 1994 and WTO provisions. For example, as noted earlier, the United States has for decades given massive subsidies and tax credits to domestic U.S. ethanol producers as part of its scheme to protect the industry. Many U.S. states also have enacted tax and subsidy measures for the protection of ethanol, and also have

c. The Pervasive Protection for the U.S. Ethanol Industry Violates GATT/WTO Provisions

D. NAFTA Article 1105 Requires Full Protection and Security

NAFTA Article 1105 also requires that States accord foreign investments "full protection and security," which places upon States an affirmative duty to protect the persons and property of aliens. As an ICSID Tribunal stated in *American Mfg. & Trading, Inc. v. Republic of Zaire*, 36 I.L.M. 1531, 1548 (1997) with regard to a similar provision,[25] States have "an obligation of guarantee for the protection and security of the investments made by nationals and companies of one or the other Party":

> The obligation incumbent upon Zaire is an obligation of vigilance, in the sense that Zaire as the receiving State of investments made by AMT, an American company, shall take all measures necessary to ensure the full enjoyment of protection and security of its investment and should not be permitted to invoke its own legislation to detract from any such obligation. Zaire must show that it has taken all measure of precaution to protect the investments of AMT on its territory.

Id. Zaire was found to have breached its obligation because it took "no measure whatever that would serve to ensure the protection and security of the investment in question." *Id.* at 1549.

States must not only accord investments "full protection and security" against injury by the government, but must also protect foreign investments from economic harm inflicted by third parties. As one commentator stated while discussing identical provisions found in the BITs, "a provision requiring states to provide 'full protection and security' to covered investment . . .

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implemented content and labeling requirements that favor the domestic product. These measures violate the international trade obligations of the United States. As tax and subsidy measures, these actions by the United States are generally not remediable under NAFTA, but have nonetheless caused – and will continue to cause – harm to Methanex and other foreign competitors of the U.S. ethanol industry.

[25] The relevant treaty, the 1984 U.S.-Zaire BIT, stated that "Investment of nationals and companies of either Party shall at all times . . . enjoy protection and security." *Id.* (quotations omitted).

requires the host state to take reasonable steps to protect covered investment against injury by private parties." K. Vandevelde, *Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties*, 36 Colum. J. Transnat'l L. 501, 510 n.28 (1998).

In this case, the United States has allowed California to take unreasonable, unfair actions that severely harmed Methanex and its investments. Moreover, these measures were intended to discriminate against Methanex and its investments as foreign competitors of the highly-protected domestic ethanol industry. Methanol and MTBE have long been the victims of a smear campaign by ADM and the U.S. ethanol industry, which was designed to influence the government and the public against these "foreign" products. This campaign was intended to inhibit methanol-based MTBE's ability to compete in the United States, and therefore to cause the methanol and MTBE industries economic harm. The United States not only failed to protect foreign industries from this denigration, but it actually *joined* in their efforts and adopted their rhetoric in enacting the wide range of tax subsidies and regulatory requirements that favor and protect the domestic ethanol industry. Such actions cannot be reconciled with the duty to provide full protection and security.

Accordingly, the United States has breached its affirmative duty under NAFTA Article 1105 to provide full protection and security to Methanex and its investments.

E. NAFTA Article 1110 and International Law Prohibit Discriminatory Measures That Are Tantamount to Expropriation

NAFTA Article 1110 states "[n]o 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 . . . ."

While international law does give some deference to a State's ability to carry out its regulatory powers, discriminatory regulation can constitute an illegal expropriation:

> A state is not responsible for loss of property or for other economic disadvantage resulting from a *bona fide* general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, *if it is not discriminatory*, . . . and is not designed to cause the alien to abandon the property to the state or sell it at a distress price.

Restatement (Third) of the Law of Foreign Relations § 712, cmt. g (emphasis added); *see also Sedco, Inc. v. NIOC*, 9 Iran-U.S. Cl. Trib. Rep. 248, 275 (Award of Oct. 24, 1985) ("A state is not responsible for loss of property or for other economic injury that is due to bona fide general taxations, to regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, *that does not discriminate against aliens*. . . ." (emphasis added; citation omitted)); *Too v. Greater Modesto Ins. Assoc.*, 23 Iran-U.S. Cl. Trib. Rep. 378, 387 (Award of Dec. 29, 1989) (same); *cf. Amoco Int'l Finance Corp. v. Iran*, 15 Iran-U.S. Cl. Trib. Rep. 189, 231 (Award of July 14, 1987) ("Discrimination is widely held as prohibited by customary international law in the field of expropriation.").

