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

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METHANEX CORPORATION,
                 :
Claimant/Investor,
                 :
and
                 :
UNITED STATES OF AMERICA,
                 :
Respondent/Party.
                 :
- - - - - - - - - - - - - - - - -x Volume 1

FINAL AMENDED TRANSCRIPT

Monday, June 7, 2004

The World Bank
1818 H Street, N.W.
MC Building
Conference Room 13-121
Washington, D.C.

The hearing in the above-entitled matter
came on, pursuant to notice, at 9:35 a.m. before:

V.V. VEEDER, Q.C., President

PROF. W. MICHAEL REISMAN, Arbitrator

J. WILLIAM ROWLEY, Q.C., Arbitrator
Also Present:

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Tribunal Legal Secretary

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Senior ICSID Counsel
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P R O C E E D I N G S

PRESIDENT VEEDER: Good morning, everyone,
and we welcome the legal representatives of the
disputing parties together with the legal
representatives of Mexico and Canada. In
accordance with our provisional schedule, we call
upon the claimant to make its opening oral
submissions, and we hand the floor to you,
Mr. Dugan.

OPENING STATEMENT BY COUNSEL FOR CLAIMANT/INVESTOR

MR. DUGAN: Thank you very much,
Mr. President, and members of the Tribunal.
Methanex is very pleased to be here and have the
merits of its case heard. Methanex recognizes that
much of the delay in this case was due to
Methanex's amendment of the claim in early 2001,
but that is now behind us. And as I said, we're
delighted to be moving forward with a full hearing
on the merits of the case.

This, obviously, is a case of significant
importance to the international arbitration
community, to the utility of international law, and
to American jurisprudence, and we realize that it
represents and presents to the Tribunal some very
difficult and very thorny issues dealing with the
American political system. But all Methanex asks
for is a fair hearing upon the merits on both the
law and the facts.

Now, in terms of the presentation that I'm
going to make today, I'd like to go over first with
the Tribunal the structure that I'd like to proceed
so that there's no misunderstanding. In terms of
the evidentiary issues, we had discussed prior to
this hearing that we are—we would be willing to do
our best to make available to the Tribunal
Mr. Puglisi and also the lawyer for whom
Mr. Puglisi works, who had also been retained by
Methanex; and the Tribunal advised that it would
take that under consideration in determining when
and how to deal with the issue of the documents.

So, unless there is some misunderstanding, I
believe we will defer that to a later point in the
Now, with respect to the other unresolved evidentiary issues, I think, and it would be my proposal, if the Tribunal agrees, to put them off to the closing, for this reason: Much of what we asserted in our evidentiary motion with respect, for example, to what we believe are U.S. admissions concerning, for example, the primary impact on foreign methanol producers of a shift in the market to ethanol, those go to the weight of the evidence, really, more than to any exclusion of the evidence; and I think as a weight-of-the-evidence issue, they're probably more appropriately and more effectively dealt with here at the closing, rather than at the opening.

Similarly, with respect to the United States's failure to produce the negotiating history, I think that that will come down to two issues. One issue is a question of whether the Tribunal is going to be willing to draw adverse inferences from that, and if so, what adverse
inferences will be drawn. And for that reason, I think that's also more appropriately dealt with, perhaps, just prior to the start of the closing. Similarly, I think the same analysis applies to the issue we raised in our evidentiary letter with respect to the United States's blocking of our attempts to obtain relevant evidence from third-party witnesses. I think the two issues that the Tribunal will have to resolve are, first, whether or not to draw inferences from that conduct; and, secondly, what inferences to draw. And again, I think that's probably all done more effectively in the closing, which will focus, in large part, on the inferences to be drawn from the totality of the evidence that's before the Tribunal.

So, with the--if the Tribunal's agreeable, that's how I intend to deal with the evidentiary issues.

Now, what I'd like to deal with today are to go over the facts and the law with respect to
Methanex's three claims: Article 1102, national treatment; Article 1105, fair and equitable treatment; and Article 1110, expropriation.

I'd then like to demonstrate why the evidence, we believe, shows quite conclusively that Methanex has significant investments in the United States and that Methanex has been significantly damaged and proximately damaged by the actions of the State of California.

And that leaves, I think, one issue, which is our application to redress—or to readdress the issue of what is the appropriate test here in terms of determining whether there exists a legally significant relationship.

And I would like to deal with that after the opening presentation, either during the closing—I think during the closing would be the preferable time to do it.

And the reason why I want to do it is, as you'll see today, there is, I think, a significant issue in the record, that has developed in the
record, since the time we filed our Second Amended
Claim--Complaint, that I think the Tribunal will
have to take issue of and that I think will affect
the contours of that argument. So, again, I think
that that argument should be pushed off to
the--after the witnesses, as well.

Now, I'd like to start with an analysis of
Article 1102, the national treatment provision of
NAFTA, and I'm starting with that because I think
an analysis of the facts and the law under that
case provides a good foundation for our arguments
with respect to 1105 and 1110. I think that each
of the arguments are equally sound; but as you'll
see from the presentation today, most of my effort
will be concentrated on 1102. But especially the
facts that we intend to develop today, we intend to
draw the Tribunal's attention to, will support the
same types of conclusions with respect to 1105 and
1110.

Now, Methanex's position with respect to
1102 is that, as a legal matter, it requires a
three-step analysis. The first step is that the Tribunal must determine whether the United States's industry is in like circumstances with Methanex and its investments. If the Tribunal finds that ethanol producers are in like circumstances with methanol producers, then the second step is to determine whether any of the methanol producers, i.e. Methanex, have received something less than the most favorable treatment that's accorded to the United States's ethanol industry.

If, as a result of the second step, the Tribunal concludes that, in fact, methanol producers, including Methanex, have received less than the most favorable treatment accorded to ethanol, then it shifts to the third step. And the third step is to determine whether there is any rational, any reasonable, any justifiable basis for that disparate treatment between the methanol industry and the ethanol industry.

And as we will see when I get into it a
little bit more, in more detail, it's Methanex's position that if we get to the third step, it's going to be the United States's burden to show if this disparate treatment is justified on an environmental basis.

Now, moving to the first step, the question of like circumstances and the question of the definition of like circumstances, Methanex makes two principal arguments concerning the meaning of "like circumstances."

First, "like" does not mean identical. That should be self-evident from the language of NAFTA. NAFTA doesn't use the word "identical." It uses the word "like," and there is a world of difference between "like" and "identical."

Similarly, if you consult the French and the Spanish text of NAFTA, you will see that the French uses the word "analog" or analogous or the equivalent of analogous. I don't speak French fairly well, so I can't pronounce it correctly, but that I think you see the import of what I'm trying
to get across, which is it doesn't use the word
"identical" either. The same is true for the
Spanish text, which uses the word "similar."
Again, all of these phrases, in my mind,
as I understand it, connote something much
different than "identical."
So, it's Methanex's position that the test
is not identity. The test is likeness. And that
means that it's irrelevant that Methanex is in
identical circumstances with other U.S. methanol
producers. That's not relevant.
Similarly, it's not relevant that Methanex
is not in identical circumstances with U.S. ethanol
producers. The critical question here is whether
methanol--and methanol U.S. in particular--is in
like circumstances with U.S. ethanol producers.
That's the test before the Tribunal as methanol
sees it--as Methanex sees it.
Now, in terms of the negotiating history,
one issue that I'd like to raise at this point is
that with respect to whether there is any
negotiating history, we're aware that the United States has indicated in other contexts--there was a case under Chapter 20 of NAFTA involving trucks from Mexico, in which the United States proffered a interpretation of like circumstances and referred to the negotiating history of like circumstances as supporting its interpretation of like circumstances in that particular case. So, we believe there may well be relevant negotiating history as to what the appropriate definition of "like circumstances" is with respect to Chapter 11 as well.

Now, moving on to Methanex's second principal argument, Methanex argues that the critical test of like circumstances is competition. If two investments compete with each other in the sense that one can take business away from the other, then they're in like circumstances.

Now, the best precedent, the best NAFTA precedent that we think establishes the importance of competitiveness in the like circumstances test is the S.D. Myers case. And we've put up on the
screen an excerpt, you can find that at Tab 2, an excerpt from the S.D. Myers case that I think explains this quite lucidly.

The concept of like circumstances invites an examination of whether a non-national investor complaining of less favorable treatment is in the same sector as the national investor. The Tribunal takes the view that the word "sector" has a wide connotation that includes concepts of economic sector and business sector, and the key phrase there, of course is "wide connotation."

And then it went on to apply that articulation of like circumstances to the facts before that Tribunal. SDMI--that's a reference to S.D. Myers--was in a position to attract customers that might otherwise have gone to the Canadian operators because it could offer more favorable prices and because it had extensive experience and credibility. It was precisely because SDMI was in a position to take business aware from its Canadian competitors, that Chem Security and SynTech lobbied
the Minister of the Environment to ban exports when
the U.S. authorities opened the border.

So, the S.D. Myers Tribunal focused quite
clearly on competition between the two parties and
whether one party was in a position to take
business away.

Now, we believe that WTO precedent is
similar to this NAFTA precedent, and the second
excerpt that we've got is just a short quotation
from a WTO organization case, an asbestos case:

"Thus, a determination of likeness under
Article 3(4) is fundamentally a determination about
the nature and extent of a competitive relationship
between and among products. Now, that's a
determination of likeness, not like products, a
determination of likeness, and we think that that
concept is equally applicable here. Likeness is
fundamentally a determination about the nature and
extent of the competitive relationship.

Now, I don't think any of the state
signatories to NAFTA disagree with that
proposition. They all recognize that competition is an important element of the likeness test. I don't think we've gotten a clear definition of what else is important from the state signatories other than an assertion that all the facts and circumstances are important, which Methanex doesn't agree with. But I think that there is at least some level of agreement, that competition is the most important element of this test.

Now, Methanex obviously asserts that it is and Methanex-US's in like circumstances with the U.S. ethanol industry; and to use the S.D. Myers analytical framework, the relevant economic sector here is the production and sale of oxygenates used in the manufacture of RFG, which stands for reformulated gasoline and oxygenated gasoline. So, the final product here, the end product is RFG and oxygenated gasoline, and the sector we're talking about is the production and use of oxygenates which are used to make oxygenated gasoline.

Now, the fact that the two oxygenates I'm
talking about, methanol and ethanol, are used in slightly different ways in the gasoline manufacturing process we do not believe has any relevance. It doesn't affect the competitive analysis, and it certainly doesn't affect the competitive analysis for the integrated oil companies.

Now, what I'd like to put up, first of all, is just a chart from the United States Environmental Protection Agency, and you've seen this chart. We included it in our brief, and the chart simply lists oxygenates, the class of oxygenates, methanol, ethanol, TBA, MTBE, DIPE, ETBE, TAME, and I think that's it. It's listed in this list. So, the list of oxygenates is extensive. There are a lot of chemicals that function as oxygenates, and methanol and ethanol are quite clearly in that class. And again, we would submit and will draw attention to this in the closing, this is an admission of the United States Government that ethanol and methanol are in a class
of very closely related products.

So, how is ethanol and how are ethanol and methanol used respectively in the production of RFG and oxygenated gasoline. We've prepared a very, very simplified chart of the gasoline manufacturing process that we think illustrates how they're used, and also illustrates that it simply doesn't make that much difference that they're used at different points.

Now, on this chart, which is chart four, the first chart deals with how methanol is used in the production of RFG, and as can you see, methanol is used in the--at the stage where isobutylene comes down from the fluid catalytic cracker. We'll attempt to tab those over lunch to make sure that it's easier for you.

You can see from the first chart methanol is used by--it feeds into the MTBE plant where it's combined with isobutylene, and then it goes from the MTBE plant to the blending process, and it's blended with or without a number of the other
various agents, and that gasoline is then delivered
to the consumer.

If methanol is not used, that's the second
chart, you can see that what simply happens is that
ethanol is blended at the blending stage with or
without all these other various other blending
agents, and then the gasoline is delivered to the
consumer.

So, it's true that methanol and ethanol
are used at different stages in the production
process of oxygenated gasoline, but we argue that
that has no relevance whatsoever. The fact of the
matter is that especially integrated oil companies
buy either methanol, or they buy ethanol, and they
buy these oxygenates--and they are both
oxygenates--in order to manufacture oxygenated
gasoline.

Now, it's important to remember that when
methanol is combined with isobutylene to make MTBE,
the isobutylene has no oxygen in it. The most
appropriate way for a non-chemical engineer to
think of it is that the isobutylene is simply a convenient delivery device for the oxygen that's contained in methanol; but it's methanol that is supplying the oxygen to reformulated gasoline that uses MTBE, just like it's ethanol that is specializing the oxygen to reformulated gasoline that uses ethanol. So, in that sense, the two are entirely equivalent, they are oxygenates with slightly different chemical character that are used by integrated oil companies in the manufacture of reformulated gasoline.

Now--and I'm focusing now on the integrated oil companies as opposed to the gasoline blender segment of the market. I think it's useful to divide the market into two segments. Integrated oil refineries are the--just what it says, integrated companies that have sometimes upstream operations, crude oil operations, and downstream operations where they deliver the gasoline to the consumer. Chevron is a good example. It has integrated operations from crude all the way down
Now, before the California ban, these integrated companies typically did just what I showed. They combined their captive stream of isobutylene with methanol, manufactured MTBE, and blended that with their gasoline at their blending plants before they delivered it to the consumers. Now, over the last several years prior to the ban, Methanex has supplied methanol to at least six of the integrated oil companies in California: ARCO, Chevron, Exxon, Tesoro, Tasco, and Valero. That's all found in the second Macdonald affidavit, paragraph 23, which I think we provided to you. Now, sales to these integrated oil companies accounted for a hundred percent of Methanex's business in California, and there is no doubt about that. It's in Mr. Macdonald's affidavit. The United States chose not to cross-examine him. It is, in essence, an undisputed fact. Now, since the ban went into effect, these
refiners, these oil companies, have shifted to ethanol. They've stopped buying methanol, and now they buy ethanol. And again, that's in Mr. Macdonald's affidavit. And they've done exactly what was illustrated on the two charts because they're now required to use ethanol.

Now, the U.S. argues that Methanex has not met its burden to show that these integrated oil company have shifted to ethanol, but that's just ridiculous. I mean, in addition to Mr. Macdonald's affidavit, evidence submitted and relied upon by the United States itself shows that that's precisely what's happened. The integrated refiners have shifted to ethanol, and what I've got up on the screen now is Exhibit 5, and it's just an excerpt from a California Energy Commission report that was submitted by the United States as part of its evidence, and I think the quote corroborates precisely what Mr. Macdonald has stated in his witness statement. This is the quote: "Since completion of the Energy Commission's previous
survey of ethanol industry production capacity in August 2001, ethanol has been successfully introduced into CaRFG"--that stands for California reformulated gasoline--"by most California refiners."

In early 2003, ExxonMobil, ChevronTexaco and Southern California BP and Shell commenced ethanol blending with Chevron Texaco, and Northern California, Valero, and Tesoro completed their transition to ethanol by December 31st, 2003.

Now, again, those are Methanex's customers. Those are precisely the same customers that Methanex had sold methanol to prior to the ban.

Now, perhaps the most vivid evidence of the--what we called the binary choice for these integrated oil companies, binary choice between methanol and ethanol, is the Valero-Methanex sales contract for the sale of methanol. And this contract has an opt-out provision because of the California MTBE ban, and if I could turn your
attention to that, that's Exhibit 6. And this is the provision of that sales contract between Methanex and Valero. "Buyers shall not be liable for any delay or failure to perform under this agreement to the extent arising from or directly related to any governmental law, regulation, ordinance, psychiatry decree, subsidy, or action of whatsoever that buyer can reasonably establish has caused an adverse effect on buyer's production of or demand for MTBE in California. In such a circumstances, buyer shall, upon prompt notice to seller, have the right in its sole discretion to restrict or cease acceptance of an amount of product hereunder"--product in that case being methanol--"which on a percentage basis represents the reduction in the demand for buyer's MTBE affected by such law and buyer's minimum purchase obligation shall be reduced by the quantities so admitted."

Now, as Mr. Macdonald explains, this provision was in the contract because of the MTBE
ban. If it went into effect, Valero reserved the right to stop buying methanol, and that's precisely what happened. The ban went into effect, and Valero, one of Methanex's customers, stopped buying methanol from Methanex and instead bought ethanol, almost certainly from a U.S. producer, in order to manufacture oxygenated gasoline.

So, for these integrated oil companies, there shouldn't be any doubt that there is direct competition, almost one-to-one competition between ethanol and methanol, and every sale of ethanol by the U.S., by the domestic ethanol industry after the ban has taken away a sale of methanol from Methanex to these producers.

Now, there's another segment of the industry. It's the gasoline blenders sector. These are not the integrated oil companies. These are the blenders and distributors who buy gasoline and then blend it and distribute it. These blenders buy now; they buy ethanol in order to deliver oxygenated gasoline. They also blend it
with various other things, depending on what the market they're operating in. Prior to the ban they bought MTBE.

Now, it's Methanex's position that although the competition between ethanol and methanol is different in this section, it's nonetheless direct. It's direct in this sense: Every purchase of ethanol by a gasoline blender since the ban directly displaces a sale of methanol to the MTBE producer. In other words, before the ban, when they were purchasing, when the MTBE producers were purchasing methanol, they purchased methanol, manufactured MTBE, and sold the MTBE to the gasoline blender. Now the gasoline blender buys ethanol, but the direct effect, the direct consequence of that purchase of ethanol by the gasoline blender is a displacement of a sale of methanol to the merchant MTBE producers.

So again, the nature of the competition is slightly different, but the displacement of methanol by ethanol as the oxygenate used in the
manufacture of RFG is still very direct, still very, very immediate.

Now, what I'd like to show you is Exhibit 7, which is simply a statistical analysis of the effect of the binary choice. And it shows--it shows what's happened in the market. In 2002, sales of methanol were 500 million gallons. Sales of ethanol were 100 million gallons. And then, as the ethanol, as the integrated--as the companies began the process of shifting to ethanol, sales of ethanol took off for 2004 that are estimated to be 900 million gallons and sales of methanol decreased correspondingly, and they are expected to be zero in 2004.

So, overall, we believe that this evidence shows the direct competitive relationship between ethanol and methanol in the oxygenate market in California. And again, the way we analyze the market, the final product is RFG, and ethanol and methanol are simply competing oxygenates that are used in slightly different ways in the manufacture
of that final product.

And we believe based on that competitive relationship, that directly competitive relationship, methanol and ethanol meet the test for being in like circumstances. Methanol producers are in like circumstances with ethanol producers because they compete directly and because one has the ability to directly take business away from the other.

Now, that's the first step. The second step is if they are in like circumstances, do they receive the same treatment? Or are they treated differently? Well, what is the same treatment? What is national treatment? Article 1102(3) defines it precisely, and I'd like to draw the Tribunal's attention to the language because we think it's critical to the analysis in this case. This is Tab 8 of our book. It's up on the screen as well.

Article 1102, subjection (3), the treatment accorded by a party under paragraphs one
and two means with respect to a state or province, i.e. with respect to California, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the party of which it forms a part.

Now, we think that couldn't be more clear. NAFTA mandates, NAFTA requires that investments in like circumstances receive the most favorable treatment accorded to any other investment in the same like circumstances. There shouldn't be any ground for reasonable dispute over this. That's what the treaty says. It's as express as it could possibly be. Pope and Talbot, which is one of the NAFTA Tribunals, has interpreted it accordingly. It said that it interprets the standards to mean the right to treatment equivalent to the best treatment accorded to domestic investors in like circumstances.

Now, this is where I think the U.S. argument about the fact that methanol--that
Methanex is in identical circumstances with methanol producers and they are equally badly damaged shows that there's no denial of national treatment. That's not the test. The United States is perfectly capable of treating certain of its own citizens in a way that is arbitrary and unreasonable and very, very inequitable and damaging, and we believe that's how the United States has treated U.S. methanol and MTBE producers, and it's recognized that this is a very—-that the shift to ethanol has been very damaging. The pending energy legislation in Congress has allocated up to $2 billion in relief for MTBE producers. So, Congress recognizes the damaging impact of this shift on the other oxygenate sectors.

But the point here is NAFTA is an international treaty, and NAFTA provides that a foreign-owned investment has to be treated as well as the comparable U.S. investment, and in this case, the comparable U.S. investment is ethanol,
not methanol.

So, the fact that the U.S. treats its own methanol producers badly is irrelevant. The question here is, does Methanex receive the same treatment that's accorded to U.S. ethanol producers, and we think the answer is, obviously, no, it doesn't. Methanol (sic) is not allowed to sell—Methanex is not allowed to sell methanol as an oxygenate for use in the production of RFG. The only oxygenate that can be sold into California for use in the production of RFG is now ethanol.

So, Methanex does not receive the same access to the market in California as the U.S. ethanol industry does.

And in terms of establishing disparate treatment, that should be the end of it. It simply doesn't receive the same treatment. It doesn't receive the same market access that the U.S. ethanol industry does.

Now, if the rule were any different, if the rule were that a state can treat one segment
very, very badly and it's immune from scrutiny under international law so long as some of the citizens, some of the entities that are treated badly are citizens of the state, that would gut international law in many respects, and it would certainly undercut the whole concept of national treatment. And again, the WTO has repeatedly recognized that it is no excuse that a nation may treat a few of its citizens equally as badly as it treats foreigners.

That's not the relevant comparison. The relevant comparison is between how well it treats the best treated of its citizens and how well it treats the foreign investment. And Methanex submits that that quite clearly is the relevant legal test here.

Now, under Methanex's three-step analysis that brings us to what really I think is the heart of the case: Is this disparate treatment of methanol justified and who has the burden of justifying this disparate treatment?
Now, taking the second point first, Methanex's position is that international law, in these circumstances where there has been a showing of like circumstances and disparate treatment, that international law places the burden of justifying the disparate treatment on the respondent country. Now, much of this law, as we'll see, is drawn from the WTO, because the WTO has been dealing with concepts of national treatment and exceptions to the national treatment obligation for over 50 years.

The U.S. asserts that WTO law has no place in this proceeding, and again, we think that's an extreme position that cannot be reconciled with the clear language of NAFTA itself.

