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 RESPONSE TO THE
SUPPLEMENTAL STATEMENT OF DEFENSE ON INTENT OF
RESPONDENT UNITED STATES OF AMERICA

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Pursuant to the Tribunal’s Order dated February 12, 2003, Methanex provides the following “brief written submission setting out Methanex’s position on the nature and timing of the next stages of these proceedings.”

I. Response to Jurisdictional Objection

Methanex’ assertion that California banned methanol as well as MTBE in 1999-2000 is not a new claim. Rather, the methanol ban is specific and compelling evidence that California intended to harm all methanol producers, including Methanex, by excluding them from the California oxygenate market, in favor of the U.S. ethanol industry. Indeed, because California has no local methanol producers, this case represents the classic model of economic protectionism – California acted to the detriment of non-Californian methanol producers, with little or no recourse to the political process, in order to favor the creation an in-state, California ethanol industry. Such evidence meets the Tribunal’s intent test and fully supports Methanex’ claim.

II. The Tribunal Should Consider All Relevant Circumstantial Evidence That Tends To Show California’s Improper Intent.

In its First Partial Award of August 7, 2002, the Tribunal ruled that Methanex may “rely generally on circumstantial materials[,]” and that it may “rely on reasonable inferences” drawn from such circumstantial evidence. (See ¶ 149.) The Tribunal’s ruling is consistent with international law, including generally accepted principles of municipal law.

In legal disputes where intent is relevant, courts and tribunals normally recognize that “intent must be inferred from conduct of some sort,” and that it is thus
“permissible to draw usual reasonable inferences as to intent from the overt acts.”

_Cramer v. United States_, 325 U.S. 1, 31 (1945). Without the use of circumstantial evidence and the flexibility of inference and deduction, it would be difficult to ever prove intentional wrongdoing, because direct proof of an actor’s intent is usually impossible to obtain. _See, e.g., Corfu Channel Case_ (U.K. v. Albania), 1949 I.C.J. 4, 18 (Merits Judgment of Apr. 9) (holding that where the direct evidence of liability is in respondent’s exclusive control, a claimant must “be allowed a more liberal recourse to inferences of fact and circumstantial evidence”); _In re Fording Coal Ltd. & U.S.W.A._, 1998 C.L.A.S.J. 670412, at *51 (British Columbia 1998) (“As motive is subjective, it may be established by inference in the absence of specific proof of intent.”) (internal quotation marks and citation omitted); _Anya v. Univ. of Oxford_, [2001] E.W.C.A. Civ. 405, at *5 (United Kingdom C.A. 2001) (stating that a finding of intentional discrimination “will therefore usually depend on what inferences it is proper to draw from the primary facts found by the tribunal”) (internal quotation marks and citation omitted); 2 J. Wigmore, _Evidence in Trials at Common Law_ § 242, at 44 (1979) (“[I]ntent as a separate proposition for proof does not commonly exist.”); _Tyler v. Bethlehem Steel Corp._, 958 F.2d 1176, 1183 (United States 2d Cir. 1992)(“[T]he basic problem . . . is that “direct evidence” of intent cannot exist, at least in the sense of evidence which, if believed, would establish the ultimate issue of intent to discriminate.”), _cert. denied_, 506 U.S. (1992) (citation omitted).

In fact, the United States in its Statement of Defense implicitly accepts and relies upon this black-letter legal rule by arguing that the record “believes any intent on California’s part to discriminate against Methanex . . . [because] Methanex was selected
for participation in an important California initiative on fuel cells.” (See ¶ 49, emphasis in original.) Thus, the United States proffers circumstantial evidence about issues wholly unrelated to California’s ban of MTBE, and asks the Tribunal to infer from those circumstances the absence of any intent to harm Methanex. If California’s conduct in awarding fuel cell business to Methanex is relevant circumstantial evidence, then surely so is evidence concerning why California imposed the MTBE ban, and what the MTBE ban was intended to achieve.

As set forth in the Second Amended Statement of Claim, it is clear as a matter of law that impermissible intent can be inferred from an unreasonable justification for an action. (See ¶ 30.) Here, a central premise of Methanex’ case is that there was no adequate scientific basis for the ban, especially now that the United States concedes that substituting ethanol for MTBE will lead to an increase in air pollution. (United States Suppl. Stmnt. of Defense on Intent ¶ 95.) That will become apparent when the Tribunal scrutinizes California’s scientifically unreasonable justification for the ban, and then compares it with, for example, the refusal of the European Union to enact a similar ban. The fact that there was no scientific justification supports the inference that some other motive was at work.

