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

METHANEX CORPORATION, Claimant/Investor, and

UNITED STATES OF AMERICA, Respondent/Party.

SECOND FINAL AMENDED TRANSCRIPT

Wednesday, June 16, 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 1:35 p.m. before:

V. V. VEEDER, Q. C., President
PROF. W. MICHAEL REISMAN, Arbitrator
J. WILLIAM ROWLEY, Q. C., Arbitrator

Also Present:

SAMUEL WORDSWORTH,
Tribunal Legal Secretary

MARGRETE STEVENS,
Senior ICSID Counsel
Tribunal Administrative Secretary

Court Reporter:  

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APPEARANCES: (Continued)

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CLOSING ARGUMENT

For Methanex Corporation: Mr. Dugan 1777
PROCEEDINGS

PRESIDENT VEEDER: Good afternoon, ladies and gentlemen. We start day eight of this hearing. And we now hear Methanex's closing oral submissions.

Mr. Dugan, the floor is yours.

CLOSING ARGUMENT BY COUNSEL FOR CLAIMANT/INVESTOR

MR. DUGAN: Thank you very much.

Members of the Tribunal, I'd like to start off with the question of what is the appropriate test here, and that will include the motion to reconsider, and the first issue I'd like to draw the Tribunal's attention to is the letter that we sent to the Tribunal on June 13th, in which we pointed out that the California regulation that we have been--that we have identified as one of the measures in this case does, in fact, ban methanol by name.

Now, I think you all have seen the letter, and it says that covered ox--I will wait for the Tribunal.

(Pause.)

MR. DUGAN: Now, if I could direct your attention to the second to the last page of the
letter, that includes the operative language of the regulation as it exists today, and on the--I'm sorry, of the exhibits to the letter. Yes, that's it.

And if you look at the left-hand column, number four, it says, covered oxygenates. Oxygen from the following oxygenates is covered by the prohibitions in Section 2262(6)(C)(1), (2), and (3), and then, of course, it lists methanol as the first one, along with some of the other familiar oxygenates that we have seen in the list from the EPA and from Mr. Caldwell. At the very end is TAME, there's also DIME, ET, BE. So, it quite specifically bans methanol in its use as an oxygenate.

And one other point to make: It specifically identifies methanol as an oxygenate.

PRESIDENT VEEDER: Mr. Dugan, just as a matter of paperwork, to what extent does this enclosure differ from the actual regulations you handed out last Monday in your opening oral submissions when you added a document to Tab 41?

MR. DUGAN: It should be identical. It should be identical. It's just a different format. This one was printed out on the computer. I think the other one was copied, actually, from the book of California regulations. But I don't have--I may be wrong, but I have no reason to believe that they are different.
Now, the issue of whether or not the California regulations banned all oxygenates other than ethanol, Methanex raised over two years ago. In its First Amended Claim on February 12th, 2002, it expressly said that one of the measures that it was complaining of at that time, before the amendment was formally granted, was that --I'm referring now to page eight, paragraph 22 of the Draft Amended Claim of February 12, 2001. The second measure that Methanex challenges is the set of California or CaRFG3 regulation adopted by CaFRB on September 2nd, 2000 which implemented Executive Order D 599. In implementing Governor Davis's Executive Order, the CaRFG3 regulations prohibited the use of MTBE as of December 31st, 2002, and facilitated its accelerated removal from all California gasoline prior to that date. The regulations, and I'm skipping the word CaRFG3 because it doesn't lend itself to an easy acronym, went beyond merely banning MTBE, however. They also provided that only methanol, which is almost entirely a domestic product, could be used as an oxygenate in California gasoline. Consequently, the regulations ban not only MTBE, but methanol as well, from competing with methanol in the California oxygenate market. Now, the difference between the regulations as they existed in proposed form in
February of 2002, and the regulations as they exist now, is that now California has specifically named methanol as one of the banned substances.

PRESIDENT VEEDER: Mr. Dugan, would it be helpful if we just came to the point that concerns the Tribunal, and it's really a clarification of your case. Are you relying upon either the proposed regulations, which you exhibited to the legal authorities to your Amended Statement of Claim or the actual regulations which came into effect in May of 2003, which you gave to us on day one of this hearing, as separate measures which you attack, or do you rely upon these documents as evidence in your attack on the two measures which you originally pleaded in the Amended Statement of Claim namely, the Executive Order and the California regulations before they expressly mentioned methanol?

MR. DUGAN: Well, the California regulations that we included with the Second Amended Claim actually include this very language.

PRESIDENT VEEDER: Well, they weren't regulations. They were proposed regulations.

MR. DUGAN: Correct. They were proposed regulations that were adopted I think two months
after we filed the claim

So, I mean, if the--we certainly are
relying on the regulations as they exist now in
banning methanol.

PRESIDENT VEEDE: But what form? Is it
evidence of your existing case or development of
your case?

MR. DUGAN: No, no. It's a development of
the case. This is obviously an amendment by
California that took place after we filed our
Second Amended Claim and we assert that it's
relevant for the obvious purpose. We go back to
what the Tribunal was concerned about two years
ago, and that was the fact that the ban did not
identify methanol, and because it did not expressly
name methanol as one of the banned substances, the
Tribunal set up this test in order to determine
whether it was a legally significant relationship
that would meet the requirements of relating to.