Article 1131(1) requires this Tribunal to, quote, decide the issues in dispute in accordance with this agreement and applicable rules of international law. We think that it's quite clear that international law, as it's customarily defined, includes decisions, includes decisions of
Tribunals such as the WTO. So, we think that is--it is particularly relevant here, and it's particularly relevant because these decisions deal with the concept of national treatment. Again, the leading body in interpreting the concept of national treatment is the WTO, and we submit it with, we believe, our Second Amended Claim, an opinion from Sir Robert Jennings, former President of the World Court, who said that it would be unjustifiable for any Tribunal not to look to this body of international law, of WTO law, in deciding a concept of national treatment under a different treaty.

Now, is WTO law controlling? No, obviously not. But should it be treated as persuasive precedent if its analysis and its rules are well developed and consistent and logical? Yes, it should be.

Now, the WTO, as I said, routinely allocates the burden of proof in national treatment cases, and if we could go to a case, the--that by
Irony is a case involving reformulated gasoline, it's a WTO case that came out at the time that the RFG standards were first set forth, and it deals with issues of imports of RFG. This is Tab 11 of your book, the particular segment of the RFG case that I'd like to draw the Tribunal's attention to, and it states, quote, "The Panel noted that as the party invoking an exception, the United States bore the burden of proof in demonstrating that the inconsistent measures came within its scope." And the exception they're talking about there, as we'll see, is the exception to poor human health. "The Panel observed that the United States, therefore, has to establish the following elements: That the policy in respect of the measures for which the provision was invoked fell within the range of policies designed to potential human, animal, or plant life or health; that the inconsistent measures for which the exception was being invoked were necessary to fulfill the policy objective, and that the measures were applied in conformity with
the requirements of the introductory clause of
Article XX."

In order to justify the application of
Article XX(b), which is the exception for health
measures all of the above elements had to be
satisfied.

So, under WTO law, and under WTO
interpretations of the natural treatment standard,
the burden of justifying an environmental or health
measure, after there has been shown that there's
disparate treatment falls on the respondent state.

Now, we believe the same is true under
NAFTA, and there has been one NAFTA case that
took--it's Tab 9, thank you.

"The Panel notes that under the Model
Rules, 33 and 34: 'A Party in asserting that a
measure of another Party is inconsistent with the
provisions of the Agreement shall have the burden
of establishing such inconsistency,' and 'A Party
asserting that a measure is subject to an exception
under the Agreement shall have the burden of
establishing the exception applies. Mexico must establish that the actions (and inactions) of the United States are inconsistent with the schedule for implementation of NAFTA. The U.S. Government bears the burden of showing that its actions and inactions in connection with Chapter 11 are authorized by an exception to NAFTA."

Now, what the U.S. was arguing in that case was that—and let me step back—NAFTA required, in theory, that the United States and Mexico open their borders to each others' trucks, and that was delayed, and frankly, it was delayed because of political pressure from the United States's unions; and the United States adopted a measure that postponed the opening of the borders because of alleged safety concerns with Mexican trucks. So, it was a safety issue, allegedly. The Tribunal found that it was the United States's burden to prove that there was a valid safety reason, and it was the United States's burden to prove that the measures that it adopted
And the Tribunal rejected the United States's position. In essence, it found that the total abolition of the total ban on trucks from Mexico couldn't be justified as a legitimate safety regulation; that if there were legitimate safety concerns, those safety concerns should be addressed in a much more proportionate, reasonable manner.

But I think the key point for what I'm trying to get to right now is that it was the United States's burden to justify the safety restrictions in this NAFTA Chapter 20 case. This wasn't an investment dispute between a private investor. It was between Mexico and the United States, but I think the principle is still the same. Once you establish like circumstances, once you establish disparate treatment and the state justifies the disparate treatment on environmental grounds, it's the respondent state's burden to justify it. They must show that this was necessary.
Now, in terms of what they have to show, we agree that they have to show that--and I think it's laid out to a degree in some of these cases--they have to show that the measure was necessary to fulfill the environmental objective. They have to show that the measure that was adopted was designed to be the most effective measure possible. They have to show that the measure is the least trade restrictive--in this case, I guess, the least restrictive of foreign investments--and they have to show that the measure is not a disguised restriction on foreign investments. And those are the four elements that we believe the United States must show, must meet in order to show that this restriction was justified.

Now, the reason Methanex believes why the burden in these types of cases is shifted to the respondent government is because there's a recognition among legal scholars, and certainly at the WTO, that local interests often tried to use pseudo-environmental reasons to justify what is
actually rank economic protectionism. This is not
a novel argument. There have already been three
such cases, the S.D. Myers case, the Metalclad
case, and the Tecmed case involved these types of
things where there's a reported environmental
justification that's really a disguise for other
reasons. Either protection of the local industry
or just acquiescence to local political pressures.

And so, it is the tendency of governments
to use environmental regulations as a pretense to
dress up what are actually other reasons for doing
it, that the WTO has in many instances confronted,
and that even a number of NAFTA Tribunals have
confronted.

So, there is very sound policy basis for
shifting the burden to the United States in this
case.

So, again, let me repeat that what I think
are the four things the United States must show
here in order to win their case, that this is not a
denial of national treatment. First, they have to
show that the environmental measure is necessary to protect the environment of California.

Second, they have to show that this measure is not a disguised restriction on foreign investment.

Third, they have to show that the measure that was adopted was the least foreign investment-restrictive, the least trade-restrictive. And what I mean by that is, and I would like to quote from the S.D. Myers case, where a state can achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it's obliged to adopt the alternative that is most consistent with open trade, and I think that principle applies equally with respect to investments.

And finally, there is the concept of proportionality. The measure must be proportionate to the problem. That concept was most recently
articulated in the Tecmed versus Mexico case, which was a Bilateral Investment Treaty case between a Spanish investor and the Mexican Government, and the Tribunal said there, "There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure."

Now, that language dealt with the concept of expropriation rather than national treatment, but I believe that the concept is equally applicable to national treatment. That's Exhibit Number 12, the quote from Tecmed.

Now, one last chart I'd like to show you, and it's not precisely on point, but I think it illustrates the analogous principle. One of the cases that we've talked about, and we'll talk about more, is the Ethyl case, Ethyl versus Canada, and that case resulted in a $20 million settlement, Canadian dollars I believe, by the Canadians to Ethyl, which is an American corporation. The issue
there was the introduction of a gasoline additive, MMT, into gasoline in Canada, and the Canadian government issued a partial ban. It banned the intra-province shipment of MMT, and it banned imports of MMT. Apparently the Canadian government under their federal system doesn't have the authority to ban the production, so production was still allowed.

It was challenged by Ethyl in a NAFTA proceeding, but interestingly enough, it was also challenged by the Government of Alberta under what is called the Agreement on Internal Trade, which is analogous to systems that attempt to impose fair trading rules in the international system, and pursuant to the Canadian agreement on international trade, a panel was convened to determine whether or not this ban on MTBE--MMT was justified, and it reached two conclusions that I think are relevant here.

First of all, it placed the burden of justifying the ban on the Federal Government, so it
was not the burden of Alberta to show that the ban was unjustified. It was the burden of the Federal Government to show that this ban, which was introduced for allegedly environmental reasons, was justified. And we can see that from the quote, and this is Tab 11.

The respondent, which in this case was the Canadian federal government, has not demonstrated that there existed a matter of such urgency or risk so widespread as to warrant such comprehensive restrictions as the Act provides on internal trade.

If the legitimate objective of the Act is as stated, to prevent MMT from being used in newer model vehicles in major urban areas, then total elimination of MMT was unduly restrictive.

And again, the key there is that this Tribunal placed the burden of justifying environmental measure on Canada's federal government.

ARBITRATOR ROWLEY: What tab was that?

MR. DUGAN: Tab 11. No, I'm being told
that's wrong.

So, that's how Methanex frames the issue as a legal matter before the Tribunal under 1102. There are three steps. Showing of like circumstances, a showing of disparate treatment, and if those two showings are met by Methanex, then the burden shifts to the United States, and then it becomes the United States's burden to justify what California did on environmental grounds, and it becomes the United States's burden to meet the four criteria that I just discussed.

Now, with that established as at least what Methanex believes is the appropriate legal framework, I'd like to go to the facts and see whether the facts under the facts of this case the United States can meet its burden of showing that the California ban on MTBE and methanol was justified as an environmental measure.

And the general thrust of our case is that what happened in California is that California singled out a proven pollution reducer for
elimination. Despite the presence of other chemicals in California's water, including other chemicals that come from leaking gasoline tanks such as benzene that are much more carcinogenic, much more dangerous, but it didn't ban benzene. It banned MTBE instead. And that singling out of MTBE, which was not the worst product that was affecting California's market, raises serious doubts about the true motive behind what California did.

Now, the first thing to keep in mind is that MTBE has been reckoned by almost everyone to be a very effective product at reducing air pollution. It's one of the best programs that has ever been developed to reduce air pollution. I would just like to show you a slide that summarizes the reduction of air pollutions that--and this is based on our expert reports--that summarizes the reduction of air pollutions. It has greatly reduced the emission of carcinogens such as butadiene and benzene, and it's reduced the
emissions of noncarcinogens, total carbohydrates, carbon monoxide, nitrogen oxide. And together, these reductions in emissions have resulted in a 40 percent lower cancer risk associated with air toxins. MTBE is a very effective product.

Now, the U.S. says that MTBE is toxic and it's carcinogenic, and we disagree. It's not toxic. The United States Environmental Protection Agency has the power and the duty to control toxic substances. It initiated a proceeding to determine whether MTBE can be considered a toxic substance under U.S. law over four years ago, and it has not concluded that it's toxic, and Methanex submits that it cannot conclude that it is toxic because it simply doesn't meet the criteria for a toxic substance.

Canada has reached precisely the same conclusion. If I could show you now what is Tab 14, it is a conclusion of Canada with respect to MTBE's toxicity. The Federal Minister of the Environment and the Federal Ministry of Health and
Welfare have concluded that the predicted concentrations of MTBE in the environment in Canada do not constitute a danger to the environment or to the environment on which human life depends or to human health—to human life or health. Therefore, MTBE is not considered to be toxic as defined under Section 11 of the Canadian Environmental Protection Act.

Now, similarly, the European Union in its refusal to ban MTBE, also concluded that there was no toxic risk from MTBE. If we could turn to—I'd like to just read you some of the quotes on what the European Union concluded with respect to MTBE. It concluded that, quote, The risk of severe toxic effects is insignificant for oral and dermal exposures; quote, that it is not foreseen that toxic effects occur, end quote, even with repeated exposure to MTBE, and, quote, MTBE is not considered to cause adverse health or ecotoxic effects at the taste and odor threshold level, end quote.
It also concluded after conducting a detailed risk assessment, quote, that the risk are not expected to consumers or human health.

So, Methanex's position is that there's no persuasive evidence that MTBE is toxic. It's not a toxic chemical. We will provide a slide for that that has all the appropriate citations as well. It was meant to be in here. I'm not sure where--why it's not.

PRESIDENT VEEDER: Just for the record, if you could give the citation to which exhibit you're reading so it will be in the transcript.

MR. DUGAN: I will. I will go back and do that. These come from European Chemicals Bureau, European Union Risk Assessment Report, 2002, at 179, and I will get you the cross-reference to the joint submission of evidence. The other one came from the European Commission recommendation of 7 November 2001, Official Journal of the European Communities, and that's at 3 JS Tab 22.

And actually, the first one is 21 JS
1  Tab 11, at Annex 1.
2  Now, the U.S. also claims in these proceedings that MTBE is carcinogenic. Again,
3  that's just not true. If we could put up a panel with respect to that, a slide with respect to that,
4  two quotes, there are many other quotes in our documentation, but the first comes from California
5  itself, and this is Tab 15. On December 10, 1998,
6  a separate committee, the Carcinogen Identification
7  Committee of the Proposition 65 Science Advisory
8  Board met in Sacramento to consider whether MTBE
9  had been clearly shown through scientifically valid
10  testing, according to generally accepted
11  principles, to cause cancer. That committee found
12  insufficient support for the proposition that MTBE
13  is a carcinogen and that there was not a
14  demonstrable majority in favor of listing within
15  that community.
16  Now, similarly, European Commission,
17  quote, The suspicion that MTBE can cause cancer was
18  not sufficiently founded by the available data, end
quote. So, that's California and the European Commission finding that MTBE is not a carcinogen.

As I said, in our papers we cited numerous other agencies that have reached the same conclusion, such as the International Agency for Research on Cancer, which is part of the World Health Organization, and the United States Federal, National Toxicology Program, which is part of the National Institute for Environmental Health Sciences.

So, we think the record is quite clear that responsible agencies that have addressed this issue have concluded that there is insufficient evidence to find that MTBE is a carcinogen.

Now, benzene, on the other hand, is both toxic and carcinogenic, and I don't think there's any doubt about that. In any case, it's set forth in the expert opinion of Pamela Williams that we provided at 20 JS Tab C at Tab 49. It's formally classified by the United States as a known human carcinogen. And that's important to keep in mind
because as we will see, California banned MTBE and it didn't ban benzene.

Now, it's our position that MTBE is not toxic, it's not carcinogenic, and that Davis did not ban MTBE as a health measure.

Now, the U.S. repeatedly characterizes it as a health measure, but that's just not true.

Let's go to the evidence. In the bill that directed the University of California to conduct its famous study, and directed Governor Davis to take appropriate action, this is Tab 16, California Legislature directed the Governor. "The Governor shall issue a written certification as to the human health and environmental risks of using MTBE in gasoline in this state. The certification shall state either the following conclusions, that on balance, there is a significant risk to human health or the environment or the environment of using MTBE in gasoline in this state."

So, this is what Governor Dais was mandated to do, and he determined when he made his
certification, he based it only on environmental reasons, not on health reasons. Even though he was expressly directed to consider the health and environmental consequences, he chose to base his conclusion strictly on environmental grounds. In the Executive Order, if we could look at the Executive Order.

My point is this: He could certify that there was a risk to human health and a risk to the environment. That's not what he certified. He certified that there was a risk to the environment only. He did not certify that there was a risk to human health. And it's that failure, that refusal to certify it as a risk to human health that we think is controlling here.

Even Governor Davis did not consider it to be a risk to health. He did consider it to be a risk to the environment, but not a risk to health. And his failure to adopt the language that was in SB 521 confirms that, that he didn't adopt the language that he was proffered to make a
certification that it was a risk to health.

Now, the important--

ARBITRATOR ROWLEY: I'm not following you.

MR. DUGAN: I'm sorry, then let me back up. The Legislature told him to look at both the health and the environment, and he had the authority in making the certification to determine that MTBE was a risk to the health or the environment or both. He chose not to do so.

ARBITRATOR REISMAN: Just to make sure that I understand, Mr. Dugan, back--this is your Tab 16, if you want to refer to it.

MR. DUGAN: Correct.

ARBITRATOR REISMAN: The certification shall state either of the following conclusions.

MR. DUGAN: I'm sorry. What's omitted there, what the ellipsis are there what is omitted, and maybe that is confusing.

The one that's submitted is one that says that on balance, there is no significant risk to human health or the environment of using MTBE in
gasoline in this state. So, the "either" before
refers to a certification of no risk or
certification of risk. We should have put that in
there for the sake of clarity.

PRESIDENT VEEDER: I'm sure we are going
to come to the Executive Order, but the actual
quote used by Governor Davis in the order, in the
preamble to paragraph one, in the order, in the
preamble to paragraph one, is a quote from the
numbered paragraph one.

MR. DUGAN: Right, but I think in his
actual claim--

PRESIDENT VEEDER: In the bill.

MR. DUGAN: In his actual finding, and I
will come to that.

PRESIDENT VEEDER: I don't think that cuts
across your point because what he says in his
certification is that--do you want to look at
Executive Order because we can dig this out and see
if we're understanding your point quite properly.

What he says is: "Now, therefore, I, Gray Davis,
Governor of the State of California, do hereby find
that, quote, 'That, on balance, there is a
significant risk to the environment from using MTBE
in gasoline in this California.'" And you're
saying is that if you look at the numbered
paragraph--one you don't have on the screen but we
do have before us, that he's not saying anything
about human health.

MR. DUGAN: Correct. He was directed to
make a certification, if necessary, with respect to
health, the environment or both, and he chose to do
it only with respect to the environment. And for
that reason, we say that this is an environmental
measure. It's not a health measure. Governor
Davis did not identify health risk. He did not
base the ban on health risk. He based it on
environmental risk only, even though he was
directed to consider the health consequences of
MTBE as well.

Now, we think that the fact that it's an
environmental rather than a health measure is shown
by how it was banned. This ban finally took place almost five years after it was announced, and it was extended for one year in 2002, and when it was extended, the reason why it was extended was simply because of economic reasons, because it cost too much to implement the ban. If we could go to the Governor's Executive Order of 2002, in which he extended the ban, he states, "I find that it's not possible to eliminate use of MTBE on January 1, 2003, without significantly risking disruption of the availability of gasoline in California"--and I'm sorry, this is Tab 17. "This would substantially increase prices, harm California's economy, and impose an unjustified burden on our motorists."

Now, if this were truly a health emergency, it's hard to believe that the Governor would have justified extending the ban for a year because it was inconvenient for motorists. And we submit that the reason why he extended it for a year was because it was not a health concern.
There was no urgent public health crisis that was pending, and that's why he felt compelled to extend it for a year, for economic reasons.

So, if MTBE is not toxic, it's not carcinogenic, it's not a health threat, the real issue is really that it gets into the water, and that when it gets into the water, it makes the water smell bad. That's the issue, and we very much recognize that that's the issue.

Now, just so it's clear what Methanex's position is, Methanex doesn't believe that anybody should ever have to drink any water with any contaminants in it. Methanex tries to run its operations as a chemical company with zero impact to the environment, and it believes that California should have run its regulatory systems with the same goal in mind; that if California were truly concerned with the question of contaminants in water, then it should have taken steps to clean up all the sources of all the contaminants in water, not to single out one chemical that happens to be
identified with foreign interests.

But let's go back to the question, the issue here of MTBE showing up in the water. How serious a concern is this, really?

Well, if you look at the UC, University of California study, what they relied upon was a figure of—they stated that, quote, 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, end quote. That's the U.C. report, Volume 4, which is 4 JS Tab 39-A.

Now, note that those are detectable levels, not necessarily above the five parts per billion aesthetic threshold that California has set, not above, necessarily above, the 13 parts per billion health threshold that California has said, and not necessarily drinking water. Those are wells, not drinking water.

Now, Methanex obviously believes that the problem of Methanex getting into the water was not a serious concern, did not justify a ban, but one
of the best pieces of evidence of that is a study that was compiled by the Natural Resources Defense Counsel, an environmental group, that was based on data collected by the California Department of Health Services for October 1999 to October 2000. That's up on the screen now. It's Exhibit 18. This is referred to in Pamela Williams's expert report. She did a similar study.

And if you look at this report, where is MTBE on the list of the top 23 groundwater contaminants? It's not. It's just not there. Now, benzene is there. It's the third from the bottom, but MTBE is not there. And again, look at the number of samples that exceeded the— I think that's the maximum contaminant level for this contaminant. It shows that for that period, benzene showed up in the water 27 times. MTBE showed up less than 27 times. So, it's not one of the leading contaminants, and even on the basis of the number of times it showed up above maximum contaminant levels, it did not
show up very often. It couldn't have shown up very often. It had to be less than 22.

And, in fact, Methanex believes that the appropriate way of approaching this problem is to look at those water sources that are actually going to be delivered to consumers. Those water--the detections that are at levels of concern, and again the levels of concern here are five parts per billion for the aesthetic threshold, smell and taste threshold, 13 parts per billion for the health threshold. Detections below those levels are simply not of concern. No one can smell it, and no one is going to be get harmed by it.

And let me say another thing about these detection thresholds. Prior to the time that this concern surfaced in California, the United States EPA has set the thresholds at 30 to 40 parts per billion.

ARBITRATOR ROWLEY: Could I just ask you to tell me what the health threshold is.

MR. DUGAN: The health threshold in
California is 13 parts per billion. It used to be 20 to 30 parts per billion as set by the United States EPA.

ARBITRATOR ROWLEY: And can you just tell me how this health threshold fits against your argument that MTBE is not a health threat.

MR. DUGAN: I guess the health threshold is a very conservative threshold to make sure that there is no possibility of contamination, and that's, as I would phrase it, a fail-safe, a fail-safe regulation to ensure that MTBE never reaches the contamination levels where it could be a problem. But I'd be willing to say that there is no credible evidence that anybody has ever gotten sick or in any way been adversely affected by MTBE in the water. So, in that sense it's not a health problem. And I think what we have to look at is, is it a health problem based on the levels at which it's expected to appear in the environment?

And what California did was set a level to make sure that, set on a very conservative basis,
it would never affect any of the consumers in California.

But again, I don't think there is any credible evidence that anyone has ever been adversely affected by drinking water at this level. So it's a conservative, very safety-conscious level that doesn't mean that water containing more than 13 parts per billion of MTBE is going to make someone sick. That is simply not the case.

Now, if you go back to the criteria that I was talking about, that the important criteria here are, first of all, look at water that consumers are actually going to drink. Second, look at the levels of detection; and three, looking at the protocols for detection. The normal protocol for detecting a contaminant is a two detection protocol, the idea being obvious, that one detection may be unreliable, that you can't be certain that there is a contaminant in the water or anything in the water until you do—until you have
Now, Methanex's expert, Pamela Williams, did that type of analysis based on the California data, and what she came up with was a much different analysis than what the UC-Davis study had come up with, and these are the slides at Tab 19, and what this shows is MTBE detection frequency for drinking water sources based on a subset of groundwater data, and when she uses the term "subset," what she's talking about are groundwater sources that are likely to be consumed by people, drinking water, at concentration levels at or above five parts per billion. And she gives both the one detection and the two detection criteria.

And using a two detection criteria, there were no instances in 1999, 2000, or 2001 of groundwater that's likely to get to consumers of being contaminated by MTBE at a level above five parts per billion, the aesthetic threshold.

Even if you use the one part per billion,
accepted scientific protocol, the percentage
detects are still very, very low, in the
neighborhood of one to two-tenths of 1 percent.

Now, the next chart at Tab 19 is the--are the actual numbers that Ms. Williams, Dr. Williams
based this data on, and you can see it reflects the
same type of thing, the subset of data, five parts
per billion concentration criterion for 2000, 2001,
number of detects, zero. For water systems as
well, number of detects zero.

If we could go to the next slide.

Now, this reflects not groundwater, but
surface water. California's water comes from two
chief sources, about 60 or 70 percent of the water
comes from reservoirs, what are called surface
water, and the remaining 30 to 40 percent comes
from groundwater.