It is equally clear that intent can be inferred by comparing the general suitability of a given decision with its purported purpose. (See id. ¶ 33.) Here, the remedy California imposed – singling out and banning MTBE – failed to achieve its intended purpose – cleaning up the water. California’s drinking water has, in fact,
become almost MTBE-free, but only because polluting jet skis were banned from reservoirs and many leaking underground gas tanks finally have been fixed.

In fact, the ban was purportedly imposed in the first place “because of leaking underground fuel storage tanks.” (United States Suppl. Stmt. of Defense on Intent ¶ 21, emphasis added.) By fixing the underlying problem – leaking underground gasoline tanks – California remedied the problem. Consequently, it was not necessary to ban MTBE. When a measure such as the MTBE ban is so obviously unsuitable to its intended purpose, it is fair to infer that some other motive was at work.

Finally, it is axiomatic that when intent is an issue, only an examination of the record as a whole can support an appropriate determination as to improper motive. (See id. ¶ 32.). Focusing on discrete issues, as the United States seems to suggest, such as legislative responsiveness, without examining all the available evidence in proper context, would be an entirely inappropriate method of ascertaining intent.

All the evidence of the circumstances surrounding the MTBE ban that was proffered by Methanex in its Second Amended Statement of Claim is relevant to the determination of intent. Of particular relevance is the material concerning the scientific justification for and the suitability of the MTBE ban. Thus, the Tribunal should reject the United States’ request that this proceeding go forward in a piece-meal fashion, limiting the next hearing to only those issues the United States deems relevant. Instead, as a matter of basic procedural fairness and commonsense, the Tribunal should consider all the evidence that Methanex has put forward, and conduct a full hearing on the merits.

This proceeding is governed by international law under NAFTA Chapter Eleven. The most relevant branch of international law in interpreting these obligations is the steadily growing body of NAFTA and WTO international trade law decisions. International trade law is clear, however, that the government imposing a measure that appears to violate international obligations bears the burden of justifying its applicability on environmental grounds.

In these circumstances, the United States has the burden of proof to justify the environmental basis of the California measures. Any environmental justification for California’s action is a limited exception from NAFTA obligations, in the nature of an affirmative defense. (See United States – Measure Affecting Imports of Woven Wool Shirts & Blouses from India, WT/DS33/R (6 Jan. 1997) (Adopted as Affirmed by the Appellate Body 23 May 1997), at 14)(holding it only reasonable that the burden of establishing a defense should rest on the party establishing it.) This position is in accord with the United States’ position in prior FTA disputes, the predecessor of NAFTA. (See In re Canada’s Landing Requirement for Pacific Coast Salmon and Herring, Final Report of the Panel (Oct. 16, 1989) ¶ 7.02 (United States, as complainant, asserted that respondent Canada bore the burden of establishing the applicability of a limited environmental exception to general obligations); Lobsters from Canada, Final Report of the Panel (May 25, 1990) ¶ 9.3 (United States as respondent bore the burden of
establishing the applicability of a limited environmental exception to general obligations).

Accordingly, it is the United States’ burden to justify the environmental need for California’s MTBE ban.

IV. Methanex Does Not Have to Prove Bad Faith.

In accordance with the Tribunal’s ruling, Methanex is required to prove an intent to disfavor one set of producers in order to benefit a different but competitive set of domestic producers. (See Tribunal First Partial Award ¶ 154.) Contrary to the government’s assertions, Methanex does not have to prove California’s bad faith. This case hinges on the existence of discrimination and economic protectionism, and such protectionism is not founded in bad faith.

The case law, both domestic and international, makes clear that Methanex is only required to prove an intent to disfavor one set of producers in order to benefit a different but competitive set of domestic producers. The WTO Appellate Body confirmed the point in European Communities —Measures Affecting Asbestos and Asbestos-Containing Products, Appellate Body Report, WT/DS135/AB/R ¶ 100 (12 Mar. 2001). “[I]f there is ‘less favorable treatment’ of the group of 22 ‘like’ imported products, there is, conversely, ‘protection’ of the group of ‘like’ domestic products.” Id. Professor Ehlermann similarly notes both the logic and inevitability of the conclusion. (See Ehlermann Op. ¶¶ 107-08 (Ex. D.).) The standard required to demonstrate economic protectionism is not the same as the standard required to demonstrate bad faith.
Indeed, the United States has itself embraced the same principle in trade proceedings involving national treatment. In *Japan — Measures Affecting Consumer Photographic Film and Paper*, for instance, the United States argued:

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

Panel Report, WT/DS44/R ¶ 7.2 (31 March 1998); *see also European Communities — Trade Description of Sardines*, Panel Report, WT/DS231/R ¶¶ 7.44-7.46 (29 May 2002) (Adopted as Affirmed by the Appellate Body (23 October 2002)(noting that not only the express purposes but also the corresponding negative implications of state action must be taken into consideration); *see also European Communities — Trade Description of Sardines*, Appellate Body Report, WT/DS231/AB/R ¶¶ 176, 179, 195 (Adopted by the Appellate Body (23 October 2002) (confirming a measure may be prescribed in either a positive or negative form).

Thus, Methanex need not prove that California acted in bad faith.

V. There Is A Clear Need For Additional Evidence In This Case.

The Tribunal concluded that, in order to satisfy Article 1101(1) of NAFTA, Methanex must demonstrate the “intent underlying the U.S. measures.” (Aug. 7, 2002 Award ¶ 172(4).) In order to satisfy this showing, particularly because proof of “intent” is usually inferred from all the facts and circumstances of a case, Methanex seeks
testimony and documentary evidence from a number of witnesses. On October 4, 2002, Methanex requested that the Tribunal issue an order allowing Methanex to begin the process of obtaining the additional evidence set forth in the Annex to Methanex’ First Request for Additional Evidence.

There should no longer be any doubt that this is very much a factual dispute that will hinge on the evidence presented to the Tribunal. For example, the United States claims that there “was no discussion of methanol at the [secret] dinner, nor was there any discussion of the benefits or detriments of ethanol as compared with MTBE.” (United States Suppl. Stmt. of Defense on Intent ¶ 43.) The fact that the attendance list was dominated by ethanol executives tends to indicate just the opposite, however, and it is hardly credible that Archer-Daniels-Midland (“ADM”) executives would not have seized so golden an opportunity to criticize MTBE. To test the credibility of the United States’ assertions, Methanex should be permitted to examine ADM’s documents concerning the secret meeting with Governor Davis. Similarly, Methanex should be permitted to examine the documents of Mr. Richard Vind and Regent International (“Regent”). As Chairman and CEO of Regent, Mr. Vind arranged for and attended meetings between California officials and ethanol producers, and he has personal knowledge of what was said, discussed, and/or negotiated in those meetings. Finally, Methanex should also be permitted to obtain the documents and testimony of California officials, including Governor Davis, that are relevant to this issue. Such evidence is undoubtedly material to this dispute, and it is necessary to the full and fair presentation of Methanex’ case before this Tribunal.
Under the International Bar Association’s rules that the United States consented to, a party is allowed to obtain relevant evidence. As agreed by the parties, Article 3 of the IBA Rules governs the exchange of documents; Articles 4 and 5 govern the presentation of testimony by expert and fact witnesses. These provisions not only permit a party to obtain relevant evidence, they require that the Tribunal take steps necessary to ensure that the party has the opportunity to do so. (See IBA Rules Arts. 3.8, 4.10 (both providing that the Tribunal “shall take the necessary steps” if the requested evidence is relevant and material) (emphasis added). 28 U.S.C. § 1782 provides that opportunity.

As the United States’ submission now makes clear, both in terms of the issues it highlights and the witnesses on which it relies, factual disputes will abound in this case. Procedural fairness mandates that Methanex be permitted an opportunity to use the available law of the situs of this arbitration to gather relevant and material evidence in order to prepare its case.

VI. The Scope of The United States’ Supplemental Statement of Defense

This is not, of course, the appropriate time for Methanex to rebut each assertion made by the United States in its Supplemental Statement of Defense. Such rebuttal is more appropriate after all relevant evidence is obtained, at a full hearing on the merits. Methanex notes, however, that the United States has repeatedly failed to respond to many of the critical assertions of Methanex' Second Amended Statement of Claim, contrary to the UNCITRAL Rules. UNCITRAL Arbitration Rules, Article 19, requires
that “[t]he statement of defense shall reply to the particulars of the statement of … claim” made by the claimant. Because the United States has failed to comply and instead simply ignored certain of Methanex’ factual and legal claims, it must be deemed to have conceded them.