Well now, the measure, the very measure

that we complain of, as amended, bans methanol, and
so, yes, we rely on the measure as amended after we
filed our Second Amended Complaint.

Now, if it's necessary for us to amend our
complaint yet again to rely upon the language that
we included in the Second Amended Complaint that
was subsequently adopted by California in, I
believe, May of 2003, eight or nine months after we
put it in, and which goes into effect I think in
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January of this year, then we move to amend the complaint because of a subsequent amendment of the regulations after our Second Amended Claim was put in.

Now, I'm not sure that's necessarily--that's actually necessary because it's the same measure that we are complaining of, and it's the same legal effect that we are complaining of; namely, the banning of everything except ethanol.

The only difference is that now the express itemization of methanol has, in fact, become a regulation.

Now, if an amendment is necessary, I don't think--there is no reason in Methanex's mind why it should be denied. There's certainly been no prejudice to the United States. They briefed every single argument.

PRESIDENT VEEDER: Just take it very slowly in stages because we are trying to see whether it goes to evidence, where obviously there is an argument for a ruling evidential case, or whether it's an additional measure or an addition to an existing measure which is subject to criticism.

And if you have referred to paragraph 22, if you could turn to that, it's page eight of your Amended Statement of Claim if you can just go...
through the language of that to see to what extent
the May 2003 regulations fit into that language.

It's paragraph 22, page eight, of Methanex's
Amended Statement of Claim

You see you there identify the second

measure that Methanex challenges is the set of Cal
Reg 3 regulations adopted by CAFRB on September the

Now, if you at this date, namely the 5th
of November, 2002, identify what those regulations
were, they will be the regulations which did not
expressly mention methanol; would that be right?

MR. DUGAN: That would be right because at
that time, obviously, we didn't have any
 regulations that expressly banned methanol. They
weren't--

PRESIDENT VEEDER: But what you say is
that those regulations implicitly banned methanol
because they provided that only ethanol could be
used as an oxygenate in California gasoline.

MR. DUGAN: Right. I don't think they
implicitly. I think--they certainly didn't
expressly methanol qua methanol, but I think they
expressly banned all alcohols other than ethanol.

PRESIDENT VEEDER: Well, I'm looking at
the last sentence.
MR. DUGAN: Correct, consequently the regulations ban not only MTBE, but methanol as well from competing with ethanol in the California oxygenate market.

I think the regulations had the same legal effect as far as the ban on methanol at that time. Methanol was not allowed to compete with ethanol at that time. So, the legal effect of the regulations was the same. The difference now is that the regulation, as amended, in more detail expresses exactly what the effect of the ban is, which is to ban methanol.

Now, we've always complained of a California measure that bans methanol, not just MTBE, but bans methanol as a competitor to ethanol. And we have consistently done that since we first put in our amended claim in February of 2002. The change here is that California has amended its regulations subsequent to our last amended claim of October 2002 to expressly name methanol.

PRESIDENT VEEDER: Mr. Dugan, if I can...
8 I think you've got to help us on jurisdiction, power, and discretion to allow that amendment, as we understand it because that is and will still be opposed by the United States.

9 MR. DUGAN: I understand that, and obviously I think, then, you know, perhaps we are relying on it for two purposes, if I could state for the record. For the second, we are clearly relying upon it as evidence of—and we would say conclusive evidence—of California's intent to harm methanol producers and to ban methanol and harm all methanol producers, including foreign medical producers.

10 Secondly, in terms of whether an amendment

11 should be allowed to put this specific measure in, we think quite clearly it should. Number one, the UNCITRAL regulations create, I believe, a presumption that amendment can be made, so long as there is no undue prejudice. We think we fit squarely within that presumption.

12 The amendment, the regulation amendment that we are pointing to, was adopted by California well after we put in our amended claim. We noted in the amended claim that we included the proposed regulations that were actually going to be adopted naming methanol. So, as of October 2002, we had done everything that we could.

13 Now, the regulations were subsequently
adopted. They did, in fact, name methanol, so it was an amended regulation.

Remember, the regulations are what we've always posited as the measure that we are complaining of, the CaFRB regulations, and this is just the latest iteration of the CaFRB regulations.

But, if an amendment is required, again, I think the presumption is we are entitled to amend unless there is a showing of prejudice, and I can't see what showing prejudice there is for the United States, since they briefed and argued at length, as the Tribunal knows well, every single argument in this case.

And it obviously prejudices them in the sense that I think it takes away any possible case for arguing that the specific intent to harm test should be applied, but that's obviously a substantive consequence that's not within the scope of a reason why an amendment should not be allowed. So, if an amendment is necessary, and I don't think it is, but if an amendment is necessary, then, yes, we formally move to amend it, and we ask the Tribunal to consider what prejudice there is to the United States, especially given the fact that this amended regulation was amended after we filed our last amended complaint.