ARBITRATOR REISMAN: Just refers to
surface water?

MR. DUGAN: No, what I just said, I'm
sorry, just referred to groundwater.
1 ARBITRATOR REISMAN: To groundwater.
2 MR. DUGAN: And what I'm showing you now--
3 ARBITRATOR REISMAN: Zero detects in
4 groundwater?
5 MR. DUGAN: Zero detects using a
6 two-detection protocol above five parts per
7 billion, five parts per billion again being the
8 aesthetic level.
9 Now, the next chart deals with surface
10 water, reservoirs, and it shows the same thing,
11 using a two detection protocol, five part per
12 billion threshold for the years '99, 2000, 2001,
13 there were zero detects in water that is actually
14 and likely to be consumed.
15 And behind that chart is the more detailed
16 data that Dr. Williams based her analysis on.
17 So, it's Methanex's position that if the
18 data for California's water are properly analyzed,
19 using those criteria, again water that's most
20 likely to be used by consumers, two-detect protocol
21 above the aesthetic threshold, which is a very low
threshold, there wasn't a problem. It simply
didn't exist. It was blown all out of proportion
for reasons that we'll get to later, but a hard
analysis shows that there simply was not a problem
with California's drinking water.

Now, Davis obviously went on to ban MTBE,
despite that, and later to ban methanol, as we will
see.

But, he banned it despite--

ARBITRATOR ROWLEY: Could I stop you there.

MR. DUGAN: Sure.

ARBITRATOR ROWLEY: I take it the UC study
showed a greater number of detects.

MR. DUGAN: It did, and as I pointed out,
it showed a greater number of detects because it
didn't define the data with the same degree of
nuance that Dr. Williams did.

ARBITRATOR ROWLEY: But just staying with
this for a moment, let's assume that Dr. Williams
is right. On the other hand, California was not
acting on Dr. Williams's correct analysis, and the analysis it had showed there were detections. Is that the basic difference?

MR. DUGAN: No, I don't think it is the basic difference, and I think that Methanex's position is that, and I think they were use, both using the same sets of data. Methanex's position is that the California study should have gone deeper into the data, that the California researchers should have looked at exactly how bad is this problem for human consumption, and to do that, they should have adopted the criteria that Dr. Williams adopted, and I think that the data was available to the researchers at the University of California, and that that is a defect in the study, and it was a defect that was known, as I will get to, because I think some of the criticisms, including by agencies of the U.S. Government, was that they had overprotected the prevalence of MTBE in water.

As I said, Governor Davis went ahead and
he banned it any way, but he banned it despite what I think were fairly significant, severe defects in the UC-Davis study that were known at the time. And those defects, I mean, were pointed out, but he banned it anyway. The first was that the UC-Davis study was incomplete. The UC-Davis had been or the University of California had been tasked by the Legislature to do a comparative analysis of a number of potential oxygenates, not just MTBE. It didn't do so. Secondly, I don't think anyone denies that the University of California study was underfunded. It was $500,000, and they themselves admitted that with that amount of money they were incapable of conducting the type of thorough and comparative analysis that they had been tasked to do. Third, as the U.S. now concedes, the University of California study completely bungled the cost analysis. In analyzing the cost of banning MTBE, it included the sunk costs of cleaning up the tanks, even those--those costs
would have to be incurred whether or not MTBE was
banned. But it added those into the costs. The
U.S. now concedes that that was the wrong approach,
and it was criticized at the time for being the
wrong approach.

Fourth, the U.S. ignores the fact that the
UC-Davis study was heavily criticized by the U.S.
Government itself. U.S. EPA, as well as numerous
independent reports and public comments, pointed
out the error of attributing to MTBE the sunk cost
of leaking tanks. And some agencies, such as the
U.S. Geological Survey, warned California that it
overestimated the future rate of MTBE impacts on
drinking water sources as well as the costs.

Fifth, the University of California study
didn't accept its own data with respect to future
rates of leakage, and we will get into in more
detail later, but it predicted a future catastrophe
on California drinking water that simply wasn't
justified by information contained within the four
corners of the UC study itself. It failed to take
into account the impact on leaking tanks of the ongoing California tank upgrade program, and we will get into that in more detail later, but that information was found within the four corners of the report itself, and it simply ignored it.

Finally, the report itself, and this is important to keep in mind, the report did not recommend an immediate ban. It didn't recommend to Governor Davis that he decide to ban it. It recommended that Governor Davis consider banning it. I think the only inference to be drawn from that, from that use of the word "consider," is that the University of California didn't feel that the information that it had found was conclusive enough to justify an immediate decision to ban it.

Nonetheless, Governor Davis went on to ban it. He went beyond what the study recommended.

Now, one of Methanex's chief criticisms of what California did is that it banned MTBE, even though there were better solutions for the water problem that were available.
Now, I will repeat it again, Methanex does not believe that anybody's drinking water should ever smell like turpentine. Neither should it have benzene in it. It shouldn't have any of the contaminants that were listed in the NRDC list.

Where did these contaminants come from? Well, I think there is general agreement that with respect to the MTBE issue, the MTBE came from two sources. It came from two-stroke engines on reservoirs, and it came from leaking underground storage tanks. Those are the causes of contamination, and from Methanex's point of view, the most effective solution would have been to address the causes of the problem, not simply one of the ingredients.

And, in fact, when California did, and California has addressed the causes of the problem, and it has had a very significant impact on the MTBE issue. Let's take two-stroke engines first. Two-stroke engines are those small, noisy, smelly engines that are used on jet skis and
outboard motors, and they're two stroke in the
sense that they combine oil and gasoline, and
they're not the normal four-stroke engines.

The consequence for the environment is
that they are very inefficient users of fuel, and
apparently they don't burn up to 30 percent of
their fuel. If you have an outboard engine that is
only burning 70 percent of the fuel, the other
30 percent ends up either on the lake or in the
air. And if the fuel contains MTBE, the MTBE gets
into the reservoir.

Now, the solution, the obvious solution,
was to get people to stop using these dirty
engines, and that's what California did. In this
period, in the late 1990s, they implemented
regulations that either banned the use of
two-stroke engines or required the use of much,
much cleaner two-stroke engines.

And as a consequence, the rate of
detection of MTBE dropped dramatically on the
reservoirs in California to the point where the
problem has been virtually solved, which is not just MTBE that's not getting into the water. It's gasoline that's not getting into the water, it's oil that's not getting into the water, it's benzene that's not getting into the water. By addressing the source of the problem, they cleaned up the whole contamination problem caused by using motors on the lakes. It was obviously the most appropriate solution for this particular problem, and it solved the MTBE problem with respect to reservoirs as well.

Now, with respect to the question of underground gasoline tanks and the leakage from underground gasoline tanks, first of all, let me be clear. As I said before, 60 or 70 percent of the water comes from—in California comes from reservoirs. So if you fix the problem on the reservoirs, you've fixed the problems for most of California's drinking water.

Secondly—not secondly, getting back to the tanks, the leaking underground storage tanks,
there is absolutely no doubt that they are the proximate cause, the primary cause of the MTBE issue. Governor Davis said so in his Executive Order itself, and let me quote from the Executive Order. "Whereas the findings and recommendations of the UC report, public testimony, and regulatory agencies are that 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."

So, Governor Davis himself expressly identified leaking tanks as one of the principal sources of the problem. He omitted any reference to the two-stroke engines, but it's quite clear that other than that, he thought that two-stroke engines--I mean, that the leaking tanks were a principal source of the problem, and we agree. They were.

Now, the reason why leaking underground gasoline tanks were a problem was because
California had not implemented its own laws, its own regulations or federal laws and regulations requiring it to clean up the tanks. And the best evidence of that is a statement from California itself, from California's State Auditor, and if I could put that up, that's Tab 21. Health services and the state and regional boards are not making certain that public water system operators, storage tank owners and operators, and regulatory agencies responsible for detecting and cleaning up chemical contamination are doing their jobs. Not only does the state regulate underground storage tanks ineffectively, it has failed in some instances to aggressively enforce the state's Safe Drinking Water Act and the laws governing underground storage tanks. Specifically, health services, the regional boards, and local agencies have not adequately enforced laws that require prompt follow-up monitoring for chemical findings and contaminated sites, notified the public about chemicals found in drinking water, and managed the
complete cleanup of chemical contamination of
water—groundwater.
The date of this report is 1998, so it's contemporaneous with the University of California study and contemporaneous with the deliberation by California as to what to do with respect to the MTBE issue. And Methanex submits that the answer is quite clear. What California should have done was enforce its own laws and accelerated its tank compliance program.
Now, California did have on the books, as is obvious, laws and regulations requiring that these tanks be cleaned up, and it was in the process of cleaning up these tanks. It was late. The goal had been delayed, and there had been a 1998 deadline for upgrading all these tanks, and it had simply not been met. There had been substantial progress, but the goal has not been met, which is what prompted the criticism by the state auditor.
But I think it's important to recognize
that substantial progress was being made in cleaning up tanks, and if we could go next to the--a chart from, again, from Dr. Williams's report, that shows the progress that was being made and shows the effect of cleaning up, of fixing the tanks. And you can see that when the efforts started to first fix the tanks in the early--in the late eighties and the early nineties, the reports of leaking tanks skyrocketed, and the number of closed tanks skyrocketed. After then that peaked in 1989 or 1990 s as the program, the compliance program and the upgrade program got purchase, the number of reported leaking underground fuel tanks dropped with a slight spike in the late nineties, and the number of closed, the number of tanks that had to be closed also dropped.

What this shows is that the tank upgrade and compliance program was working.

The next slide, which is still in Tab 22, shows--I'm sorry, next tab--next slide, which is Tab 22, shows the same thing. It shows what
happened to leaking tanks after the 1998 deadline. Now, again, this is where California was deficient, as the State Auditor pointed out, but it was making good progress, and the number of tanks reported after the deadline has continued to drop significantly to the point where it's now reached what the scientists call an asymptotic level. It's approaching zero and never actually gets to zero, but it's approaching zero, so there has been tremendous progress in the program of fixing the tanks and fixing the problem.

Now, the reason why that's important--I'll just give you the cite--well, the reason why that's important is because even at the time that the University of California study was being done, California officials recognized that fixing the tanks would fix the leakage problem. They knew that at the time. And I would like to give you two sources that showed that they knew that. The first is Tab 24. Tab 24 is a citation. It's a quote from the University of California report itself. I
think it's very important because it shows exactly the type of data that was in the report and should have been acted on. To estimate the probability of MTBE release to groundwater from UST systems, regression analysis was performed on leak data for six annual periods, '92 through 1997. This analysis showed annual baseline leakage possibilities ranging between 2.5 percent and 2.9 percent of USTs active between 1992 and 1997.

In order to assess projected UST leakage probability in light of new regulatory standards mandating improved storage facilities and practices, a California leaking tank information database was examined for cases in which systems qualifying as upgraded to the new standard appeared. The number of these qualifiers was then balanced against the number of systems in the general UST population known to be upgraded. Following this rationale, a figure of 0.07 percent per year was calculated for upgraded systems.

So, if you compare those two figures, 2.5
percent and 0.07 percent, what you're really comparing of 250 and seven. So, in other words, what the University of California found was that once the tanks are upgraded, the leakage rate would drop from a number of 2.50 to .07, from 250 to seven. That's a drop of about 97 percent. So, within the report itself, there was data and knowledge and evidence that the solution to this problem was coming. Once the tanks were upgraded, the number of leaks containing MTBE would diminish greatly. They knew that. And at the bottom, if you look at the quote at the bottom, that had been predicted before by the California EPA. Upon the completion of the tank upgrades program, the leaking of gasoline components, including MTBE in soil and groundwater should greatly diminish.

So, it was known at the time that fixing the tanks would fix the problem.

Now, California officials, after the ban was announced in 1999, before it was actually
implemented, have admitted that this program of fixing the tanks has gone a long way towards solving the problem. And if you would like, I will draw your attention to Tab 25, a chart that we put up that includes some of these statements by California officials themselves.

Now, the most compelling quote is from Governor Davis himself. As I mentioned earlier, in 2002, he decided to extend the ban on MTBE--the ban--extend the deadline for starting the ban of MTBE for one year, and one of the reasons why he did so was because, quote, Strengthened underground storage tanks requirements and enforcement have significantly decreased the volume and rate of MTBE discharges since Executive Order D-5-99 was issued in March of 1999.

Gordon Schremp, who works for the California Energy Commission, stated at the 2002 World Fuels Conference that, quote, The frequency of MTBE showing up in wells is a lot less than anticipated in the UC study.
He's wrong about that because as I showed you, the UC study itself anticipated that the number of future impacts of MTBE would be very, very low as the tanks were cleaned up.

He goes on to say, University of California research in 1998 projected that annual water cleanup bills could reach 1.5 billion if MTBE were kept in gasoline, but that by using new assumptions gleaned from four years of MTBE experience, cleanup costs would be less than one-sixth of that figure.

Winston Hickox, former Secretary of the EPA--I think he was Secretary at the time when he made the statement--and he made the statement at the same time that Governor Davis or just before Governor Davis issued the delay, he urged the delay in the MTBE ban because, quote, The pace of contamination has slowed tremendously. This is the Secretary of the California EPA saying that the pace of contamination has slowed tremendously.

And finally, a study by Malcolm Pirnie,
it's not a government statement but it finds the same thing. Future MTBE computation of groundwater and surface waters in California is likely to be much less severe than predicted by UC researchers. Again, I would take issue with that because I say that the UC researchers themselves knew that contamination was going to drop off greatly. They simply ignored that particular piece of data that was in their own report. So, what it comes down to is that if California had been truly protected and protecting its water source and making sure that none of those 23 contaminants got into the water or at least those that they would control, it would have accelerated its tank compliance program. It would have done what it could to get that in place as fast as it could, and it would have accelerated the elimination of two-stroke engines from reservoirs. Had it done so, that would have taken care of the problem. And not only would it have taken care of the problem of MTBE, but there wouldn't be benzene
in the water either. There wouldn't be gasoline leaking into groundwater that's used for drinking water. There wouldn't be oil leaking into it. There wouldn't be any of the other long list of contaminants in gasoline. It would have been by far the better solution.

But California didn't do that. Instead, it singled out one component, MTBE, that was not the most prevalent component. That was benzene. But it singled out MTBE, and it banned it, and what I will get to after the break is why it did that.

ARBITRATOR REISMAN: Are you planning to take a break now?

MR. DUGAN: Um-hmm.

ARBITRATOR REISMAN: I would like to go back and just make sure I understand something. Your presentation of Dr. Williams's analysis, the expert report and subsequent analysis, using a double detect technique, there are no contaminations.

MR. DUGAN: Correct.
ARBITRATOR REISMAN: So MTBE if you use her method, MBTE problem doesn't exist. Simply doesn't exist.

MR. DUGAN: Correct. It was not just the double detect protocol, remember?

ARBITRATOR REISMAN: So, all of the other discussions of statements that--addressing the leaking underground storage tanks or fuel tanks will diminish the problem are incorrect because there is no problem?

MR. DUGAN: No, there is a problem, and here is the distinction. MTBE was being found in the water, but what Dr. Williams did was she looked and said, yes, it's being found in the water. It is being detected in the water, there's no doubt about that, but how serious a concern is this? She went--

ARBITRATOR REISMAN: So just--my notes are incorrect, then. Then double detect doesn't show that there is no MTBE in the water. MTBE is in the water, according to her.
MR. DUGAN: Yes, but the point she tried to make is MTBE, the double detect. Remember, it was the two charts that I showed you that showed zero detects, not only used the double detect protocol, but they were looking at a restricted class of those times, those incidents when MTBE was detected. In other words, she looked at the subset of data, as she calls it, of water that was actually likely to be consumed as drinking water, so she ignored detects of MTBE in wells that were drilled, for example, right next to a leak, to assess the leak, which were included in the database. She only focused on those wells that were likely to provide drinking water for the consumer.

And if you look at only drinking water wells and you use the double detect protocol, and you ignore all detections below five parts per billion—in other words, if there's a detect, even in a drinking water well of one part per billion, no one can smell that. It's not a health threat.
And if you ignore that detection as not being a
detection at a level of concern, if you apply all
three of those criteria and analyze the data in
that manner, then you come up with no detects.

ARBITRATOR REISMAN: Which means

that--which would mean that the testimony that was
given in the public hearings after the UC study
with people indicating that they had detected it,
that was an illusion?

MR. DUGAN: No, it's not an illusion. And

I guess I'm not making myself clear. What

Dr. Williams focused on, again, was a very--a
subset of the data, but there was no doubt that
there were many other cases where, for example, in
wells that weren't intended for drinking, there
were single detects at levels, for example, of two
parts per billion, four parts per billion, or even
a single detect at nine parts per billion. As long
as it wasn't a double detect, she didn't--she
concluded, using the double detect protocol, she
concluded that there were no detections.
But there were a lot of detections. It's a question of how she analyzed it, and what she analyzed as the serious concern, and to maybe simplify it she said, yes, there had been a lot of detections of MTBE in the water, but how many detections have there been of water that's really going to be drunk by consumers and how many detections have there been at a level that can be smelled by consumers, and how many true detections have there been using the two-detect protocol. And once you apply those three conditions to this whole mass of detects, you come out with a much smaller universe. You come out with a zero universe. Using those three criteria you come out with a zero universe. But it's not denying that the existence a much larger universe of detects.

PRESIDENT VEEDER: Thank you. Let's have a break for 10 minutes.

MR. DUGAN: Sure.

(Brief recess.)

MR. LEGUM: With your permission,
Mr. President, one--one note, we understand now that the claimant is going to make part of their presentation of their case-in-chief not today but in their closing on Wednesday of next week, and we would just like to put a placeholder that if that is, indeed, the way they wish to proceed, then we may need to revisit the schedule in terms of the amount of time between their closing/presentation of this one part of their case-in-chief and when we provide our rebuttal to that.

Thank you.

PRESIDENT VEEDER: We appreciate what you're saying. We noted what was being said by Mr. Dugan. We will come back to that at some appropriate time tomorrow.

Mr. Dugan.

MR. DUGAN: Thank you.

So, where we left off before the break was, I--we think Methanex has shown that MTBE is not toxic, it's not carcinogenic, it's not a health risk, and there were better solutions to deal with
the contamination problem. And that the UC-Davis study itself had some well-known serious defects. Was the—was the legitimate question was MTBE contamination so serious, some type of looming public health disaster that, as the amici argue, a responsible government actually had no choice but to ban MTBE? Well, I think the best way of examining this is to look at what Europe did. Europe did not think that MTBE contamination posed this type of risk whatsoever.

Agencies in Germany and in the European community have determined that banning MTBE, because of its infrequent detect in drinking water would not benefit the environment, and what I would like to put up now is a slide with some of the quotes, some of the relevant quotes. First is the German Environmental Protection Agency. German EPA ultimately concluded that, quote, MTBE is an important component for the production of gasoline 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.

Similarly, the European Commission, the
European Commission Working Group on the
Classification and Labeling of Dangerous
Substances, quote, reached an agreement not to
classify MTBE as dangerous for the environment, end
quote. And this is Tab 26.

And it went on to say, "After conducting a
thorough and extensive risk assessment, of MTBE,
the EC concluded that it would not ban MTBE.
Consequently, MTBE will continue to be used
throughout Europe to reduce fuel pollution--to
reduce air pollution." I'm sorry.

Now, I think the best way of summing this
up is to cite a press release that was issued by
the European Community on May 11, 2001, and I think
this is found in the--Dr. Williams's report on
leaking underground storage tanks at 22. And what
they said sums up in many ways Methanex's position.
Quote, At this stage, the Commission believes the
best way to tackle the problem of possible
underground--of possible groundwater contamination by MTBE is to ensure that all underground tanks used to store fuel at service stations comply with the best available technical standards and that these standards be robustly enforced.

PRESIDENT VEEDE: Whenever you cite something, if you could give the reference for the transcript.

MR. DUGAN: Okay, I did. That's from Dr. Williams's leaking underground storage tank expert report at 22, and we will give you the appropriate cite to whatever it is the JS or the JA.

PRESIDENT VEEDE: Thank you.

MR. DUGAN: Now, Denmark presents a particularly interesting case with respect to MTBE because it actually proposed a phaseout of MTBE because of what it thought were the environmental concerns, but that phaseout was reversed due to upcoming new EU standards for automotive emissions. Those standards will result in an increase in the percentage of MTBE used throughout Europe,
including in Denmark, and for that reason they 
reversed the ban.

Now, the U.S. takes the position that 
Europe is different from the United States 
principally because it doesn't use as much MTBE.
But that shouldn't make a difference. If trace 
levels of MTBE are a true problem, then it should 
be a problem everywhere.

More importantly, there are portions of 
Europe that use MTBE in significantly greater 
portions than the United States. Finland, for 
example, it uses MTBE in concentrations of up to 
15 percent in contrast to the typical U.S. 
concentration of 11 percent. And it's well-known 
that Finland is a land of a lot of lakes. It has a 
fairly high water table.

Nonetheless, the--Finland, which served as 
the rapporteur for the EU Risk Assessment and the 
scientific work on the report was prepared by the 
Finnish Environmental Institute, the national 
product control agency for health and welfare, and
the Finnish Institute of Occupational Health, and they are the ones who concluded that MTBE did not present a risk.

So, Finland, which uses MTBE again at substantially higher concentrations than the United States does, has concluded that it's not a risk, and that the EU as a whole has concluded that it's not a risk because of the--because the better way of solving the problem is to enforce the existing tank regime, the best I can submit is it's not possible to conclude that the problem in California was so serious, so severe, that only an MTBE ban would serve to fix the problem.

In fact, the European Community, as I mentioned, it's so confident in the success of its improved underground storage tank program that it has proposed to increase the use of MTBE in Europe in the future, in order to reduce air population. Now, I think the best perspective on why California actually enacted the ban comes from two sources that we cited. If we could put that slide
up. This is Tab 27. And these are from two DeWitt conferences. DeWitt is a trade publication for MTBE and oxygenates. And at a May 2002 international conference on oxygenates, the foreign delegates expressed, quote, disbelief that a product that has little or no proven health risk could be banned without regard for the commercial impact or even a fair hearing based on science and the facts."

At another conference it was said, quote, It has been said many times and many ways that the situation in California has been blown out of proportion and that the decisions surrounding the ban of MTBE from that state's gasoline were based on political expediency and not science.

I should point out that DeWitt was the employer of one of the United States experts for many years. It's a very reputable organization.