For example, the United States ignores the fact that Governor Davis expressly intended that Methanex’ methanol sales would be replaced by sales from a new California bio-mass ethanol industry. By its own terms, Executive Order D-5-99 mandated steps to foster development of a domestic ethanol industry in California, and only an ethanol industry, to help replace MTBE. (See Exec. Order D-5-99 ¶¶ 10-11; Second Amended Statement of Claim ¶¶ 159-160.) There can thus be no dispute that the intent of the Executive Order, and the subsequent regulations implementing such Order were to create, favor, and protect a California ethanol industry. This intent to create a favored California industry is at the heart of Methanex’ asserted case, and the United States’ failure to rebut Methanex’ assertion that the requisite intent is displayed in the Order itself must be deemed an admission.

legislative record acknowledges: “There are several fuels that can be blended with gasoline to form oxygenated fuels, including ethanol, ETBE (an ethanol derivative), methanol, and MTBE (a methanol derivative).” Clean Air Act Amendments of 1990: House Debate, Pub. L. No. 101-549, 104 Stat. 2399, reprinted in 1990 CAAA Leg. Hist. 2446, 2516 (emphasis added); see also Regulation of Fuels and Fuel Additives: Renewable Oxygenate Requirement for Reformulated Gasoline, 59 Fed. Reg. 39,258, 39,260 (Aug. 2, 1994) (codified at 40 C.F.R. pt. 80) (discussing a “proposed renewable oxygenate requirement . . . defined in the proposal as ethanol and methanol from renewable sources, and their ether derivatives”) (emphasis added); Clean Air Act Amendments of 1990: House Debate, supra, 1990 CAAA Leg. Hist. at 2518 (“Another potential oxygenated blend is a methanol/gasoline blend. Like ethanol, methanol can be splash blended with gasoline.”); See also 67 F.R. 68242, 68414 (Nov. 8, 2002) (“The analytical equipment for measuring emissions of oxygenated compounds (for example, methanol) is specified in Subpart I of this part.”) (emphasis added).

In fact, the Environmental Protection Agency currently has methanol listed as an oxygenate in its website.1 The United States’ failure to “reply to the particulars” of its own past statements should be deemed an admission that methanol can be used as an oxygenate.

The United States also does not address Methanex’ showing that an intent to harm can be inferred from the fact that the harm was foreseeable. Here, there is no doubt that because the harm to Methanex was actually foreseen by Sen. Burton, it was foreseeable by Governor Davis. The United States’ refusal to “reply to the particulars” of this assertion must be taken as a concession that the harm to Methanex was foreseen by, and thus intended by, California.

Another of Methanex’ central arguments is that methanol competes directly with ethanol because refiners which are captive MTBE manufacturers have a binary choice between buying methanol to manufacture MTBE, or buying ethanol for splash blending in gasoline. Instead of responding to this assertion, the United States pretended that the binary choice was between splash blending methanol or splash blending ethanol. Because it once again failed to “reply to the particulars” of Methanex’ assertion, the United States should be deemed to have conceded that methanol competes directly with ethanol in the refiners’ market.
### VII. Proposed Procedural Schedule.

<table>
<thead>
<tr>
<th>Date Range</th>
<th>Description</th>
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<tbody>
<tr>
<td>April 1, 2003 to September 30, 2003</td>
<td>Obtain evidence, both in case-in-chief and for rebuttal, and resolve related disputes. Methanex requests the Tribunal recognize the potential need to extend this period because of opposition by the United States.</td>
</tr>
<tr>
<td>April 30, 2003</td>
<td>The United States shall submit its evidence-in-chief, including witness statements, on the issues set forth in Methanex’ Second Amended Statement of Claim.</td>
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<tr>
<td>May 30, 2003</td>
<td>Any submissions by Canada or Mexico pursuant to Article 1128, and limited in accordance with that article, or any submissions by <em>amici curiae</em>, shall be made.</td>
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<tr>
<td>November 30, 2003</td>
<td>Thirty days after all additional evidence has been obtained, parties submit rebuttal witness statements and identification of witnesses to be cross-examined at hearing.</td>
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<tr>
<td>December 15, 2004</td>
<td>The Tribunal may advise the parties whether there are any witnesses not called by the parties whom the Tribunal wishes to call.</td>
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<tr>
<td>January 2004</td>
<td>Full hearing on the merits (estimated to require approximately 8 days).</td>
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Respectfully submitted,

/s/ Christopher F. Dugan

*Attorney for Methanex Corporation*

Dated: March 26, 2003
EXHIBIT 1

Methanol Listed As An Oxygenate

http://www.epa.gov/swerust1/oxygenat/oxytable.htm

U.S. Environmental Protection Agency Website

dated

March 25, 2003