Furthermore, one NAFTA Tribunal has held that regulatory takings can be unlawful even where they are not discriminatory:

> While the exercise of police powers must be analyzed with special care, ... [r]egulations can indeed be exercised in a way that would constitute creeping expropriation . . . . Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation. For these reasons, the Tribunal rejects the argument of Canada that the Export Control Regime, as a regulatory measure, is beyond the coverage of Article 1110.

See Pope & Talbot v. Canada Interim Award (June 26, 2000)   99. Article 1110 covers "nondiscriminatory regulation that might be said to fall within an exercise of a state's so-call police powers." *Id.*, ¶ 96.

Under settled international law, expropriation occurs where government action unduly interferes with an alien's use or enjoyment of property. *See, e.g. Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA*, 6 Iran-U.S. Cl. Trib. Rep. 219, 225 (Award of June 22, 1984); *Starrett Housing Corp. v. Iran*, 4 Iran-U.S. Cl. Trib. Rep. 122, 154, 172 (Award of Dec. 19, 1983); *Restatement (Third) of Foreign Relations* § 712, cmt. g (1987); L. Sohn & R.R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens*, 55 Am. J. Int'l L. 545, 552-53 (1961). The United States itself has recognized that expropriation covers "a multitude of activities having the effect of infringing property rights." Statement of the President, U.S. Government Policy in International Investment (Sept. 9, 1983), *reported in* [1981-88] 2 *Cumulative Digest of U.S. Practice In Int'l Law* 2304, 2305; *see also* M. Whiteman, *Digest of Int'l Law* 1007 (1967); *Corn Prod. Refining Co. Claim*, 1955 Int'l L. Rep. 333, 334. Expropriation can occur where the State itself acquires nothing of value, but "at least has been the instrument of redistribution." A. Mouri, *The Int'l Law of Expropriation as Reflected in the Work of the Iran-U.S. Claims Tribunal* 66 (1994) (citation omitted). *See, e.g.,* G. Aldrich, *The Jurisprudence of the Iran-United States Claims Tribunal* 188 (1996); *Tippetts*, 6 Iran-U.S. Cl. Trib. Rep. at 225.

Expropriation can include a wide range of government actions.

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

> benefit of property even if not necessarily to the obvious benefit of the host State.

Metalclad Corp., supra, 103.

Market share, market access, and goodwill are all property interests that can be illegally expropriated. "The tribunal recognizes that there are a number of other bases on which SDMI could contend that it has standing to maintain its claim including that . . . its market share in Canada constituted an investment." *S.D. Myers*, ¶ 232. *See also Pope & Talbot*, *supra,* 96 ("the Tribunal concludes that the Investment's access to the U.S. market is a property interest subject to protection under Article 1110"); *see id.* 98 ("While Canada suggests that the ability to sell softwood lumber from British Columbia to the U.S. is an abstraction, it is, in fact, a very important part of the 'business' of the Investment. Interference with that business would necessarily have an adverse effect on the property that the Investor has acquired in Canada, which, of course, constitutes the Investment. . . . The Tribunal concludes that the Investor properly asserts that Canada has taken measures affecting its 'investment,' as that term is defined in Article 1139 and used in Article 1110.")

The California measures violated Article 1110. First, these measures had the effect of severely infringing and interfering with Methanex's ability to conduct business in the United States, particularly in the state of California, and the ability of its U.S. investments, Methanex U.S. and Methanex Fortier, to do the same. By preventing Methanex and its U.S. enterprises from maintaining their market share, and instead transferring that market share to the domestic ethanol industry, the United States "t[ook] a measure tantamount to . . . expropriation of . . . an investment." 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.

Third, as explained above, these measures were not imposed "on a non-discriminatory basis," but rather were intended to protect the U.S. ethanol industry.

Fourth, as was also noted above, given the discriminatory, arbitrary and excessive nature of the measures, they fail to meet the requirement of Article 1110(c) that they comply with "due process of law and Article 1105(1)."

Finally, Methanex has not been compensated for the harms it has suffered as a result of these measures tantamount to expropriation.

VII. CAUSES OF ACTION

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.

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.

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.

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.

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

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.

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

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.

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.

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

VIII. CONSENT AND WAIVER

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. However, to meet the spurious U.S. objections, Methanex will file additional consents and waivers when this claim is finally filed.

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.

February 12, 2001

Respectfully submitted,

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