So, it's Methanex's position that the ban, the MTBE ban in 1989, was totally unjustified, and that the later ban on methanol was unjustified.
There was no health crisis, and a prudent, rational consideration of the scientific evidence, especially a rationale consideration of the level of the leakage into true drinking water and the impact of the tank upgrades would have led an unbiased decision maker to reject the ban and instead focus on the causes of the problem, which were the two-stroke engines and the leaking tanks. But the MTBE ban itself is only half the story, and from Methanex's point of view it's not the most important half. The most important half of the story shows that in addition to banning MTBE, Davis decided to use ethanol as a substitute, as a substitute oxygenate, and he made this decision, he rushed to this decision precipitously long before there had been any reasoned evaluation by California of the advantages and disadvantages of ethanol as an oxygenate.

Now, let's look at the evidence. Before Governor Davis--before Gray Davis became governor, California was actually opposed to the use of
ethanol. Governor Davis's predecessor, Governor Pete Wilson, had actually vetoed a bill to exempt ethanol from the restrictions imposed on all of their oxygenates. And in doing so, Governor Wilson, he detected and he laid bare the bill's efforts to give a market advantage to ethanol over all other oxygenates. Quote, This legislation, while purporting to provide access to the market, seeks to enhance the advantage of this product, ethanol. There are no regulatory barriers to its use, and state law should not be used as a means to achieve market advantage, especially when the consequences will foul our air.

So, Davis's predecessor thought that using ethanol would foul the air in California, and he turned out to be right.

But beyond that, there was another case. In 1993, the United States EPA proposed a 30 percent ethanol requirement in the national oxygenate market, and that was actually the proposal that generated one of the critical pieces
of evidence in the case that we will get to later,
but that proposal met with a lot of opposition, and
some of the opposition came from California itself.
Governor Wilson filed a brief, resisting and
arguing against that program, and one of the
reasons why he argued against the program was that
California thought that at that time in 1994, that
shifting to ethanol would result in, quote,
irreparable injury to the health and welfare of
California citizens and to the environment.

So, prior to Davis, prior to the time that
Davis took office, California had a very negative
view of using ethanol. California thought that
using ethanol would harm the health and the
environment in California. And actually, that fear
of using ethanol was very well-founded because
ethanol's problems were very well-known even in
1999. And, in fact, the UC report itself
identified a number of these very serious ethanol
problems.

Let's take a look at the actual summary
recommendation that California--that the University of California provided to Gray Davis. And this, I believe, is paragraph nine of the summary of recommendations from the University of California.

The University of California said, quote, Assessed environmental impacts of using other oxygenates such as ethanol. And then the emphasis is actually in the original. It must be stressed, however, that there are potential adverse health effects associated with incomplete combustion products of ethanol and further study of combustion byproducts and potential health effects of such products is required before substitution of ethanol for MTBE on a large scale can be recommended.

So, the University of California quite clearly did not endorse the use of ethanol. As we will see, Governor Davis decided to use it anyway.

Now, one of the most important things that the University of California found is what it just alluded to: Adverse health effects associated with incomplete combustion. And what they're talking
about there is that by using ethanol, what would happen is concentrations what are known as acetaldehyde and formaldehyde are known carcinogens as the UC-Davis study recognized. And that if--the study itself recognized that if ethanol were substituted, cancer could increase in California up to 2800 cases a year--not a year. 2800 total, I believe. That is an extraordinary, extraordinarily large increase in cancer. It showed that the use of ethanol would have very, very serious health concerns.

And I would like to show the exact source from the UC-Davis study that says that because I think it's important, the exact quote. This is from the UC report, volume one, summary recommendations, quote, Under ambient conditions, unburnt ethanol is converted to acetaldehyde and eventually to peroxyacetyl nitrate and formaldehyde. The ambient concentrations of acetaldehyde and formaldehyde, both air toxics (sic) and known carcinogens are expected to
increase if ethanol is substituted for MTBE as the oxygenate of choice.

So, California itself recognized at the time—the University of California recognized that if you substituted ethanol for MTBE it would cause a very, very substantial increase in cancer across the state. A very, very serious problem associated with the use of ethanol.

Now, it also became clear, although not at the time but later, that using ethanol could have the same types of problems in water as MTBE could—as MTBE did. There was a study completed in 2001. It was actually the last of the studies that were ordered by Governor Davis to evaluate the use of ethanol, and it found that the use of ethanol could cause a four-fold increase—four-fold decrease in the rate of benzene degradation, and increase benzene plume lengths by 250 percent. And we would like to show you a slide that we hope captures this graphically. And this is Tab 32.

Now, what this slide shows is when ethanol
is added to gasoline, what it does is ethanol biodegrades faster than benzene, but by doing so it depletes all the oxygen in the soil. Because there is no oxygen in the soil, it makes it hard for the other ingredients of gasoline, such as benzene, to biodegrade. And because the oxygen has been depleted, benzene spreads farther.

And what this report that was commissioned by California and delivered in 2001 found was that the benzene plume can extend 150 percent farther if ethanol is used in the gasoline. And again, this is a California report that this is based on.

And the reason why that's important, if we go back to the chart--and I'm not going to put it back up there, but the chart that we saw earlier, the list of the 23 prevalent contaminants in drinking water, one of them is benzene. And here we have the report by California itself saying that if you use ethanol in place of MTBE, you're going to aggravate the already very serious benzene problem, and Methanex believed that's precisely
that's what's going to happen, that benzene contamination, as a result of the substitution of ethanol, is going to get much worse in California.

Now, in addition to that, one of the things that the University of California recommendation referenced was problems with air pollutants, and since the time that ethanol has started to be used in California, there have been a number of reports that it has increased air pollution in California.

In fact, the best evidence of that is a letter that Senator Dianne Feinstein wrote, questioning the switch to ethanol. This is what she said, quote, As you know, the south coast air district has already experienced 31 days above the Federal ozone standard in 2003. This is worrisome because there are only 21 days exceeding the Federal ozone standard in all of 2002. Moreover, for the first time in five years, Southern California experienced a stage one smog alert on Friday, June 11, 2003. The switch to
ethanol-blended gasoline is considered one of the main culprits of this increased ozone. So, Senator Feinstein at least believes that air pollution is getting worse because of the switch to ethanol. That was slide 33.

Now if I could also put up two more slides that are derived from our experts' reports that quantify the ranges of how ethanol can cause a damaging impact to the air quality in California—and this is based on the Williams study—it's possible that the use of ethanol could increase concentrations of carbon monoxide by up to 370 percent, nitrogen oxide up 100 percent, peroxyacetyl up to 300 percent, and formaldehyde up to 21 percent.

And moving on to slide 35, it could increase acetaldehyde by up to 13 percent, and that's the increase that causes the up to 2,800 additional cancer deaths. It increases evaporative emissions in benzene by up to 44 percent, total hydrocarbons of up to 55 percent, and chemicals
with ozone-forming potential by an increase of up to 72 percent. Ethanol is simply not good for the air.

So how did Governor Davis respond to all these known cancer and water pollution and air pollution problems of ethanol? Well, frankly, I think the evidence shows that he just didn't care about them. He was determined to shift to ethanol, and the evidence that he had already decided to shift to ethanol, I believe, Methanex believes is compelling and conclusive.

Let's start with what happened in March '99, when he announced the decision to ban MTBE. He announced a lot of other things at that time as well.

And one of the things he requested at that time was, he requested from the United States EPA a waiver of the oxygenate mandate because he didn't think it was economically feasible for ethanol to cover all the needs of California for oxygenated fuels, so he asked for a waiver, but he also made
it clear when asking for the waiver, he went out of
his way to make it clear that a very significant
chunk of the market was going to be set aside for
ethanol. And this is what he said, and this is
from his waiver request. This is Tab 36.

One final aspect bears emphasis. Even
with a waiver of the Federal RFG oxygen mandate, a
significant portion of California gasoline would
still contain ethanol.

Now, that's emphasized in the chart that
I'm giving you, but it's also emphasized in the
original. Governor Davis wanted to emphasize that
he was going to shift to ethanol. The MathPro
analysis indicates that from a cost savings
perspective, the optimal share of nonoxygenated
CaRFG would be less than 50 percent. So,
oxygenated RFG would be more than 50 percent.
Moreover, ethanol would still be needed to meet the
continuing requirement for oxygenated gasoline in
the winter in the greater Los Angeles area.

Now, he's saying that a significant
portion of gasoline would still contain ethanol before any studies had been done. He's already making it clear that he's going to shift to the ethanol industry a big chunk of the California market.

Next piece of evidence. In the Executive Order banning MTBE, he did two things with respect to ethanol, and this is California Executive Order D-5-99, and it's paragraphs 10 and 11. And this was the actual order banning MTBE. The first was that he—in paragraph 11, he ordered, quote, The California Energy Commission, CEC, shall evaluate by December 31st, 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."

So he's directing the California Energy
1 Commission to take steps to start or to continue to
2 try to develop a biomass ethanol industry in
3 California. He wants to have California's own
4 industry.

5 More importantly, in paragraph 10 of the
6 Executive Order, he stated, quote, The California
7 Air Resources Board and the State Water Resources
8 Control Board shall conduct an environmental fate
9 and transport analysis of ethanol in air, surface
10 water, and groundwater. The Office of
11 Environmental Health Hazard Assessment shall
12 prepare an analysis of the health risks of ethanol
13 in gasoline, the products of incomplete combustion
14 of ethanol in gasoline, and any resulting secondary
15 transformation products. These reports are to be
16 peer-reviewed and presented to the Environmental
17 Policy Council by December 31, 1999.
18 As we'll see, the reports weren't finished
19 actually until October of 2001.

20 But more importantly--

21 ARBITRATOR ROWLEY: Mr. Dugan, could you
remind me the date of the Executive Order.

MR. DUGAN: It was March 25th, 1999.

But more importantly, why did he select only ethanol as an oxygenate to study? Let's go back if we can, and I would like to put back up the list of oxygenates that the EPA carries.

There are a lot of oxygenates here besides ethanol. Methanol, TBA, MTBE--obviously it's not that--but DIPE, ETBE, and TAME. So, there are a lot of oxygenates that were possible, that could possibly have been by California as a replacement for MTBE.

In addition, let's go to the witness statement of James Caldwell that the United States has put in, and let's look at another list of oxygenates used under the oxygenated fuel program for potential ones. This list is even longer.

This is Tab 39.

Now, this tab includes MTBE, ETBE, TAME, DIPE, TBA, ethanol, TBA again, MTBE again, and then a methanol-TBA blend, a methanol-GTBA blend, a
methanol blend with butanol or some other type of alcohol, a five percent, 2.5 percent methanol co-solvent alcohol blend, something called Octamides, which is five percent methanol and 2.5 percent co-solvents, and then 15 percent MTBE.

So, the universe of oxygenates that were potentially capable of being used in California was quite large, and remember, although it's quite true that many of these oxygenates had not been certified for use in California or elsewhere at that time, as it turned out, California had almost five years to come up with an appropriate alternative, and even at the time that the ban was enacted, Davis knew that they had almost four years to come up with an appropriate alternative.

Why didn't Davis order an analysis of all these other oxygenates or at least some of these other oxygenates? Why did he simply single out ethanol as the only oxygenate that California was going to study as a replacement for MTBE? That's a very important question. And our answer, as we
will see, is because he'd already determined, even
at that point, to substitute ethanol for MTBE.
He'd already made the decision.

ARBITRATOR REISMAN: So, if I understand
it now, it is your submission that the Governor
banned MTBE with the intention of favoring ethanol.
Why, then, did the Executive Order also include a
reference to securing the waiver of the Federal
requirement banning oxygenates that would have
excluded ethanol as well?

MR. DUGAN: Because the waiver would not
have excluded all of ethanol. What the waiver--

ARBITRATOR REISMAN: Quite right. But if
he is trying to favor ethanol, why does he take a
step that substantially reduces his government's
ability to favor ethanol?

MR. DUGAN: Because he was splitting the
baby, as politicians do, and he was faced with two
competing concerns. He thought that he had tried
to substitute ethanol for the entire market in
California. It would have produced supply
disruptions, increased gasoline prices, and
consumer outrage. There simply wasn't enough
ethanol to supply all of California at that time.
So, his idea was simply to split the baby. He
would give ethanol a big share of the market,
perhaps half the market, and the other half of the
market would be serviced by reformulated gasoline
without oxygen.

ARBITRATOR REISMAN: I understand what
you're saying, but I'm having trouble fitting it
into the pattern. He also deferred the initiation
of the ban for a period of time. If he was
interested in favoring ethanol, he could have
defered the application of the ban of MTBE until
ethanol was able to produce enough for the market.
Why did he--my question is why did he take a
permanent step that deprived ethanol of 50 percent
of the market if the hypothesis is that he was
trying to favor ethanol?

MR. DUGAN: Well, giving ethanol
50 percent of the market is still a very, very
significant benefit. The question is, I mean, did he think that giving them 50 percent of the market was enough? And our argument is that he did, that giving them 50 percent of the market, while at the same time maintaining price stability for gasoline in California was the way for him to resolve a lot of competing concerns.

Politicians are often faced with competing demands. In this case he was faced with the demand to, we believe, favor ethanol with the demand for doing it in such a way that he did not unduly burden the consumers in California, and the only way to reconcile those, in his mind in 1999, was to give ethanol approximately half the market and give the other half of the market over to the--to a gasoline that would not include an oxygenate.

PRESIDENT VEEDER: If I could raise one question for which you will need to go back to the Senate Bill 521 because in Section 2 of the Senate Bill, if you look at Section 2 and Section 3, perhaps I could read it out, what the Legislature
was mandating the study to be undertaken by the University of California was not simply MTBE and ethanol, but also ETBE and TAME.

MR. DUGAN: Yes.

PRESIDENT VEEDER: And your case is that the University of California study obviously looked at MTBE, but incompletely did not look at ETBE, TAME, and ethanol.

MR. DUGAN: Correct.

PRESIDENT VEEDER: And then, when you come on to the Executive Order, paragraph 10, instead of finding ethanol and TAME and ETBE, you simply find a reference to ethanol.

MR. DUGAN: Correct. Precisely my point. And even beyond that, that he ignored the possibility of using TAME, for example, but he ignored the entire other universe of oxygenates that could be used, and instead he went out of his way to single out ethanol as the only oxygenate that was going to be studied by the University of California for a replacement, as a replacement for
MTBE.

Now, just to get back to your question, yes, he could have given the ethanol industry even more than he did. And it turns out they got the entire market anyway. But I think his intent at the time was to give them a portion of the market, a big portion of the market, but do it in such a way it didn't cause him any political damage because of supply disruptions.

Now, the next piece of evidence is what Davis told the United States Congress in October of 1999, and this is slide 40. And at that time there was testimony from a California official, Michael P. Kenny, and he said, quote, I'm pleased to be here on behalf of Governor Gray Davis, the California Environmental Protection Agency, and the California Air Resources Board to discuss our state's perspective on the report and its findings. Once MTBE is eliminated, the only feasible oxygenate will be ethanol.

Now, again, the date of this is
October 1999. This is before any of the studies of ethanol and its use had been completed. The first study was completed in December of 1999, and there were subsequent addenda and then the final study was completed in October of 2001.

ARBITRATOR REISMAN: What does the word "feasible" in that statement mean?

MR. DUGAN: I don't know. I mean, we focused far more only "only" rather than "feasible" because at that time it wasn't known what was feasible. I guess our point is, had California conducted a thorough study of all the available oxygenates to see which ones were feasible, then that question could be answered. But at this time it was clear, in our mind, that Governor Davis was intent on adopting ethanol without even bothering to study any of the other potentially feasible oxygenates.

And again, that official was speaking on behalf of Governor Davis.

Now, throughout 2000 and 2001, the
deliberate shift to ethanol continued. In March of 2000, the Secretary of the California EPA reported to the Renewable Fuels Association, which is the ethanol lobby, that he expected, "substantial use of ethanol in the production of California gasoline even with the waiver." And that's found at 23 JS Tab 42.

Thereafter, in order to accommodate ethanol, California made two other significant changes to the prior regulations. The oxygen content limit for ethanol was raised, and new regulations raised the re-vapor pressure limit for reformulated gasoline just enough to allow refiners flexibility to blend ethanol than was possible under the old regulations.

Now, in contrast, California made no such allowances for competing alcohol oxygenates such as TBA, for example. And at the same time that California was accommodating ethanol, it was banning all of its competitors. In 2001, it issued a regulation making clear that its intent was to
ban all alcohols other than ethanol. Now, that regulation didn't name methanol by name. It was--I believe that that quote comes from--that comes from 1999. But the clearest intent that California wanted to get rid of all the competitors except ethanol comes from the latest amendments to the California RFG3 regulations, which were adopted in December 2002. And if we could put those up, please.

Again, these are the California regulations with respect to the MTBE ban, and this is found at Tab 41. It states that (reading) Starting December 31, 2003, no person shall sell, offer for sale, supply, or offer to supply California gasoline which has been produced at a California production facility with the use of any oxygenate other than ethanol or MTBE unless a multimedia evaluation of use of the oxygenate in California gasoline has been conducted and the
1 by the Public Resources Code Section 71017 has
2 determined that such use will not cause a
3 significant adverse impact on the public health or
4 the environment.
5
6 It goes on to state, the covered
7 oxygenates, oxygen from the following oxygenates is
8 covered by the prohibitions in 2262. I won't go
9 through the rest of the cite. But here for the
10 first time, California names methanol as one of the
11 prohibited oxygenates. It hadn't done so before
12 this. It did so in regulations that were passed at
13 the end of 2002, and that came into effect either
14 at the beginning of this year or, I think, in July
15 of this year.
16
17 Now, it also lists many other potential
18 oxygenates that were banned that were never studied
19 by California. Isopropanol, n-Propanol n-Butanol,
20 and all the others. I won't read the whole list.
21 It's a long and tortuous chemical list. But my
22 point is that this evidences two things. First of
23 all, it's further evidence of California's intent
to make sure that only ethanol got the market in California, only ethanol had studies for it funded by the state studying its impact. None of these others were funded by the state studying its impact.

So, it's further evidence of California's intent to favor ethanol by creating a market for ethanol to the exclusion of its competitors, including MTBE and including methanol and all the ones listed here.

Now, the second reason why this is particularly important, the Tribunal has always been concerned with the fact that the original 1999 Executive Order by Gray Davis did not name methanol. It only banned MTBE by name. And the United States, on the basis of that, has asserted repeatedly that methanol--and Methanex--do not belong in this case because they are only remote suppliers. They're not named in the order. That as a consequence, the California measure, the 1999 measure, does not relate to methanol, that there is
no legally significant relationship between the 1999 measure and methanol.

Well, Methanex submits that that legally significant relationship has now been established by this California regulation, because this California regulation expressly prohibits the use of methanol in order to provide oxygen in RFG.

So, California's use, California's labeling of methanol as a banned oxygenate, which took place as I said at the end of 2002, after we filed our Second Amended Complaint, now supplies that missing link, that legally significant relationship that the Tribunal was concerned was lacking in 1999.

Actually, would it be appropriate to take a break for lunch here? We have been going for two and a half hours.

PRESIDENT VEEDER: Yes, of course.

MR. DUGAN: Why don't do that and then come back at, say, five past two.

MR. LEGUM: Of course.
PRESIDENT VEEDER: Let's break and come back.

MR. DUGAN: Thanks very much.

(Whereupon, at 12:05 p.m., the hearing was adjourned until 2:05 p.m., the same day.)
AFTERNOON SESSION

PRESIDENT VEEDER: Let's resume.

MR. DUGAN: Okay. Thank you.

Now, where we left off, we had mentioned briefly in the morning session California's intent to create an in-state ethanol industry, and I would like to focus on that, if I could, for a few minutes.

I'd like to put up a slide with a few quotes from California officials with respect to what was going on in California.

As I noted earlier, the Executive Order banning MTBE specifically required state agencies to take steps that were, quote, intended to, quote, foster the development of a biomass ethanol industry in California. After that, other California state officials made it clear that they were very much intent on developing an in-state ethanol industry. James D. Boyd, the Commissioner of the five-member California Energy Commission and the presiding members of the Transportation Fuels
1 Committee said: "The number one barrier to
2 creating that industry is the assurance of a
3 long-term market for ethanol here in California.
4 Assurance, I can be very specific on that.
5 It requires—and this, by the way, is Tab
6 42. It requires the investment folks looking down
7 the road and seeing a market for somewhere in the
8 reasonable 10-year period, which is a tough, tough
9 barrier for creating a biomass ethanol industry in
10 California. California Energy Commission biomass
11 to ethanol report, "The driving force for an
12 in-state ethanol production is the impending
13 phaseout of MTBE by December 31, 2002."
14 Again, at a biomass-to-ethanol hearing,
15 quote, The only reason that all of us are even here
16 today is there's a phaseout going on of MTBE.
17 So, it's Methanex's position that what was
18 taking place in California was that California was
19 trying to foster a local industry through subsidies
20 and through the ban of its competitors, and that's
21 what make it is illegal. While it may be
appropriate to subsidize local industries in certain circumstances, you can't do it by banning its competitors, and that's what was taking place here.

Now, the U.S. response to this evidence, this pervasive evidence of an attempt to create a California in-state ethanol industry is that the attempts were a dismal failure, and no one has yet succeeded in actually starting a California ethanol industry. And that may well be true, and I think that illustrates two things. First of all, ethanol is not a very economic product. It's hard to start up an industry that creates it in an economic way because it's so expensive, and it's so ineffective in doing the jobs that it's supposed to do. That's why it needs political support to exist.

Secondly, the fact that California failed to create the market, California failed in delivering on its intended purpose, doesn't mean that it didn't have an improper intent to start with. It did have an improper intent. It did want
to create an in-state market, and it did want to do so by banning MTBE, and that's the intent that has to be focused on, not whether they were successful or not.

Now, against that background, I'd like to turn to another of the key issues in the case, and that's the role of the ethanol industry in what happened in California. And we think that the role of the ethanol industry is what explains why Governor Davis moved so precipitously to embrace ethanol.

Now, it's worth noting two points, if I could, up front. First, the conclusions that we asked the Tribunal to draw from ADM's role in this matter are not necessary to prove California's discriminatory intent. We think that can be shown by Davis's rush to embrace ethanol before the evaluative studies were completed, and his rush to--not his rush, but his exclusion of all the other oxygenates, potential oxygenates that could have been used in the four- to five-year period
before MTBE was phased out.

So, the intent, the improper intent of California can be inferred from the evidence that I've already gone through, we believe, but the facts and circumstances of the ethanol industry's involvement and ADM's involvement in particular supply a critical factual link. It explains why there was this rush to ethanol. It explains why Governor Davis, in particular, went out of his way to reassure the ethanol industry that they would get a big chunk of the California market after MTBE was banned.

The second is that the ethanol industry's and California--ADM's role in the promulgation of the California measures wasn't limited to the events concerning the contribution. They were involved with the manipulation of the public opinion and the whipping up of the degree of concern about MTBE that simply wasn't merited by the facts, and they did it because the ethanol industry sensed that this was an opportunity to
displace MTBE, and as it turned out, they were
correct. But they were there right from the
beginning, long before the meetings in Decatur in
1998, and long before the ban was actually
implemented.

Now, before we get into the specifics of
the ethanol industry, the first thing I'd like to
go through is the nature of U.S. politics. We've
been accused of making things up, makes things up
out of whole cloth, that this is somehow some
fantasy that Methanex invented with respect to what
happened in California. Methanex submits that it's
not fantasy, that it is reality, unfortunately, and
that the best evidence of that reality is simply to
look at the pronouncements of the United States
Government itself and some leading officials of the
United States Government.

We have submitted information to the
Tribunal in which we quoted from the decision and
the briefs that were submitted to the United States
Supreme Court in the McConnell decision, and I
think it's very important that we go over exactly what was said and who said it, and what the Supreme Court concluded in that opinion, because Methanex believes that the Supreme Court's findings in that opinion and what was said by the Solicitor General, conclusively validate Methanex's position here.

So, if we could turn to the first one, which is Tab 43, this is the belief of the United States Solicitor General in arguing the McConnell case before the Supreme Court. It's 21 JV tab 1, at 37-38.

Now, the McConnell case, if we can go back a few years, there has been a long campaign for campaign finance reform that culminated in the passage of the bill called the McCain-Feingold bill, campaign reform bill, campaign finance reform bill. This was challenged by Senator McConnell, who opposed it on constitutional grounds, and the case went all the way up to the Supreme Court.

And one of the questions was, was this necessary, and the Solicitor General defended the
campaign finance law before the Supreme Court, and in defending the law and in arguing to the United States Supreme Court that prophylactic measures of the type that were included in the bill were necessary, he said, and this is the quote, he referred to a treasure trove of testimony from members of Congress, individual and corporate donors and lobbyists, as well as documentary evidence, establishing that contributions, especially large non-Federal donations, are given with the expectation that they will provide the donor with access to influence Federal officials and that this expectation is fostered by the national parties, and that this expectation is often realized.

Former Senator Warren Rudman testified large soft money contributions in fact distort the legislative process because they affect whom Senators and House members see, whom they spend their time with, what input they get, and make no mistake about it, the money affects outcomes as
well.

One lobbyist testified that the amount of influence that the lobbyist has is often directly correlated to the amount of money that he or she or his or her clients infuse into the political system.

Next, I'd like to go to what the Supreme Court itself--before I do that, I'd like to just step back and say, this is the Solicitor General of the United States, the highest litigating official in the United States in the Department of Justice, and this is the position that he took on behalf of the United States Government before the Supreme Court. He quite clearly recognized, if nothing else, the possibility that large campaign donations can affect outcomes. And he quoted Senator Rudman in saying that to the United States Supreme Court.

And the Supreme Court upheld the law, and in doing so, they accepted these types of arguments. The idea that large contributions to a national party can corrupt or, at the very least,
create the appearance of corruption of federal
candidates and office holders is neither novel nor
implausible. There is substantial evidence in
these cases to support Congress's determination
that such contributions of soft money give rise to
corruption and the appearance of corruption. For
instance, the record is replete with examples of
national party committees' peddling access to
Federal candidates and office holders in exchange
for large soft money donations.

Just as troubling to a functioning
democracy as classic quid pro quo corruption is the
danger that office holders will decide issues not
on the merits or the desires of their
constituencies, but according to the wishes of
those who have made large financial contributions
valued by the office holder. Even if it occurs
only occasionally, the potential for such undue
influence is manifest. And unlike straight cash
for votes' transactions, such corruption is neither
easily detected, nor practical to criminalize.
Now, if I could just break out for a
second from the quotes, the United States has made
much of the fact that we have not accused anyone of
any criminal conduct, and that's correct. We have
no proof that any criminal transactions took place.
That's not the issue here. The issue here is not
whether there was a criminal quid pro quo. The
issue is whether this type of political corruption
that the Solicitor General and the United States
Supreme Court is referring to, took place here.
That's the issue.

Now, if I could go back to the quotes from
the Supreme Court, to claim that such actions do
not change legislative outcomes surely
misunderstands the legislative process. More
importantly, plaintiffs conceive of corruption too
narrowly. Congress's legitimate interest extends
beyond preventing simple cash for votes corruption
to curbing undue influence on an office holder's
judgment.

Implicit and as the record shows,
sometimes explicit, is the sale of--in the sale of access is the suggestion is that money buys influence. It's no surprise, then, that purchasers of such access unabashedly admit that they are seeking to purchase just such influence. It is not only plausible, but likely that candidates would feel grateful for such donations and that donors would seek to exploit that gratitude.

Next is another Supreme Court case, an earlier case dealing with another campaign finance reform issue. This is the case of FEC, Federal Election Commission, versus the Colorado Republican Federal Campaign Committee. "Corruption being understood not only as not quid pro quo agreements, but also as undue influence on an office holders' judgment and the appearance of such influence. The money parties spend comes from contributors with their own personal interest. Parties are necessarily the instruments of some contributors whose object is not to support the party's message or to elect party candidates across the board, but
rather, to support a specific candidate for the sake of a position on one narrow issue or even to support any candidate who will be obliged to the contributors.

There is an expectation that giving to party committees helps you legislatively. We all know that one of the greatest political evils of the time is the apparent hold on political parties which business interests and certain organizations seek and sometimes obtain by reason of liberal campaign contributions. Many believe that when an individual or association of individuals makes large contributions for the purpose of aiding candidates of political parties in winning the electrics, they expect and sometimes demand and occasionally at least, receive consideration by the beneficiaries of their contributions.

Now, Methanex's position is, and I think it's undeniable based on those quotations that this is, unfortunately, a pervasive aspect of the American political system. And what we'd like to
focus on next is a very precise example involving Mr. Vind, the ethanol industry, and Congressman and then Senator Toricelli of how this system works. And it's an exemplar of how the system works and how it operates.

ARBITRATOR REISMAN: I want to make sure I understand the inference that you're drawing from those quotations from the Solicitor General and the Supreme Court in the McConnell case and the FEC case.

Is it that these various authorities are saying that every action by an elected official, whether in the Legislative Branch, the Executive Branch, or the judiciary, where the judiciary is elected, in whatever level of government is presumptively corrupted?

MR. DUGAN: No, that's not our position at all. Our position at all, at least as a minimum, is that what these quotes and what these statements by the Solicitor General established is that if a certain fact pattern is present, it is very much a
permissible inference for anyone judging that fact
pattern to infer, to use Senator Rudman's words,
that money affected the outcome. That's a
permissible inference.

ARBITRATOR REISMAN: And the fact pattern
that you are referring to is the payment of money?

MR. DUGAN: Well, it's a combination of
things. I mean, I think that the more facts that
point to us, the stronger the inference. If there
is a payment of money, if there's a meeting between
the official and the contributor, if there is
thereafter a change in policy that benefits the
contributor, if there is after that yet another
contribution, then I think that step by step and
point by point the evidence and support of that
inference grows.

Now, this is a newspaper story that was
reported in New Jersey in 1998, and it was an
analysis and a description of a series of political
contributions and the responses between Mr. Vind
and Robert Toricelli, who at the time was a
Congressman in New Jersey, who later ran for the Senate, was elected, and then later resigned because of allegations of corruption.

Mr. Vind had--who is, remember, a Los Angeles or at least a California businessman, made contributions to Representative Toricelli, who is a New Jersey representative, and I'm inferring that the reporter wanted to know why a California businessman was making contributions to a New Jersey political representative. And Vind's response was, quote, we are a free country, and I can go ahead and support anybody I want. If I think a guy is going to be a bulldog and weigh in--and going to support American businessmen in these banana republics, hell, yes, I will support him.

What he was referring to was Mr. Vind's particular problem in El Salvador. He had purchased some type of plant there that was associated with the production of ethanol, and he was having trouble obtaining the requisite business
approvals to operate it. So, he gave a
contribution to Representative Toricelli, hoping to
get Representative Toricelli's help in solving the
problem.

Vind, and this is the next slide and, by
the way, for the record, this is 11 JS tab at 231
at 3, Vind contributed $500 to Toricelli's campaign
on March 1st, the first contribution he had ever
made to the New Jersey Democrat campaign finance
records show. He then wrote to Toricelli for help.
Within days, Toricelli wrote a letter to the U.S.
Trade Representative Mickey Cantor. The Government
of El Salvador, and this is Toricelli's words, the
Government of El Salvador has not lived up to the
commitments it has made to American companies,
particularly western petroleum importers,
Toricelli's March 13th letter said. I find it very
troubling that we accede to requests from
El Salvador for more assistance.

The next slide, on March 28, two weeks
after the letter, Vind made a second $500
contribution to Toricelli's campaign. There would be more contributions and more letters to come. On September 5th, Vind and his wife Joan contributed $3,000 to Toricelli's 1996 Senate campaign, the maximum allowable records show. That same day, Vind's son and daughter-in-law each made $1,000 contributions to the campaign. In addition, Vind donated $5,000 on September 25th to the Senate Democratic Committee, which was running ads on behalf of Toricelli and other Senate candidates.

Next slide, Vind is a self-described Democrat with a history of involvement in local, state, and national politics. Since 1984, he and his family have contributed more than $184,800 to candidates and committees in both parties, Federal records show. He says he has raised money for a whole bunch of folks, including Toricelli.

Meanwhile, Toricelli's first letter to the Clinton Administration helped Vind. Cantor brought up Vind's problems during a trade mission with El Salvador's Minister of Economy, Vind said.
Now, in addition to the letters, Toricelli voted twice in the Senate to extend a fuel excise tax exemption to ethanol producers, an issue worth millions to Archer Daniels Midland, also important to Vind. ADM is known to have bank rolled a multi-million dollar lobbying campaign to extend the credit.

Toricelli's Senate votes, his first that dealt solely with the tax credit issue, were unusual for a New Jersey Senator. Senator Frank Lautenberg, democrat of New Jersey, voted against the credit, and for years Toricelli's predecessor in the Senate, Bill Bradley, was known as a leading opponent of the credit, accusing supporters of reaching deeper and deeper into the pockets of American taxpayers to benefit a handful of special interests. In 1994, he introduced a bill to repeal it.

Now, next is a quote from Mr. Vind. He said to the reporter, is there a quid pro quo? Absolutely not.
And finally, there is a comment from Mr. Gary Ruskind, director of the Congressional Accountability Project, a Ralph Nader-affiliated group. The only thing missing here is a handshake. It's one more government official for hire by the largest contributor and one more reason we need campaign finance reform.

So, that's a vignette of how the process works. Contributions are made, an official changes his position or does something, and more contributions are made.

Now, again, Methanex is not alone in asserting that Archer--ADM and the U.S. ethanol industry have used this type of political influence and political lobbying to gain their ends. California has itself said the same thing. After Governor Davis banned MTBE and applied to the United States EPA for a waiver of the oxygenate mandate, the EPA denied it, and at that point the Government of California sued the EPA, and one of the things they alleged in the course of that
proceeding was that the reason why EPA turned down the waiver request was because, quote, Following a national election, a change in administration and after intense lobbying by the ethanol industry, the U.S. EPA reversed course and denied California's waiver request, end quote, purportedly on scientific grounds.

So, California itself believes that the ethanol industry exercises its political influence to subvert the regulatory process and to obtain decisions, policy decisions that are not justified by the science, and Methanex fully agrees with the State of California. That is precisely what the ethanol industry does in the United States.

Now, United States doesn't deny that the U.S. ethanol industry would not exist without the protectionist measures and the subsidies provided to ethanol by U.S. Federal and state governments and that had been provided for a number of years. Once again, the best evidence of that are the words of the United States itself. And I would like to
draw the Tribunal’s attention to a statement by the United States General Accounting Office, which is the investigative arm of the United States Senate. And what it reported was, quote, 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.

So, that’s the GAO—again, the United States Congress investigating arm—saying that without the subsidies, without the tax incentives, there would be no U.S. ethanol industry.

Now, how did the ethanol industry get these tax incentives? Let’s turn to the words of Senator John McCain. Now, if you will recall, the campaign finance bill, the campaign finance legislation that went up to the Supreme Court was called the McCain-Feingold bill, and it was named after McCain because he sponsored it and he reported it. Here is what Senator McCain has to
say about the ethanol industry and the tax
subsidies that are received by the ethanol
industry. And this is from a speech on his
letterhead that we have included in the judge's
books for you. "Americans care deeply about tax
reform. The Tax Code is a bewildering 44-page
catalog of favors for a privileged few and a
chamber of horrors for the rest of America. We
must have systemic reform. But reform is not
possible when Archer Daniels Midland, the nation's
largest ethanol producer, like so many other
special interests, trade huge political
contributions to both parties in exchange for
special tax subsidies. And you lose, speaking to
the American people.

So, Senator McCain says it explicitly
there: What ADM does is it trades huge political
contributions in exchange for special tax
subsidies. That's why this ethanol industry
exists.

Now, beyond those tax subsidies, the
United States doesn't deny that the U.S. ethanol industry is also heavily protected from foreign competition by tariffs and other political pressures aimed at neutralizing competition. Ethanol imports are subject to a duty that amounts to a total of approximately 54 cents per gallon. The current price is about $1.80 a gallon. It's at a historic high, so you can see this import duty of 54 cents is a forbidding barrier to the entry of foreign ethanol.

And in fact, if you look at the slide that we've included and we've put on the board, unsurprisingly, the United States's ethanol industry has captured 93 percent of the United States ethanol market, and it should be further pointed out, that the 7 percent that are imports are legislatively mandated imports. They come in through the Caribbean Basin Initiative, and they're a special exemption for the Caribbean Basin.

But for that, no other imports from any other country coming into the United States, even
though it's generally agreed that, for example, Brazil is a more efficient producer.

Now, in terms of its campaigns, the ethanol industry's campaigns to obtain these types of subsidies and tariffs and other forms of protection, one thing that we would like the Tribunal to take note of is the fact that throughout these campaigns there is always a note that methanol and MTBE are foreign products. There is always a nationalistic appeal to the fact that corn is produced in the Midwest by Midwestern farmers, and it competes with foreign sources of methanol or MTBE.

For example, this is a statement from representative Jim Nussell, member of the House Ways and Means Committee, Co-chairman of the Congressional Alcohol Fuels Committee. He said methanol is derived from oil and other petroleum-based products, increased use of MTBE transmits into even more dependence on foreign energy supplies.
In 1992, at the start of the debate about oxygenates in general, Senator Daschle, a well-known supporter of ethanol, emphasized the punitive approach. He introduced a tax package that would put a 50 cent per gallon duty on imported methanol, which would have translated into a 17-cent per gallon hike in the MTBE price. Now, where does this nationalistic rhetoric come from, this jingoistic rhetoric? From the ethanol industry.

Next I would like to draw the attention's to a quote from Wayne Andreas, who was at the time Chairman and CEO of ADM. He stated in an interview with Money Line--now, 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, O.P.E.C. states, same places we get our oil from and will cost billions of dollars in foreign exchange. Well, ethanol means a billion dollars to American farmers, so it's Middle East versus Middle West.
In terms of the market, by the way, it's also worth pointing out and following up on your question earlier this morning, the size of the market in California is very, very big. The California Energy Commission estimated that the ethanol market for this year will be approximately 900 million gallons, and the current price is $1.83 a gallon, so that comes out to be about, I think, about $1.8 billion.

Now, going back to what we said this morning about Methanex's position that Governor Davis intended to give the ethanol industry half of that market, that amounts to approximately $900 million. So even if it was only half of the market, Governor Davis was conferring on a very large political contributor a very, very significant benefit and a very large market.

Now, going back to this campaign to brand methanol and MTBE as a foreign product, public interest group have also picked up the theme. One of them, Citizen Action, has stated that because of
the CAAA, which is the Clean Air Amendments Act, I believe, the demand for MTBE and methanol have increased substantially leading to the reopening of mothballed and the construction of new methanol plants both in the United States and abroad. Because methanol can be produced cheaply in many foreign countries, primarily because of access to very low cost natural gas resources, the United States is importing an increasing amount of methanol.

As the United States seeks to reduce pollution from gasoline by shifting to cleaner-burning fuels and components, there are concerns that oil import dependence may be exchanged for foreign methanol import dependence. In fact, Citizen Action went out of its way to excoriate and identify, quote, foreign-owned Methanex.

PRESIDENT VEEDER: Would you help us, what is Citizen Action?

MR. DUGAN: Citizen Action is a public
interest group. It's a public interest group that's an NGO. It's a lot like some of the people who are sitting in the audience today. It's concerned with public interest issues, and they're the ones who launched this accusation against Methanex.

And they went on to accuse, quote, foreign-owned Methanex, end quote, of leading methanol producers in, quote, creating market panic and driving prices above anticipated competitively determined levels, and that's found at 3 JS tab 32. It's Tab 53.

Now, again, another example of the ethanol industry constantly depicting methanol as a foreign product is a letter from Doug Vind, who, I believe, is related to Richard Vind, the witness who will be coming here. It's on Regent International letterhead. And it states that we must insist--and it's a letter to Mr. Ted Hope of the Los Angeles County Metropolitan Transit Authority I think is what it stands for, and the letter was with respect
to the purchases by the Transit Authority of methanol. And Mr. Vind says to Mr. Hope, "After reviewing this information, we must insist that the MTA's procurement office immediately stop the current practice of purchasing foreign-produced methanol to supply the MTA's alcohol bus fleet."

So again, he's identifying the foreign statement and telling a local government to stop buying foreign methanol.

Now, this whole edifice of subsidies and protection, to use the words of Senator McCain, ADM has received in trade for its political contributions, we believe, violate world trade laws.

Now, it's not directly relevant here, but we think it's important background information. We believe that the combination of the tax subsidies and the prohibitive import duty, in essence, are intended to create an import replacement scheme, and that's illegal under WTO laws.

Similarly, the whole ethanol production
scheme is built upon the massive subsidies that corn farmers receive from the United States Government.

And finally, we believe that the effort to restrict oxygenates to ethanol is a violation of the WTO technical barriers to trade agreement. Now, that's not necessarily relevant here because those subsidies are not the subsidies at issue here, but I think it's important for the Tribunal to note that these are the types of agricultural subsidies that now threaten to undermine the entire world trading system. It's because of these types of subsidies similar to the common agricultural program in Europe, similar to the subsidies that Canada provides to its farmers, similar to the subsidies and protection that Japan provides in Japan that the Third World is so upset about.

The Third World complains that the protection and the subsidies deprive them of the opportunity and the ability to compete fairly in
these types of products. Brazil is a good example.

Brazil has abundant amounts of excess sugarcane that can be used to produce ethanol. Brazil is probably a much lower cost ethanol producer, but it's completely shut out of the market and the Third World countries are protesting that the system is unfair and it's tilted against them precisely because of the types of subsidies and protection that ethanol receives.

Now again, that's an equitable concept that may or may not guide you, but this is the type of program in place and this is the impact this type of program is having on the world trading system.

Now, where does ADM fit into this whole scheme? As we've said in some of our pleadings, ADM is the ethanol industry. It's the lead actor in the ethanol industry.

Now, we've made a lot of allegations about ADM, and I think it's fair to say the U.S. doesn't deny many of them. It doesn't deny that ADM is the
largest beneficiary of the tax incentives for
ethanol or that it's among the most prominent
corporate--recipients of corporate welfare anywhere
in the United States. It doesn't deny that
43 percent of ADM's profits come from this heavily
subsidized, heavily protected ethanol program.

How did ADM become the beneficiary of such
government largess? Well, you saw the quote from
Senator McCain, but others said the same thing.
He's not the only one to say that it's these
political contributions that ADM makes, that ADM
trades for favorable policies. If I could draw
your attention to--this was a statement, there is
the statement from Senator McCain again. I won't
reread that, but underneath that is just a--and
there are numerous articles like this that can be
found--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.

And that was reflected in some of the
Supreme Court comments that we just read, where the
Supreme Court noted that often contributions are
given not because the contributor supports a
particular ideology, but because the contributor
wants to obtain a special benefit because it's a
special interest, and Methanex submits that ADM is
the paradigm of that pattern.

Now, in addition to their political
contributions, ADM engages in what Methanex
considers to be numerous forms of unfair
competition. They have many times tried to create
health scares about methanol and MTBE, and one
particular example is what happened in 1994, and
this is a report from a newspaper, from a trade
publication, the New Fuels Report, and the title of
the news article is "False MTBE Moratorium Report
Wreaks Havoc for Methanol Industry." The stock of
a major producer, which as it turns out was
Methanex, took a nose-dive last Monday, July 8, after unfounded reports surfaced that the American Medical Association, AMA, had called for a nationwide MTBE more moratorium."

"By the end of last week, however, the stock of Methanex, Inc., of Houston had recovered. The spot market for the petroleum-based fuel additive remained unaffected by publicity generated by false reports of the 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 for the AMA's action."

Next, who is Fuels For The Future? Well, this is a quote from a Bloomberg story. Fuels For The Future is financed by farmers' groups and
companies like Archer Daniels Midland, a company of Decatur, Illinois, which would benefit from greater use of ethanol, a corn derivative.

Now, just so that the Tribunal is clear on precisely what type of company ADM is, and again this is material that's in the record, it's not a company that engages in fair competition. The United States Department of Justice brought a price-fixing investigation, launched a price-fixing investigation against ADM, and as a result three of ADM's senior executives, including Michael Andreas, the son of former ADM Chairman Dwayne Andreas, were convicted of price fixing and sentenced to prison. On appeal, the United States Court of Appeals for the Seventh Circuit--

PRESIDENT VEEDER: Sorry to interrupt, could you go back to Tab 56, and just help us if we look at the full report "False MTBE Moratorium Report Wreaks Havoc in the Methanol Industry." We are having trouble with the fourth paragraph, the third line: Fuels For The Future will have painted
the misleading picture.

MR. DUGAN: We had trouble as well. I think it says that MTBE's use should be suspended until scientific studies can be conducted. In fact, AMA's proclamation only dealt with reports of MTBE-related health--

PRESIDENT VEEDER: I think somebody's highlighted it because it's important, and because it's highlighted we can't see it, but we can come back to it later.

MR. DUGAN: Okay. It's not because of the highlighting, it's because of the copying. The copying make it is very unclear, but I think it refers to something health-related something cases.

Next going back to the lysine price-fixing case, the United States Court of Appeals for the Second Circuit not only affirmed the convictions, but in a relatively unusual judicial act it increased the defendants' prison sentences and condemned ADM's corporate culture, and this is what it said. It said: "The facts involved in this
case represent an inexplicable lack of business ethics and an atmosphere of general lawlessness that affected the very heart of one of America's leading corporate citizens. Top executives at ADM and its Asian co-conspirators throughout the 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.

So, that's the Seventh Circuit talking about ADM. That's not Methanex.

So how did ADM operate in California? What did it do in California with respect to this MTBE ban? Well, the first thing it did was in 1997, it started the whole process. The ethanol industry started the whole process of trying to develop the appropriate political framework and background for this type of ban trying to generate support. Mr. Wright's witness statement, and the materials he relied upon make that clear. For
example, in January 1997, at about the same time that Senate Bill 521 was being drafted, and that was the bill that ultimately called for the study and then called for the Governor to take appropriate action, Lynn Suter, ethanol's lobbyist in California, reported, and this was with respect to a hearing on MTBE, "This hearing was something of a lovefest and received very good play in the legislature, the press, and in the larger community. Every single speaker invited by the committee to describe options to MTBE or to tout benefits of ethanol as a market alternative was generated by efforts of our team last year. In addition, a long list of environmental groups, business and agricultural interests attended the hearing and made comments during the public address portion of the hearing. Nearly all of these speakers were also generated through our coalition building last year.

Yesterday's Supreme Court decision throwing out most of the campaign contributions in
Proposition 208 means that we will probably have to become players in the campaign donation game. My intention would be to keep this participation to a minimum, but I can see a $20,000 effort looming if we are to take advantage of the influence that might bring.

Now, in fact, ADM and Regent International in the end contributed over more than $200,000 to California politicians.

Now, the press has also called attention to how these things take place and to what ethanol was doing in California. This is the story from the Los Angeles Times in 1997, and it's talking about someone who is alleged to be an operative for the ethanol industry. "While most promoters try to maintain as high a profile as possible, Bob O'Rourke admits that only when pressed that he is a public affairs consultant for the ethanol industry. He also acknowledges that he sometimes gives advice to a controversial citizens group called Oxybusters, which is campaigning to ban a
petroleum-based additive that competes with ethanol to make gasoline burn clearer, but O'Rourke refuses to disclose the name of his employer. He blames covert consultants in the opposing camp for trying to create the impression that he's quietly working on behalf of the nation's most controversial ethanol producer, Archer Daniels Midland Company. It also serves as a cautionary tale for California consumers who are being bombarded through radio talk shows and news outlets with information challenging the safety of the petroleum additive, which is called MTBE. Insiders say some of the controversy is being generated by industry-paid operatives such as O'Rourke, whose allegiances are not always clear."

Next is an article from the trade journal World Refining. "The assault on the use of MTBE in California has been the product of a well financed, organized, negative media and public profile campaign orchestrated by Archer Daniels Midland, top executives, and the resulting hysteria created
by ADM and conservative radio talk show hosts.
Over time, 1996 to March of 1999, this created
hysteria and the inability to promptly solve the
Santa Monica tank and pipeline leak problem wore
out all of California's rational thinking."

Well, why was ADM so politically active in
California? Because it had an uphill battle there.
As we went over earlier, Governor Wilson and
California at the time was very much opposed to the
use of ethanol. They thought, to quote their own
language, that it was harmful to the citizens, the
health of the citizens of California, and to the
environment.

In fact, as noted, Wilson vetoed
legislation that would have given ethanol a helpful
boost, but Wilson's term was coming to an end, he
wasn't running for re-election, and his lieutenant
governor, Davis, was campaigning hard to replace
him.

And this was in 1998, and so next I would
like to go to the facts surrounding the secret
meeting in Decatur, Illinois. What we have done is
put together a time line, and we will hand out as
well the binders of the evidence that backs up this
time line, but the time line is meant to—to put
into compressed format all the evidence.

All right. The first point on the time
line, March 20th, 1998, said California state
Senator John Burton, who plays a role, remember, in
this case as well, he is one of the politicians who
travels out to Decatur and he also is the
politician who informs Methanex in very candid
terms precisely what's going to happen to it.

He sends a letter to Richard Vind
introducing himself as the new President pro tem of
the State Senate. We don't know why he sent the
letter. I think we can infer that given Mr. Vind's
prominence as a political contributor, that must
have played a role in it.

Next, on May 28th, 1998, Davis receives a
contribution of $5,000 from ADM. June 2nd, 1998,
Davis receives the Democratic nomination for
Governor. The same day, Davis receives another contribution of 5,000 from ADM.


Then the floodgates open. August 17, 1998, Davis receives a contribution of a hundred thousand dollars from ADM. Burton receives a contribution of $25,000 from ADM.

December, Davis receives another--November 3rd, Davis gets elected. Davis receives another contribution of $25,000 from ADM.

January 4th, he's sworn in as Governor; March 25th, 1999, he issues the Executive Order banning MTBE, which includes the statement in his
request for a waiver that a significant portion of
the market would still go to ethanol.

September 24th, 1999, Davis receives
contribution of $50,000 from ADM.

March 30th, 2001, the Wall Street Journal
reported that Davis had received a total of 200,000
in contributions from ADM.

So, those are, I think, the relatively
undisputed facts concerning it. Now, there's some
important points to make about that. First of all,
Davis sought out then and asked for a meeting with
ADM, and he did so in the middle of his campaign
for Governor, which is historically a busy time for
any candidate.

Now, Methanex believes there shouldn't be
any serious doubt as to why Governor Davis
contacted Vind to set up a meeting with ADM. He
was soliciting campaign contributions. That's why
he contacted him. That's why he affirmatively went
out of the way. We believe that's the only
inference that can be drawn.
Now, it's apparent from the schedule and
the itinerary for the meeting why the participants
were coming together in California, and if we could
look at that schedule, that itinerary, which is Tab
61 in your books.

Now, what's important to note here is that
all of the participants who are not senior
executives, all the lower level participants, all
have a direct connection to ethanol, starting from
the bottom, Bob Daneen, Legislative Director for
the Renewable Fuels Association, is--Renewable
Fuels Association, as we've stated, is the ethanol
trade lobby. Dick Vind, Chairman and CEO of Regent
International, which as we know from Mr. Vind's
testimony, is an ethanol company. John Burton, of
course, is the politician. Rick Reisling is Senior
Vice President. And then Roger Listenberger, who
was Western Marketing Manager, Fuel Ethanol.
Marty Andreas, Alan Andreas, Dwayne
Andreas, were all senior executives.

So, the people with line responsibility,
had line responsibility only for ethanol. There is no one here from ADM's lycene business or its corn business. It's only ethanol.

Now, it's also interesting to keep in mind that at least two of the meeting's scheduled participants were known to be responsible for statements that had condemned methanol. Dwayne Andreas was the one who said that methanol, with an M, is a foreign product. It's the Midwest versus the Middle East. And Vind was associated with Regent International, which sent the letter to the Los Angeles County Metropolitan Transit Authority asking them to stop their purchases of foreign methanol.

Now, we say that this meeting is secret. It didn't become public knowledge until early 2001, and the participants went out of their way to conceal the existence of this meeting. The official campaign documents filed by the various participants, and this is one of them, this is the expense--this is Tab 62. This is a recording of
the expense for Gray Davis for his flight to Illinois, to Chicago, and it puts down there as the purpose for the meeting, meeting with Ron and Steve Powell, AFL-CIO. Well, his other purpose for going to Illinois was to meet with ADM, but he's studiously avoiding putting this purpose down on the campaign disclosure document.

Now, once the meeting finally became public in early 2001, ADM publicly misrepresented its nature. Its first public response concerning the meeting, and this was the Tab 63, a top official of ADM in a telephone interview with Mobile Source Report said in response to Methanex's NAFTA case that we don't hold secret meetings.

Well, for a company that's been convicted of price fixing, it's pretty ridiculous for them to say they don't hold secret meetings.

Five days after that, that statement, ADM was forced to acknowledge that it had in fact met with Davis, but even then, it issued a more preposterous denial, claiming that the meeting was
only a get-acquainted session related to ADM's
extensive food business in California.

PRESIDENT VEEDER: If you go back to the
Tab 63, after the quote that you've read, A top
official of ADM in a telephone interview with
Mobile Source Reports said we don't hold secret
meetings. But in the same report it goes on,
however he did not deny there were meetings between
ADM officials, and then a misprint for the
candidate Davis.

MR. DUGAN: I'm sorry, which one are you
talking about here?

PRESIDENT VEEDER: I'm looking at Tab 63.
And after the quote, "We don't hold secret
meetings," if you run on in the full document that
you have appended, they confirmed there was a
meeting.

MR. DUGAN: Right. Correct. What he was
saying, what I was pointing out was the claim there
that they don't hold secret meetings. I think that
is the claim that cannot be supported. They do
hold secret meetings.

PRESIDENT VEEDER: I thought you were suggesting that at the time they were denying a meeting, and only five days later they admitted there had been a meeting.

MR. DUGAN: I wasn't. If I did suggest that, and I think we did suggest that in our brief, that was incorrect. I didn't think I suggested it here.

The second statement, the second quote from the Reuters report, "The U.S. agricultural giant does extensive food business in California, so it was only natural to have met with Governor Gray Davis during the 1998 campaign and contribute 200,000 to its coffers," ADM spokesman Larry Cunningham said. "Our contributions are public knowledge," Cunningham told Reuters adding that the meeting with Davis at ADM's headquarters was a get-acquainted session.

Well, just recalling who the participants were in the session, it doesn't appear that it was
a get-acquainted session. It appears that it was a session about ethanol. Only people with line responsibility for ethanol were at the meeting. Bob Daneen was at the meeting. He was an ethanol guy. Dick Vind was at the meeting. He was also an ethanol guy.

So this statement that it was simply a get-acquainted session and the suggestion that it had to do with the extensive food business in California is simply not supported by the record.

Furthermore, the witness statement of Roger Listenberger, who we'll be cross-examining on Thursday, indicates a much different purpose for the meeting. He said--and he said, quote, Mr. Davis--this is paragraph two of his witness statement. "Mr. Davis was campaigning to become the Governor of California. It was my understanding that the dinner was arranged in order for me and others to meet Mr. Davis, discuss his candidacy, and assess whether to support his campaign."
So, ADM was going to talk with Mr. Davis and see if it was worthwhile making a contribution of over $200,000 to Mr. Davis. So, it's quite apparent that this was not a get-acquainted session. This was a session between a heavy duty political contributor that wanted to see whether Governor Davis was the type of candidate who was suitable for ADM to make contributions to. And we know that thereafter, within weeks of the meeting, ADM made a huge contribution to Governor Davis, a hundred thousand dollar contribution, and the question becomes what happened at the meeting that led ADM to come to the decision to heavily support Gray Davis, and heavily support him they did. Again, hundreds of thousands of dollars flowed into his coffers as a result of this.

Now, on the basis of the evidence that's in the record, and we believe it will be augmented by the examinations of Mr. Vind and Mr. Listenberger, I think a number of conclusions
can be drawn. First of all, the meeting had two purposes, ethanol and whether ADM was going to support Governor Davis. The fact that ethanol was the purpose of the meeting can be inferred from all the ethanol participants who were there, and the fact that the question of whether ADM was going to support Gray Davis comes from Mr. Listenberger's witness statement.

Second, the parties wanted to keep the meetings secret, and they wanted to keep it secret, and that's why Davis did not disclose it in his campaign form because of the obvious reason of the appearances it would create.

I think it's certainly permissible and safe to infer that public knowledge of the meeting would create the appearance that the ethanol industry had obtained improper influence over Gray Davis.

The third point to keep in mind is that after the meeting took place and after the contributions were made, Gray Davis did, in fact,
implement a policy decision that heavily favored ADM. We put into the record evidence about ADM's press releases, announcing higher profits. They're at 23 JS Tab 39 at 1. ADM has benefited enormously from this. One of the oldest legal maximums for finding the truth is cui bono, who benefited, who received the benefit here? It's quite clearly ADM. Now, is this set of facts, this pattern of facts, unusual for Davis? No. This set of facts was quite clearly part of Governor Davis's dealing with other industries as well; and what I would like to put up now is Tab 65. It's a newspaper Article from The Sacramento Bee. Sacramento is the capital of California, and again this is The Sacramento Bee's words, making the same points that I think we have been making. First of all, the title, "Is it all simply a coincidence? During the first year of his governorship, Davis pulled in a record $14 million from a wide variety of special interests groups averaging $38,000 a day, or $1600 an hour. A
certain pattern developed. Farmers, timber company executives, leaders of the managed health-care industry or other interest groups would stage fundraising events for Davis in conjunction with their discussions of pending issues. And by some coincidence, he would soon adopt policies that found favor with the interest groups involved. The most obvious example involved healthcare company regulation, with Davis insisting on the final version that companies could tolerate but that health consumer advocates found wanting. Lobbyists believed that the surest way to get Davis's attention was to stage a fundraising event, and Davis political aides, lobbyists say privately, make it clear that the minimum required for personal appearance by the Governor is a $100,000, four times his threshold in 1998." So, that means in 1998, $25,000 would have gotten a personal appearance. ADM and Regent International ended up contributing $200,000 to Governor Davis's campaigns.
Now, in the context of what Governor Davis was raising, that was a large amount of money. They were--$25,000 was the threshold for personal appearance. $200,000 must have been considered by the campaign to be a very, very significant contribution.

And so that's the question. That is, I think, the hard question that the Tribunal faces. Was it all simply a coincidence? Methanex's position is no, it was not simply a coincidence. Whatever happened at the secret meeting--and we cannot prove, as we've always said, anything criminal. We can't prove any quid pro quo. We can't prove any handshake deal. But to use Senator Rudman's words that were quoted by the Solicitor General to the Supreme Court, ADM's money affected the outcome of the MTBE debate.

To use Senator McCain's words--I mean, to use Senator McCain's words, ADM traded its political contributions for a share of the market in California. And to use the Solicitor General's
words, Davis succumbed to the temptation to favor
the interests of large contributors. Methanex
submits that is the only credible inference that
can be drawn from this pattern of facts that
happened in California, and that led Governor Davis
to both ban MTBE and then rush to embrace ethanol
before any thorough evaluation of its advantages
and disadvantages had been undertaken, and that's
why Davis focused California's attention on ethanol
and not on any of the other 5 or 10 or 15 other
potential oxygenates that could have been used to
replace MTBE.

Now, one of the reasons why that's the
only credible inference to be drawn here is because
of the empty chairs. Perhaps if Governor Davis
were here or the Andreases were here to contest
that inference, to proffer an alternative, more
credible inference, it might be a different story.
But they're not.

The only evidence before the Tribunal is
what I have gone through and what we will see from
Mr. Vind and Mr. Listenberger, and Methanex submits that the only inference to draw from that evidence, the totality of the record, what happened and who benefited is, again in the words of Senator Rudman, "the money affected the outcome."

Now, is the fact that Senator--Governor Davis used a purported environmental measure as a basis for giving ADM a market share? Does that in some way insulate it from this Tribunal's scrutiny? No, of course not. The fact that it's labeled as an environmental measure should in no way insulate it from this Tribunal's scrutiny. Methanex's position is that based on the evidence in the record, this is a classic case of a domestic industry using unjustifiable environmental measures to protect and further the interests of the industry.

Now, that's not a new or novel argument. That doesn't place this case outside the mainstream of international jurisprudence or even domestic jurisprudence. This type of pattern has been
And what I would like to quote are three international legal scholars and their take on the problem. Exhibit 66. The first is a quote from an Article by D. Farber and R. Hudec, Professor Hudec, who unfortunately is deceased, was a leading International Trade Law expert. The quote here is, quote, International legal scholars have frequently acknowledged the danger that environmental regulations may be captured by protectionists who will use them as a guise for erecting barriers to imports.

Next quote, Without strict interpretation of health and safety clauses, alleged health and safety clauses could easily become used as a pretext for illegitimate discrimination.

Next, As tariffs have diminished, a, quote, suspicion arises in some cases that announced concerns about health and safety are mere pretense for regulation that is motivated by protectionist ends.
And again, Methanex submits that that's what precisely happened in California between 1999 between 2000. The ethanol industry, the United States ethanol industry, captured the quid pro quo process and used it for its own ends.

Now, in addition to those quotes, the case law is replete with these types of things, instances in which the domestic industry used an environmental regulation for purely protectionist ends, and the best example of that is the S.D. Myers case. As I'm sure the Tribunal recalls, S.D. Myers was an American company that specialized in the remediation of PCB wastes, and it wanted to start doing business in Canada, and it wanted to export PCB wastes from Canada to the United States for final disposal. And its competition was in Canada, western Canada, and it appeared it was not as competitive. It wasn't as well run a company. It didn't have as much experience as S.D. Myers. So, what developed then was a fact pattern that is not greatly dissimilar from what has
developed here. The Canadian competitor went to its government and started lobbying its government for some type of protection, and lo and behold it got it. Now, there was no suggestion there of campaign contributions. It was clearly an attempt by the local Canadian competitor to lobby the government, and it got it in the form of a ban on PCB exports that was purportedly done for environmental reasons.

Now, the PCB ban, it was found not to have had any valid scientific basis. There was no health reason to ban the exports, and the ban was later lifted. Similarly here, Methanex takes the position that the MTBE ban had no scientific basis, and the conclusive proof of that is the European Union, including Finland, which uses up to 15 percent MTBE, found no reason to ban it. The same was true with the ban of PCB exports by Myers and Canada.

Fourth, the Tribunal in Canada in the Myers case noted that there were less protectionist
alternatives that could have addressed Canada's claimed environmental concerns. The same is true here. There were far less protectionist measures that could have addressed California's environmental concerns, namely an effective ban on two-stroke engines and upgrading—accelerating the tank upgrade program to take care of the leak and tanks.

ARBITRATOR ROWLEY: Mr. Dugan, you say there was no reason to ban it, and you give the European Union's actions and support. Do you have to go as far as that? Do you have to say that there was no reason to ban it in order to succeed?

MR. DUGAN: No, and as I think as we have tried to persuade the Tribunal earlier, that's not our burden. It's the burden of the United States Government to convince the Tribunal that the ban was necessary. I offer up the evidence of what the European Union did as evidence to the contrary, compelling evidence to the contrary. The United States cannot meet its burden because the EU action
shows that the ban could not have been necessary,
that the ban was not necessary.

Next, the Tribunal analyzed who benefited
from the PCB ban, and in that case--

ARBITRATOR ROWLEY: One further question.

Assuming that you're right and the burden shifts to
the United States, do they have to show that the
ban was necessary or is it sufficient that they
show simply that the ban was reasonable?

MR. DUGAN: I think they have to show that
the ban was necessary. I think that that is the
rule of international law that comes out of the WTO
decisions--and as we know, this Tribunal is
governed by international law, and this dispute has
to be resolved in accordance with international
law--and the WTO quite clearly places the burden on
the respondent state to prove that the ban was
necessary, to prove that the environmental measure
was necessary. That's one of the critical showings
that a respondent state must make in order to
justify a measure that involves disparate treatment
Now, what I was saying was that the S.D. Myers Tribunal looked at who benefited from this ban, and they found there that the benefit flowed entirely to a Canadian company. The same is 98 percent true in this case, as well. It's the United States ethanol industry that will benefit from the ban of MTBE and methanol in California. The Tribunal in S.D. Myers also analyzed the burdens, and in Myers it was much clearer because it fell on the U.S. competitor. Here, the situation is such that the burden falls on both foreign-owned ethanol producers such as Methanex, and it also falls on U.S. methanol producers. So, the burden is not entirely shared by foreign companies, but Methanex submits that that doesn't make any difference. Again, going back to the treatment that Methanex is entitled to receive under Article 1102, it's the best possible treatment.

So, to sum it all up, the S.D. Myers
Tribunal came to the conclusion that this purported environmental measure was improper under NAFTA because, in essence, it was a measure that was intended to protect a Canadian industry, and that precedent, we think, is particularly relevant to this case, as well, because that's precisely what we are alleging.

There are other cases as well. I will do one more case and then we will have a break. The Metalclad case, Metalclad versus various the United Mexican States. As it turned out, one of the key measures in that case was an ecological decree that was issued by the local Mexican Government against a hazardous waste facility that turned it into a preserve for endangered cactus species. It was proffered as an ecological measure, a measure to protect the environment, but I think the Tribunal concluded that the real purpose behind it was to satisfy the political demand in jurisdiction to shut down the hazardous waste facility, and that the ecological aspect of the decree was very much
subordinate to the political intent to shut down
the hazardous waste facility.

As a consequence, the Tribunal ruled that
it was an expropriatory measure, and it was that
basis on which the Tribunal actually awarded the
funds—the $16 million to Metalclad, and it was
that finding that survived the subsequent appeal in
Canada.

And again, that's an example of a measure
that purports to be one thing, and that case an
ecological decree, that actually has after the
Tribunal examines all the relevant facts and
circumstances and has a relevant true purpose. And
Methanex submits that's precisely what happened in
California.

Shall we take a 10-minute break at this
point?

PRESIDENT VEEPER: Yes, let's come back at
half past three.

(Brief recess.)

PRESIDENT VEEPER: Let's resume.
MR. DUGAN: Thank you.

The third case I'd like to turn to that deals with the issue of a regulation that is dressed up as an environmental regulation that has no substance is the case of Ethyl versus Canada.

It was one of the first NAFTA cases brought. It was brought by Ethyl Corporation of America, which manufactures a gasoline additive called MMT, and it had a production plant in Canada, and the Government of Canada issued a law which prohibited the importation of MMT into Canada, and equally prohibited the interprovincial trade in MMT. It didn't actually ban the production of MMT because as I understand it, I'm not a Canadian law expert, the Federal government didn't have the power to do that. I may be wrong, but that was my understanding.

In any case, Ethyl brought a NAFTA complaint alleging that this was a violation of NAFTA. And even more interestingly, the Government of Alberta brought a case against the central
Government of Canada under what is known as the Agreement on International Trade. That's an internal Canadian agreement that in many ways mirrors and parallels an international trade agreement. And under that agreement, a panel was convened in order to determine whether this restriction was justified. Now, earlier this morning, I think we made reference to the fact that that panel placed the burden of establishing the environmental bona fides of that order on the Canadian government, and it concluded that the Canadian government had not established that it was environmentally necessary to implement that ban. The other thing that was particularly interesting about it was that the panel concluded that the ban was the product of--it was pushed for by the Canadian automobile industry, and it was opposed by the Canadian oil industry. And I think the importance for this Tribunal is that it's another example. It's
another example of a ban that purports to be an environmental ban that cannot be justified as an environmental ban, and that it was the respondent country's burden to justify it. And because the Government of Canada lost at the AIT, it then settled the case with ethanol—Ethyl and paid Ethyl I think $20 million Canadian.

The final example I'd like to draw the Tribunal's attention to, is the recent Bilateral Investment Treaty case involving Tecmed in Mexico. I think I touched on this as well. Tecmed was a Spanish company that was operating a hazardous waste facility in Mexico, and as an aside, it seems that so many of these cases involved either additives to gasoline or hazardous waste facilities in Mexico. They seem to be dominating the NAFTA and the Bilateral Investment Treaty legal scene. In any case, Tecmed had opened up a facility in Mexico and wanted to renew the operating permit for the facility. And it was denied by the Mexican Government extensively on
environmental grounds. And what the Tribunal ultimately did was decide that there were no valid environment grounds, and that the real reason why the Tribunal had denied the renewal by the Mexican Government, had denied the renewal of the operating permit was because of political pressure, because Mexican residents near the dump did not want to have one in their backyard. And it concluded that that type of political pressure, the type of parochial political pressure was not a sufficient reason for closing the dump, and it awarded Tecmed a fairly significant sum of money.

So, that's a fourth example of a decree, of a government measure that purports to be one thing, but is actually another thing. And again, without beating a dead horse, that's precisely the case that Methanex makes here. That what happened in California between the MTBE ban and the bans on methanol and the rush to embrace ethanol, although dressed up as a series of environmental measures, is actually a series of measures intended to
protect the ethanol industry that cannot be justified on environmental grounds.

Now, members of the Tribunal, that more or less sums up Methanex's case-in-chief concerning Article 1102. In a nutshell, what Methanex argues is, first, that methanol and ethanol and the respective investments are in like circumstances. Secondly, methanol, because of ADM's contributions to Davis, was denied the best treatment accorded to ethanol.

Third, it's the U.S.'s burden to justify the ban on methanol and MTBE and the shift to ethanol, and it cannot justify that because it cannot prove any of the four following points, and it has to prove all of them. It has to show that the ban and the shift to ethanol were necessary as an environmental measure; it has to show that they were the most appropriate solution for the problem; it has to show they were the least investment, the least foreign investment-restrictive solution; and it has to show that they are not an arbitrary and
disguised restriction on foreign investments.

Methanex submits that it can't make any of those four showings, and for that reason, it's in violation of the Article 1102.

Now, with respect to 1105, the provision of NAFTA that requires fair and equitable treatment, there has been a lot of argumentation about what it actually means. As the Tribunal knows there has been a Free Trade Commission so-called interpretation that Methanex believes if it's taken at face value is actually an amendment.

What I'd like to do is simply to draw the Tribunal's attention to a recent case, the Waste Management case that was chaired by Professor James Crawford that attempted to review the developments in fair and equitable treatment over the past five or six years and synthesized them into a relatively comprehensive standard. And that's the quote that we have provided to you from Waste Management, and I think it bears reading.

A general standard for Article 1105 is
emerging. Taken together, the S.D. Myers, Mondev, ADF, and Loewen cases suggest that a minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory, and exposes the claimant to sectional or racial prejudice, leading to an outcome which offends judicial propriety, as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process.

In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied upon by the claimant. Evidently the standard is, to some extent, a flexible one which must be adapted to the circumstances of each case.

Now, Methanex believes that this is an excellent articulation of the standard of fair and
equitable treatment as it has developed over the years and as is required by the express text of 1105, which requires fair and equitable treatment. Methanex further submits that what happened in California violates this standard. What California did in banning MTBE and methanol and adopting, precipitously adopting ethanol was arbitrary, it was grossly unfair, it was unjust, and it was idiosyncratic in the sense that methanol (sic) was pandering to a domestic U.S. industry, the ethanol industry. It was discriminatory because it discriminated against foreign-owned investments such as Methanex, and that the whole process by which this took place in which the critical meeting was not the public hearings held in California, but the meeting between Davis and ADM in Decatur, Illinois, indicates a complete lack of transparency and candor in the administrative process. What was driving the adoption of ethanol in California was the political debt that we believe Davis felt he owed to ADM in return for its political
contributions, and that was not apparent in the administrative process whatsoever. So for all those reasons, we believe that the evidence that we have described today supports a violation of 1105, just as it supports a violation of 1102. Now, with respect to 1110, we have very little to add what we've put into the record already. The one point I want to make with respect to 1110, is that at the heart of what we are alleging here is discrimination, discrimination by Davis in favor of campaign supporters and discrimination against foreign-owned investments such as Methanex. And I don't think any public action that is discriminatory can ever be squared with the requirements of 1110, even by its own express language. It requires a nondiscriminatory act. This was a discriminatory act. And for those reasons, the same evidence that supports a violation of 1102 and 1105 equally supports a violation of 1110.
Now, next I'd like to turn to the question of Methanex's investments in the United States and whether they have been damaged. Methanex does, indeed, have valuable investments and assets in the United States as set forth in Mr. Macdonald's witness statements. Methanex owns several companies in the United States, and there are two principal operating entities. Methanex Company, which we call Methanex Methanol Company, which we call Methanex-US, that is responsible for the sales, inventory, and distribution of methanol throughout the United States. It has a sales staff. It has extensive leases where it stores the methanol. It has a fleet of rail cars. It generates considerable profits. In its best year it generated over $44 million in profits. It owns a lot of goodwill, as we will see. It has paid a lot for the goodwill that it has acquired, and it is indisputably a significant operating investment in the United States.

The second important company in the United
States is Methanex-Fortier which owned the Fortier methanol production facility in Louisiana. That facility was initially closed in 1999, prior to Governor Davis's MTBE ban, and it was finally written off as an asset, permanently closed as an asset by Methanex only a few months ago. And those are two of the main investments in the United States that Methanex has.

Now, the government has chosen not to cross-examine Mr. Macdonald, and I think that for that reason his evidence, even though United States doesn't agree with it, stands essentially unrebutted and unchallenged. The existence of the investments in the United States are clear—is clear. They are significant and they are very important to Methanex, and as I said, those investments have generated a very significant amount of profits over the years.

And just to illustrate them, I will put it up on the board, the Methanex organization chart which sets forth the relationship of the companies
in the United States to Methanex in Canada, and this was provided as part of Mr. Macdonald's affidavit.

Now, going into some detail about what the assets in the United States, the investments in the United States consists of, Methanex-US, which is the sales and distribution company, its assets include a very substantial amount of goodwill and marketing rights. For example, in 2002, Methanex paid 25 million for a customer list, a U.S. methanol customer list, from a company known as Terra Corporation and for certain production rights regarding that company's Beaumont, Texas, methanol plant. By the same token, in 2002, Methanex also acquired similar assets from a chemical company known as Lyondell, a customer list for $10 million. In fact, in 19--I believe it was 1995, Methanex in Canada, the parent company, bought the one-third of Methanex-US that it did not own for approximately $30 million, suggesting a valuation in 1995 of $100 million for Methanex-US.
Now, the U.S. response to these undisputed points of evidence in the Macdonald affidavits by saying that goodwill, market share, and customer base are not by themselves investments that are capable of being expropriated. We believe that they are quite clearly precisely the types of investments that are protected by NAFTA, and the starting point for any analysis as to whether these types of assets are investments that are protected by NAFTA is, of course, NAFTA itself, the text of NAFTA. Article 1139 of NAFTA provides a definition of what an investment encompasses, and Article 1139(g) is the subsection that is most relevant here. It's Tab 69.

And the relevant language is, investment means real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes.

Now, when a company spends $35 million for customer lists, it seems to me that it's impossible
to deny that that is intangible property acquired
in the expectation and used for the purpose of
economic benefit. And that is part of
Methanex-US's goodwill. It's part of its marketing
ing rights. It's part of its access to customers in
the United States. It's part of its going value
concern. And all that is set forth in
Mr. Macdonald's affidavit.
And this definition quite clearly
encompasses those types of assets.
Now, the U.S. argues that 1139 is an
exhaustive list and because the word "goodwill"
does not appear in the text of NAFTA, it's not
covered. But we believe that misses the point.
The point here is that Article 1139 describes a
class of investments that are protected by NAFTA
and encompassed within that class are goodwill,
goodwill and marketing rights, and the rights to
have access to valuable customers. Those are the
types of intangible property that have a real
value, and that are acquired and used in the
expectation of making profits, of obtaining economic benefit.

There's no doubt that both international law and relevant municipal law recognized that goodwill is a corporate asset. We've cited in our briefs the Manitoba case, which expressly recognized and ordered compensation for a taking of goodwill. U.S. law also recognizes that a company's goodwill, customer base, and market share are intangible assets that are routinely considered in terms of appraising a business and determining what its market value is.

The United States Supreme Court in the case of Newark Morning Ledger Company versus The United States accepted that goodwill was an intangible asset.

Similarly, two NAFTA Tribunals have dealt with this issue, and both of them have concluded that the types of rights that we're talking about here that Methanex-US has on its balance sheet are the types of investments that NAFTA was meant to
protect. The first of those, Pope and Talbot, Canada, Pope and Talbot v. Canada, the Tribunal concluded that, "The investor's access to the U.S. market is a property interest subject to protection under Article 1110," and that's Pope and Talbot paragraph 96.

Now, applying that standard here, Methanex's access to the California market is a property interest subject to protection under Article 1110, and it's precisely that access to the California market that has been taken away from it.

In S.D. Myers, the Tribunal recognized that, "There were a number of other bases on which SDMI could contend that it had standing to maintain its Chapter 11 claims, including its market share in Canada, including that its market share in Canada constituted a market investment." The Tribunal went on to state that, quote, Rights other than property rights may be expropriated, and international law makes it appropriate for Tribunals to examine the purpose and effects of
Again, Methanex's market share in California, of which it had a significant chunk until the MTV ban went into effect, is precisely the type of property interest, precisely the type of intangible property that is subject to protection under NAFTA.

Finally, there is a case, the Iran-U.S. claims Tribunal. The Amoco International Finance Corporation versus Iran, which also recognized that goodwill is the type of asset that can, indeed, be expropriated. It said, quote, Of going concern value encompasses intangible values which contribute to a company's earning power, such as contractual rights, as well as goodwill and commercial prospects.

To the extent that that Tribunal found that--to the extent that those assets exist and they have value, if they're expropriated, they must be compensated, and Methanex believes that's precisely the situation here. Methanex-US is very
much an operating company. It has significant
goodwill. It carries it on its books as goodwill,
and that goodwill, that value was severely damaged
by its loss of its market in California and in
other states as well, because of the MTBE ban that
California enacted, and the methanol ban that
California enacted.

Now, Methanex-Fortier. Methanex-Fortier
is the entity that owns the methanol production
plant in Louisiana that even, I believe, the United
States concedes is a protected investment under
NAFTA. Methanex-Fortier was closed in 1999, before
the MTBE ban, but it wasn't finally written off
until 2004. And it was finally closed--it was
finally closed in 2004, and one of the reasons why
it was closed is set forth in Methanex's annual
report, which is filed with the United States
Securities and Exchange Commission. And what that
says is, and this is Tab 71, the language in the
annual report states, (reading), Limiting or
eliminating the use of MTBE in gasoline in
California, or more broadly the United States, will reduce demand for MTBE and methanol in the United States and negatively impact the viability of MTBE and the methanol plants, such as our Fortier facility in the United States.

So, the corporation recognized, and this was the annual report for 2002 that was filed in 2003, a year before it was actually written off. The company recognized that the MTBE ban in California had so depressed demand for MTBE that they had to keep the Fortier facility closed and this was one of the--also one of the reasons, and again this is referenced in Mr. Macdonald's affidavit, the MTBE ban was a significant factor in the decision to finally close the Fortier facility in Louisiana.

So, those are the two investments that Methanex has in the United States. Methanex-US, its sales, distribution, and operating entity, and Methanex-Fortier, and we think the evidence that's in the record, and principally the evidence of
Mr. Macdonald, which again is unchallenged by the United States, conclusively supports the idea that there were valuable assets in the United States that were subject—that were entitled to protection under NAFTA.

Now, Methanex also contends it has suffered significant damages to these investments because of the ban, the California ban on MTBE and methanol. And I mentioned earlier that the shift to ethanol has been recognized by the U.S. Congress as causing substantial damages. The bill that is pending in Congress provides for 2 billion in assistance to MTBE producers, so this was not a shift without significant economic consequences, and some of those consequences were equally felt by Methanex as a methanol producer.

And one of the first, I think some of the most important evidence of causation is what I just went over. The SEC Commission filing, which as the United States points out, is subject to all the rigorous requirements that it be truthful, was
filed with the SEC. It points out the link, the
causal link, between the MTBE ban and the permanent
closure of the Fortier facility in Louisiana, as
does Mr. Macdonald's affidavit. That's evidence of
the damage that was suffered. And that was caused
by the ban itself, directly caused by the ban
itself.

Next, Mr. Macdonald's affidavits show, we
believe conclusively, that the ban severely damaged
Methanex by triggering simultaneous downgrades in
Methanex's debt ratings. Moody's Investor Service,
Fitch, IBCA, and Standard & Poor's all downgraded
Methanex's debt, and the evidence from these rating
agencies themselves clearly demonstrates a direct
link and a damaging one between the MTBE ban and
Methanex's finances, and what I'd like to show the
Tribunal are some of those quotes from some of
those press releases that were issued by these
three debt-rating agencies. The first two come
from Fitch IBCA, quote, In addition, the downgrades
also considered the growing uncertainty in the U.S.
surrounding methyl tertiary butyl ether's (MTBE) use in gasoline, which could potentially decrease MTBE demand over the medium term. Presently, MTBE demand represents about 4.3 million tons for the U.S., including 1.5 million tons for California. Also adding to the already weakened industry fundamentals, in March 1999, the California Governor issued an Executive Order requiring a phaseout of MTBE in California by 2003. So, this is express—an express statement from Fitch's, that the downgrades considered the impact of the MTBE ban. Similarly Standard & Poor's. Methanex is the world's leading producer and marketer of methanol. The downgrade reflects the impact of continued weak industry fundamentals on the company's financial performance. The cyclical decline has been longer and deeper than anticipated, and the prospects for recovery are still uncertain, given expected new capacity and the possible phaseout of methyl tertiary butyl
ether (MTBE) in California and the rest of the U.S.

    Again, this is Standard & Poor's,

referencing the ban in California as one of the
reasons why it downgraded Methanex's debt rating.

    Methanex submits that that is compelling
and conclusive evidence of the damage that methanol
(sic) suffered as a direct result of the MTBE ban
that was put in place in California.

    In addition, the California measures
damaged Methanex by seriously depressing its stock
price in the first three months of 1999. The
evidence in the record from Macdonald's affidavits,
Mr. Macdonald's affidavit shows this, and what I'd
like to show you now is one chart for the period
January 29th to February 9th, 1999. And this was a
period when the market was discounting the effect
of impact of a ban of MTBE on Methanex's share
price, and it dropped 21.3 percent, which is
approximately $180 million Canadian.

    Now, the United States has challenged this
on the grounds that this happened before the ban,
and that's true. It did happen before the ban, but that doesn't mean it didn't happen because of the ban, and the evidence submitted by Mr. Macdonald made that clear, and the evidence we're talking about are reports from equity analysts who followed the market very closely, who followed Methanex very closely as a company, and who made it clear that they were concerned about the possibility of the MTBE ban further damaging, which I think there have already been a couple of references to the already weakened industry fundamentals.

Now, I'd like to go over a couple of those analyst reports if I could. The first one is from Scotia McLloyd, Inc., in Toronto, Canada. It states, In addition to California, New Hampshire, Connecticut, East Texas, and Maine are considering the anti-MTBE bills. California has chosen a threshold level for MTBE content in water of five parts per billion that other states are now considering.

Next is from Goepel McDermid Securities.
Methanex shares continue to be under pressure as a result of MTBE concerns in the U.S. That's March 17th, 1999, a week before the ban was announced. A complete ban would be chaos for the industry and would have a significant negative impact on the economy as MTBE plants are closed. Even so, Methanex is only trading at about 30 percent of replacement cost and 75 percent of book value after plant closures which suggests the MTBE risk is fully factored into its stock price. Therefore, Methanex's share price should be close to the bottom.

So, that recognizes there that the risk posed by the potential California MTBE ban had been factored into Methanex's share price and already caused a depression in that price. It goes on to state, However, if a decision to ban or phase out MTBE is given, it still might temporarily knock the stock down further. And that was correct. That's precisely what happened, except that it wasn't temporary. It
was a permanent downward shift on the stock price. And I think Mr. Macdonald makes that clear in his evidence as well, and that subsequent decline in the 10 days after March knocked another $150 million off the price of Methanex.

Now, finally, the United States makes reference to statements by Methanex's past Chairman, Mr. Pierre Choquette about the present status of Methanex and how the MTBE ban phaseout has not damaged Methanex as much as it was initially it believed that it would. And Mr. Macdonald in his affidavit, again unchallenged, uncross-examined, explains the context of that, and it's really quite simple. Methanex is in a very tight supply situation right now, and in a tight supply situation, obviously the bottom is not going to fall out of the market when there is a significant decrease in demand for methanol. And I think what Mr. Choquette said is that Methanex has been continuing to grow at 2 percent a year, and as Mr. Macdonald made clear, but for the California
ban, it would be growing at 4 percent a year.

So the real impact of the MTBE ban and
phaseout starting in 2003, and continuing to the
end of 2003, was that it ameliorated a price
increase that almost certainly would have occurred,
but for the MTBE ban, the price of methanol now
would be substantially higher, Methanex's revenues
would be substantially higher, and Methanex's
profits would be substantially higher. As I said,
the bottom didn't fall out of the market, but that
doesn't mean that Methanex is not poorer because of
the ban. It would be a much healthier company
financially if the aggregate demand represented by
the California MTBE market were still in place.

PRESIDENT VEEDER: You said, Mr. Choquette
was the past Chairman of Methanex?

MR. DUGAN: Yes, I believe he's stepped
down now and has been replaced by Mr. Bruce Aitken.
I'm being corrected by my colleagues.

He was Chairman and CEO; now he is solely
Chairman.
ARBITRATOR REISMAN: May I ask a question.

You may be getting to this. How do you account for the contribution of the California ban to the declines you're describing and the contributions of the bans in the rest of the United States, some of which are in effect?

MR. DUGAN: Right. To a degree that might be better dealt with when we get to the damages phase, but let me address it here quickly. California, in and of itself, is a very big market. It's one of the biggest markets for methanol in the world because it's such a huge economy. And the market for MTBE and methanol in California is itself a very big market. So, the loss of that market, in and of itself, is very, very significant for a company like Methanex. But more importantly, California has also been viewed as an environmental front runner, in that if California does it, then it's likely that other states will follow California and themselves implement a ban. And to a degree, that has
happened. It's Methanex's position that the bans in places like New York were triggered by California's action.

And, in fact, the review in Europe of MTBE was also triggered by California's ban.

ARBITRATOR REISMAN: So, I'm sorry if I'm anticipating something you plan to deal with at another phase, but--so, all of the declines worldwide are due to California?

MR. DUGAN: Well, yes, we would say when we get to that stage, we will say that it was the California's action--California represents 6 percent of global methanol demand. So, it's a big market, 6 percent in a commodity market is a very significant aggregate factor, but more important to that, to the extent that the California ban triggered similar bans in other states, and it has in a few other states, we intend to show those bans were caused by the California ban, and thus the damage to methanol that's caused by all of the bans put together can be laid at
Next, I'd like to discuss the issues of causation. The United States argues that if Methanex suffered any injury at all, which it denies, those injuries were not proximately caused by California's NAFTA breaches, and therefore, Methanex's claim must fail.

First, to the extent that the Tribunal continues to require that Methanex show that California intended to harm foreign methanol producers, that's a wrong, that's intentional, and I think it's fairly well recognized that such wrongs do not require proximate cause.

Second, we believe that the U.S. has misstated the applicable legal standard in NAFTA itself. It's misinterpreted the clear language of NAFTA.

And third, even if proximate cause is the applicable legal standard, and this is the most important point, Methanex still quite clearly meets it. We think that the evidence in the record,
especially the unchallenged evidence from Mr. Macdonald, shows a direct causal link between the MTBE ban and the damages that were suffered by Methanex.

Now, as to the first point, I will simply quote from one of the cases that the U.S. itself relies upon, the Dix case. This is with respect to an intentional wrong, quote, Governments, like individuals, are responsible only for the proximate and natural consequences of their acts. International as well as municipal law denies compensation for remote consequences in the absence of deliberate intention to injure, end quote.

So, to the extent that the Methanex must show intentional harm, by definition, I think, it need not show proximate cause.

Secondly, and we went over this, I think, in considerable detail at the jurisdictional hearing, the text of NAFTA, Methanex submits, does not require proximate cause, and the starting point for this is the text of 1116 itself. It states
that a claim by an investor that deals with the
claim--the title is A Claim by an Investor of a
Party On Its Own Behalf. And one of the
requirements is in the last phrase of Article 1116
that the investor has incurred loss or damage by
reason of, or arising out of, that breach.

Now, the United States has taken the
position that that word or, "or arising out of," is
not a disjunctive statement, but a conjunctive
statement, that it really means "and."

As we pointed out at the last hearing, at
the jurisdictional hearing, we went through one of
the United States's briefs, and we noted every time
that it used the word "or" and every time that it
used the word "or," it used it in the disjunctive
sense and not the conjunctive sense. And we think
that that piece of evidence still stands. "Or" is
normally interpreted in the disjunctive, not in the
conjunctive, and by using the word "or" here, the
drafters of NAFTA intended two separate standards,
two separate causation standards. The first
causation standard was for damage by reason of, which is the shorthand for proximate cause. But the second standard was for damage arising out of that breach. And in our prior submissions we detailed all the cases, the municipal law cases particularly in the United States and Canada in which the phrase "arising out of," "damage arising out of," has been interpreted to create a more liberal causation standard, to allow for the recovery of damages that are caused less directly than damages caused proximately. And we think that municipal law is quite clear on that point. And we further think that the way NAFTA is phrased, it recognizes two separate standards, and if the Tribunal is to give meaning to all the words in the treaty, it has to recognize Methanex's position these two separate standards. But the third point that I want to make which I think is really the most important point, is that whatever the standard is, whether it's proximate cause or whether it's some lesser
standard, Methanex has quite clearly satisfied it, and the evidence in the record establishes that, we believe, without any doubt.

Going back to the contract with Valero, in the contract itself, it said that if the MTBE ban goes in place, Valero had the right to stop buying methanol. What clear example of proximate cause could anyone want? The ban caused a customer of Methanex to stop buying methanol. That is as emphatic a statement of proximate cause as I can think of. And Methanex submits that it's the loss of its entire market in California, all the sales that it used to make to integrated oil companies for the production of reformulating gasoline. All those sales have now disappeared, and they've disappeared because the State of California has put in place the MTBE and methanol bans, and those bans directly caused the loss of those sales.

Similarly, we take the position that the MTBE ban was a significant factor in the permanent closure of the Fortier facility, and that it
proximately caused the permanent closure of the Fortier facility.

And finally, we think the evidence with respect to the downgrades in Methanex's debt rating and the severe depression in Methanex's share price in the first half of 1999 are, by the evidence of the analysts that Mr. Macdonald put in through his witness statement, that those create a direct, causal, proximate link between the MTBE ban and the drop in the credit rating and the drop in the share price.

All of those points of evidence together, Methanex believes, overwhelmingly show that it suffered damages that were proximately caused by California's MTBE ban.

Now, I think one of the key things about proximate cause--and this is important for the Tribunal to focus on and for other reasons as well, especially with respect to the intent test--is the question of foreseeability. Was the damage that was caused to Methanex foreseeable and was it so
foreseeable that it cannot be fairly characterized as remote? And Methanex believes that's completely the case. And it cites to two pieces of evidence that established that. Again, we think, beyond doubt.

Now, the first is the United States Environmental Protection Agency argument—argument is the wrong word. Their statement, their conclusion in 1993 that if there were a partial shift to ethanol, that that partial shift would have as one of its primary impacts damage to foreign methanol producers. It's worthwhile looking at the actual statement itself.

This is Tab 76, 22 JS Tab 28.

As I said, the United States, the EPA was proposing to create a 30 percent ethanol renewable set aside for ethanol in the oxygenate market. And as part of its obligations in proposing that rule, it had to analyze the economic consequences of that action. And this is what it concluded:

"The primary impacts of this proposal
include crude oil savings, the added cost of
producing and using the renewable oxygenate, the
reductions in revenues to the U.S. Highway Trust
Fund and the impacts on the various oxygenate and
fuel industries affected."

If you go to the document itself, it goes
through all of these various primary impacts, and
it gets to the last one.

(Reading) Finally--and again, this is the
primary impact as described by the United States
EPA itself--Finally, there could be economic
impacts on a number of industries and economic
sectors due to this program. The revenues and net
incomes of both corn farmers and ethanol producers
should rise significantly, as they surely have for
ADM, due to higher corn and ethanol demand and
prices, respectively. Expenditures for government
farm price supports could decrease. Revenues and
net incomes of domestic methanol producers and
overseas producers of both methanol and MTBE would
likely decrease due to de reduced demand in prices.
Oil refiners could experience transitional costs due to an additional requirement and would likely face higher oxygenate costs. So, on the basis of that, Methanex argues that it is simply impossible for the United States to contend that the damage that the shift to ethanol in California inflicted on Methanex was not foreseeable. It was not only foreseeable, it was foreseen by the United States EPA itself. And we further submit that--we further argue that this statement by the United States EPA, in precisely analogous circumstances, should be treated as a conclusive admission. There is no doubt whatsoever that the damage to Methanex was foreseeable.

Now, the second piece of evidence that shows that the damage was foreseeable is the statement by Senator John Burton to representatives of the MTBE and methanol industries in January of 1999, before the ban was actually implemented. There are affidavits from both Mr. Wright--or two
affidavits from Mr. Wright describing this meeting, and there have been documents, contemporaneous documents submitted as part of Mr. Macdonald's affidavit which also document this meeting.

And this was a meeting between the lobbyist, the California lobbyist for MTBE and methanol, and California officials. And here is the statement from one of the documents that we have included. Quote, We held about 20 meetings with legislators and Ned Griffith this week. There were a few meetings in which we received some encouraging words. However, for the most part, the members told us they believe a phaseout is inevitable. Susan McCabe scheduled a meeting with Senate President Pro Tem John Burton which we attended along with Rick Lehman and Barry Brokaw. Burton was perhaps the most candid legislator to date, suggesting in only two words that a phaseout is inevitable. He also suggested that OFA, AMI—and that stands for Oxygenated Fuels Association, which is the methanol and MTBE trade
association, and AMI stands for American Methanol Institute--that those two trade organizations should focus on the terms of the phaseout.

Now, in Methanex's mind, and some of the other affidavits go into more detail about what was said, but they make it clear that Senator Burton knew two things, that a ban was coming, and he knew also that the ban would severely damage Methanex, and he said--and this is in other evidence that has been presented by Mr. Wright, that Methanex--anyone who wants to make money on the ban should sell Methanex's stock short. So he was aware of the fact that methanol industry supporters were in the room because of the AMI connection, the American Methanol Institute connection. He was aware of the fact that Methanex was one of the players in the methanol industry, and he was aware of the fact that Methanex was going to be severely damaged by the ban when it was implemented. And we believe that all of those inferences can and should be drawn from the evidence before the Tribunal.
Now, that means that Senator Burton also foresaw the certainty that Methanex was going to be severely damaged by the California ban, so we have two pieces of evidence, two compelling pieces of evidence to show that what happened to Methanex to show that the damage that it suffered was both foreseeable and foreseen.

ARBITRATOR REISMAN: Just to make sure I understand your reference to the fragment from Senator Burton, I don't understand this as saying anything about damage, only that a phaseout is inevitable.

MR. DUGAN: Well, what he said was you're blanked, to use the barnyard--

ARBITRATOR REISMAN: What you put here in red is--simply says that a phaseout is inevitable.

MR. DUGAN: Agreed, and that says that a phaseout is inevitable. What it says there suggesting in only two words that a phaseout is inevitable, but what he said, the phrase that he used, which I won't use here, suggested more than a
phaseout is inevitable. It suggested also that Methanex was going to be put in a bad way because of it. And there are others. This is just one piece of evidence that reflects this statement. There is other evidence in the record to that effect, and we think that the connotations of using this phrase, this barnyard phrase, quite clearly indicate damage as well as inevitability.

ARBITRATOR REISMAN: I understand your argument, but it doesn't seem particularly clear to me. The barnyard phrase could simply the phaseout is inevitable. If the lobbyists for Methanex were saying we don't want a phaseout, isn't the conclusion the plausible interpretation here very simply saying the phaseout is inevitable?

MR. DUGAN: I guess that is a possible permissible inference from that.

ARBITRATOR REISMAN: I just read that because of the highlighted section that you put.

MR. DUGAN: I agree, you could infer that from the language. We infer, again, the idea that
not just that you're going to lose, but that you're going to be damaged as well.

And in addition, the statement by Senator Burton that anyone who wants to profit this from this themselves should sell Methanex's stock short by--clearly recognizes that Methanex is going to be damaged by that, and that its stock price is going to drop. So, even if this weren't sufficient, the statement that the recommendation that people sell Methanex short, I think, is an irrefutable statement of the foreseeability of the foreseen damage to Methanex because of the ban.

PRESIDENT VEEDER: I think I misunderstood your point. I thought your point was really not so much on the barnyard part of the phrase, which could cover all sorts of possibilities, but it's the use of your word "your," Methanex, MTBE phaseout which recognized, I think, according to your argument and your written submissions by Senator Burton as being damaging not simply to an MTBE producer, but to Methanex?
MR. DUGAN: Precisely, to Methanex in particular, and it's reinforced by the fact that he used the word, he named the company as a company whose stock's to be sold short, and all of those prove that Senator Burton at least was fully cognizant of the fact that Methanex, as a company, was going to be damaged by the ban.

ARBITRATOR REISMAN: Let me make sure the two pieces of evidence that establishes this issue, I want to make sure I understand it. The reference here in the document is "we." Who is the "we" here? "We held about 20 meetings." Who are the "we"?

MR. DUGAN: The "we" there is Rosen Kendall are the lobbyists for the MTBE interests and the methanol interests. They're the lobbyists--

ARBITRATOR REISMAN: Were they the lobbyists for Methanex?

MR. DUGAN: I don't know the answer to that question. They were certainly the lobbyists
for the AMI, which is the American Methanol
Institute, of which Methanex is the largest member.
Whether they were actually the lobbyists for
Methanex, I will have to go back to the record and
check and see. I don't know the answer to that.
But the "we" there, I think, refers to
Rosen Kendall and the lobbying firm that had been
hired by MTBE and methanol producers in order to
present their side of the story to the California
Legislature.

ARBITRATOR ROWLEY: Mr. Dugan, could I ask
you to turn to Tab 60, please, of your time line.

MR. DUGAN: Certainly.

ARBITRATOR ROWLEY: And putting the Burton
date in that, we see it's shortly
after Davis is sworn in as Governor. And a month
or two before Davis issues the Executive Order, and
it's permissible, I presume, to read into this that
legislators, including Burton, at that time
considered a ban to be inevitable, but that would
be regardless of whether there had been
contributions to Davis because those contributions, I take it, were not known at that time. The secret meeting was not known at that time. Would I be right in that?

MR. DUGAN: I think you may be conflating two issues. The way I would phrase it is this, is that I think you're right to infer that as of the date of this meeting, which was the last week of January 1999, a decision had already been made to ban MTBE. As we know, the only person who had the power to make that decision was Governor Davis. Senate Bill 521 empowered him, if he found that there was a risk to the environment to take whatever action he deemed appropriate. It didn't mandate a ban, but it deemed that he could take the action that was appropriate. But it empowered him and only him to make that decision. The Legislature had no role in it.

Nonetheless, I think that what can be inferred from that piece of evidence is that Governor Davis had made the decision to ban MTBE,
and he had communicated that decision to Senator Burton. And that word of the impending ban was spreading in the legislature in California, and Burton who was, after all, the Senate--the President pro tem of the Senate, was a very powerful legislator. He would be in a position to know precisely what had happened.

Now, the fact that Davis's decision flowed, in our view, from the contributions and the secret meeting wouldn't in any way impact the knowledge that these legislators would have that the ban was coming.

All they knew is that the ban was on the way, and apparently it had been decided as of the last week in January. The fact that they didn't know what had caused the ban, I don't think in any way undercuts the fact that the ban had been decided by then and was well-known in the Legislature in California.

Now, also bear in mind Burton was himself a recipient of ADM's contributions. He is someone
who would have an interest in knowing what the
Governor was going to do about the ban. He is
someone who would be in a position, and again this
is an inference, to find out from the Governor's
Office what was going to happen with the ban. He
had flown to Decatur. He had himself received
contributions from ADM and Vind, and he had a dog
in that fight. He wasn't immune from it.

In fact, many of the players here had dogs
in that fight, to use the vernacular. Senator
Mountjoy, the Senator who introduced the
legislation to start with, was a member of
Oxybusters. If you recall the newspaper article
that I read that identified Oxybusters as one of
the groups that was lobbying for the replacement of
MTBE with ethanol, Governor Mountjoy had ties to
Oxy Busters as well. He had ties to the ethanol
industry as well. The reference for that is 12 JS
Tab A, which we've submitted in the record already.
And so I think it's important to note that a lot of
the lead players in this drama had benefitted from
ADM. Senator Mountjoy had, the Senator who introduced the legislation had benefited from Oxy Busters and was tied to Oxy Busters. Senator Burton, who announced the ban to the methanol supporters, methanol lobbyists and the Methanex lobbyists, had received money from ADM, and Governor Davis, of course, was the principal beneficiary of the largess from ADM.

So, if we look at the record, ADM is all over this, and has made contributions and supported all the key players, and it's important to recognize that because ADM is an expert at how this game is played.

So, in terms of foreseeability, which is the last factor with respect to causation that I wanted to focus on, Methanex submits that between the EPA statement in 1993, and the discussions with Senator Burton in 1999, it's indisputable that it was foreseeable and, indeed, foreseen that the MTBE ban would damage Methanex and damage it severely. And because it was foreseeable, there's no question
that the damage was proximately caused by the ban.

Now, that concludes Methanex's oral presentation of its case-in-chief.

Before I get started on just a very short summing up, the regulation that we cited today that names methanol we had, which was Exhibit 41 in your book, was apparently a proposed regulation that incorporated the language that's in final order but is in not the actual final regulation itself. I have copies of the final regulation that I would like to hand up to the Tribunal.

Now, this proposed regulation was cited in the Second Amended Claim at Volume 1, Tab 30. It's actually at Volume 1, Tab 30, and it was cited in the Second Amended Claim, the legal authorities to the Second Amended Claim. The proposed order was cited because it was at that point in the process only a proposed order. It wasn't a final order.

PRESIDENT VEEDER: Is the reference for the document you have just given us in the bundles?

MR. DUGAN: No, this is the final version
of the--what's included in Exhibit 41, and it
contains the same language, the same operative
language as is in what is in Exhibit 41. It's just
that this is the final version that doesn't have
the material that was red lined out in that
proposed order.

ARBITRATOR REISMAN: Mr. Dugan, I wonder
if you could help me, make sure that I understand
the inferential--the inferences that you're
drawing, and obviously we are involved in trying to
reconstruct the situation that existed at a prior
time and to try to identify the key factors.

At the time that Senator Burton--that the
lobbyists from the MTBE lobby--

MR. DUGAN: And the methanol lobby.

ARBITRATOR REISMAN: And the methanol
lobby, or whoever, you weren't exactly sure whether
Methanex was involved.

MR. DUGAN: Correct, but I think from
the--from that letter it referenced AMI, which is
the American Methanol Institute.
ARBITRATOR REISMAN: At that time, you already had SB521. The UC report had already been published. The public hearings of the UC report that involved many of the legislators had already taken place.

MR. DUGAN: I think they were in the process of taking place at the end of January.

ARBITRATOR REISMAN: Perhaps, I'm sorry. Would it have been difficult for anyone who was following this to have concluded that in light of SB521 and the options clearly spelled out there, in the light of the conclusions of the UC report, defective or not, as you say, that one would conclude that the days of MTBE were numbered and that a ban was going to go into place? Isn't it quite possible to infer from all of these public records, quite innocent public records, that it was common knowledge, so Senator Burton or anyone else who was consulted would say, we're sorry, we understand people from the methanol and MTBE lobbied your interests, but the matter has already
been decided or it's virtually decided?
MR. DUGAN: Well, I don't think that is the permissible inference because I think what was going on was, and--

ARBITRATOR REISMAN: Why not?
MR. DUGAN: --the record reflects this is that after the UC-Davis report came out, the MTBE lobby and the methanol lobby and some of the oil refiners themselves launched a vigorous lobbying campaign to try to convince Governor Davis that the report was wrong and that the ban on MTBE was the wrong solution; that a better solution would be to deal with the leaking gasoline tanks. So, I don't think it was a foregone conclusion after the publication of the report.

ARBITRATOR REISMAN: But SB521 didn't give the Governor discretion to do something like that, did it?
MR. DUGAN: Yes, it did. Expressly it did, and in fact, that's what it was focusing on because that's very important. If we can--I don't
I know if we could readily go to SB521.

ARBITRATOR REISMAN: Let me draw your attention to what I was referring to—and I may be incorrect on this—it is page three of Chapter 816. It's subsection 11(d)(e). It says, "Within 10 days from the date of completion of the public hearings, et cetera, the Governor shall issue a written certification as to human health and environmental risks using MTBE in gasoline in the state. The certification shall be based solely upon the assessment and report submitted pursuant to this section."

So, defective or not, didn't that report essentially constrain the decision and that anyone would have known about that?

MR. DUGAN: What was the decision? If you go down to subdivision F, it says, "If the government makes the—if the Governor makes the certification described under paragraph two of the subdivision E, then notwithstanding any other provision of law, the Governor shall take
appropriate action to protect public health and the
environment." And in our view, he was empowered by
that statement to take any action that he deemed
appropriate, and he could, for example, have issued
an immediate ban on two-stroke engines and required
that all California tanks that had missed the 1998
deadline meet it by the end of 1999, that that
would have been an appropriate reaction to protect
the environment.

So, in Methanex's view, he did have very
considerable discretion to tailor the action that
he was going to take to what he believed was the
risk and what he believed was the most appropriate
decision. There is certainly nothing in there that
required a ban of MTBE.

ARBITRATOR REISMAN: Thank you for that
clarification.

MR. DUGAN: Now, what we've tried to show
in our presentation of our case-in-chief, despite
the publicity that this case has garnered, there is
really nothing new in this case from a legal
perspective, at least. At the heart of this case is an industry, the U.S. ethanol industry, that exists solely because of politics and protectionism. Again, to use Senator McCain's words, ADM trades its political contributions for the tax subsidies and the other protections that allow its ethanol industry to exist.

It's undisputed here that without this massive scheme of subsidies and import duties, the industry wouldn't exist at all. And Methanex asserts that what happened in California was just an extension of that entrenched protectionism that the ethanol industry has created for itself to protect itself.

Equally, the methodology that it used in California, using a purported environmental regulation to disguise a form of protection for it, is not a new legal situation. We tried to take the Tribunal through the commentators who have recognized the prevalence of this. Certainly, NAFTA cases have recognized the prevalence of this
type of sham environmental protection in order to
cater to local political interests or in order to
protect a domestic industry.

So, that aspect of our case again, we
believe, is well within the mainstream of
international jurisprudence, with trade law
jurisprudence and investment law jurisprudence.

Now, what's new here for an international
tribunal in particular are the factual allegations
concerning the political corruption that we believe
was at the heart of this case. That allegation of
political corruption, I don't believe, has ever
been presented to an international tribunal for
adjudication. But the allegations that we are
making, which we also tried to show as clearly as
we could, are not new. The recognition that this
type of--that the use of this type of massive
political contributions to obtain preferred policy
outcomes is not something that Methanex has made
up. It's been accepted, acknowledged by the United
States Department of Justice. It's been accepted
and acknowledged by the United States Supreme Court. And using again the words of Senator McCain and Senator Rudman, they have frankly admitted that this is, unfortunately, how business is done in the United States from time to time—not always, but from time to time.

We have also tried to show that ADM and the ethanol industry are paradigms of this way of doing business. This is how they do business. This is why the ethanol industry exists.

Now, it's not a pretty picture, but we believe it is reality in the United States, and we submit that anyone who denies that it is reality in the United States is--has a blinkered view of reality. It's simply--it's true, like it or not.

We acknowledge that asking an international tribunal to pass judgment on the internal political processes of a country is a very difficult task. This is only a quasi-judicial body--it is not a judicial body like the Supreme Court--and it places the Tribunal in perhaps an
unprecedented position, and asks it to undertake a
very difficult task. Nonetheless, Methanex firmly
believes that that is the Tribunal's duty here,
that this is a Tribunal constituted in accordance
with an international treaty and in accordance with
the implementing legislation of each of the
countries, including the United States. The NAFTA
powers agreed to a treaty that empowers a tribunal
like this to judge the actions of both the
constituent states of the United States and the
Federal Government itself. Whether or not this
precise type of proceeding with respect to the
political corruption was envisioned by the
signatories on this type of case of a Tribunal
sitting in judgment of the official acts of a
government quite clearly was envisioned; that's the
whole purpose of these tribunals.

And there is nothing about this case, the
purported environmental justification, in
particular that is outside the scope of what
traditional tribunals have done. This Tribunal has
the duty to determine whether that purported environmental justification was a pretense or whether it was valid, and it has the duty to determine whether or not what happened in California and its impact on Methanex was fair and equitable, pursuant to the terms of the 1105.

And Methanex asks simply and respectfully that the Tribunal take on the duty that we think the Treaty imposes upon it, and adjudicate the difficult facts of this case fairly and in accordance with law. That's all Methanex is entitled to expect, and that's what it expects.

Thank you very much.

PRESIDENT VEEDER: Thank you very much, Mr. Dugan. That concludes your oral submissions in opening.

MR. DUGAN: That does conclude our oral submissions, yes.

PRESIDENT VEEDER: And I think, subject to one matter we would like to raise you with at this stage, we shall break, and then we will resume.
under our schedule with the United States tomorrow morning at 9:30 for the oral submissions.

The one thing we would like to raise is to come back to the Regent International documentation, and what we would like to have, if it's possible from you before we start tomorrow morning, are the originals of the disputed documents as set out in paragraph 12 of Mr. Vind's witness statement. I will read them out for the record, but they're in the new Volume 6, and the Tab Numbers 52 to 61, 64 and 66; the new Volume 7, 151 to 153, 155 to 156, 159 and 160, 162 and 165; and in Volume 11, Tab Numbers 202, 216, 219, 222, and 223, 226, 258, and 259. You will find that, as I said, in paragraph 12 of Mr. Vind's witness statement.

MR. DUGAN: Okay. I know we have already contacted Mr. Puglisi and asked for copies of the originals. I don't know where we stand on that, but we are trying as we speak. We have been trying all day to get the originals, not copies of the
originals, but originals. When I say "originals," what he obtained initially which in some cases may be copies, but we will go through that tomorrow.

PRESIDENT VEEDER: We know exactly what you mean. That's what we are after. Thank you very much.

Unless there is something else that somebody else wants to raise from the disputing parties, we shall break now until 9:30 tomorrow morning. Anything from the USA?

MR. LEGUM: No, Mr. President.

MR. DUGAN: Nothing from Methanex.

PRESIDENT VEEDER: Thank you very much, indeed.

(Whereupon, at 4:47 p.m., the hearing was adjourned until 9:30 a.m. the following day.)
CERTIFICATE OF REPORTER

I, David A. Kasdan, RDR-CRR, Court Reporter, do hereby testify that the foregoing proceedings were stenographically recorded by me and thereafter reduced to typewritten form by computer-assisted transcription under my direction and supervision; and that the foregoing transcript is a true record and accurate record of the proceedings.

I further certify that I am neither counsel for, related to, nor employed by any of the parties to this action in this proceeding, nor financially or otherwise interested in the outcome of this litigation.

DAVID A. KASDAN, RDR-CRR