PRESIDENT VEEDE: Another possible complication is not Article XX alone, but also the
scope of the dispositive in our Partial Award. Would you like to address us on that.

MR. DUGAN: I'm not quite sure what you're referring to.

PRESIDENT VEEDER: If you refer to--if you can refer to the Partial Award, and if we can start with the dispositive at the very end, it's page 74, paragraphs four and five.

MR. DUGAN: I'm sorry, I must have a differently paginated version.

PRESIDENT VEEDER: It's Chapter M, 102. If you go to paragraph 172, if you start with subparagraph three, and then turn to four.

MR. DUGAN: Yes, I see that. I guess our response would be that this is overtaken by subsequent facts.

PRESIDENT VEEDER: Just to complete the reference, turn back to 162, which is page 68 of our pagination.

MR. DUGAN: Paragraph 162?

PRESIDENT VEEDER: Paragraph 162, which is page 68. And if you turn to line six, The fresh pleading must not exceed the limits of Methanex's existing case, pleaded and unpleaded. That's reference to the oral argument that you advanced on jurisdictional hearing.
MR. DUGAN: Correct. Um-hmm

PRESIDENT VEEDER: We do not intend

Methanex to make any new claim in its fresh

pleading and so on.

MR. DUGAN: And I don't think we did. Remember, that's why I pointed back to what we

filed in February of 2001, before this came out. We argued in 2001 in our First Amended Claim that

what California had done was to ban all competing

alcohols, including methanol from competing with

ethanol.

So, we made the same claim in the February

2001 First Amended Claim as we made in the Second

Amended Claim

So, I don't think the Second Amended Claim

went beyond what was in the First Amended Claim

any way.

And I think--the reason why I don't think

an amendment is necessary is I think the operative

legal effect of these various measures has been the

same in their various amended forms. And their

operative legal effect is to ban all competitors to

ethanol. That's what we alleged in February of

2001, and that's what we allege now. The
difference, of course, is that there has been a

specific amendment to this expressly name methanol,

and that's been adopted and come into force.

ARBITRATOR REISMAN: Mr. Dugan, perhaps
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you could help me, since I was not part of the
Tribunal for the rendering of the Partial Award.

Didn't the RFG2 say that other oxygenates
could not be used until a multimedia study was
conducted and RFG3 simply indicates which other
oxygenates have not yet been the subject of the
multimedia study.

MR. DUGAN: No, I would agree that is
correct. And it's what the--

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ARBITRATOR REISMAN: My next question then
goes to the substantive implication, if in the
Partial Award the Tribunal was unable to get over
1101 on the basis of something that was implicit,
why would it get over Article 1101 now when
subsection four simply makes explicit what was
already available to the Tribunal at the time of
the Partial Award?

MR. DUGAN: Because the way I read the
Partial Award, the Partial Award couldn't get over
1101 because methanol was not expressly named. And
I think that's referred to a number of times in the
Award as one of the principal bases, principal
bases why the measure did not, on its face, meet
the relating-to requirement because it didn't name
methanol.

Now, obviously that has now changed, and I
don't think it was a question of whether it was--in
fact, I would go so far as to say that the Tribunal
implicitly rejected our argument that the
California regs implicitly banned methanol and required an express naming in order to meet the relating-to test on a per se basis. And now we have that.

ARBITRATOR ROWLEY: Mr. Dugan, if you could turn with me to paragraph 33 of the Partial Award, if you have it handy, and if not, I will read it to you.

MR. DUGAN: Paragraph 33?

ARBITRATOR ROWLEY: Yes, paragraph 33.

MR. DUGAN: Yes, I have it.

ARBITRATOR ROWLEY: And you will see there is a bolded subtitle of the California regulations, and if you drop down to the fourth, last line in the middle, and there is a reference to several of the earlier California reformulated gasoline regulations, but in the fourth line it says, in particular, subsection 2262.6 provided at Subsection A 1 that starting in December 31, 2002, and it reads on.

Now, as I understand it, that regulation was referred to in your Draft Amended Claim because, if you look at paragraph 32, we say the U.S. measures, and I emphasize that, the U.S. measures, our language, for the purposes of Article
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1101. NAFTA, as alleged in the Amended Statement of Claim and actually it was a draft Amended Statement of Claim are the California Executive Order described above and the CFRFG3 regulations described below.

So assuming that we are right on that, that in your draft Amended Statement of Claim you referred to, 2262(6), that was a regulation which you said was a measure under attack as falling foul of Chapter 11.

MR. DUGAN: Correct.

ARBITRATOR ROWLEY: Now, that measure did not mention methanol specifically.

MR. DUGAN: Correct.

ARBITRATOR ROWLEY: You now, and the President has read you the language of our order found at paragraph 162 which says, We do not intend Methanex to make any new claims, and it must not exceed the limits of Methanex's existing case pleaded and unpleaded.

What we now understand you to say is that you are attacking as a measure the California regulation, albeit of the same number which has recently been amended to name methanol, and I suppose will be argued by the United States that that is, indeed, because it has been amended, is a different measure than was previously attacked.

And I have a couple of questions that
would follow from that argument, if that argument is right.

One, are there preconditions to Methanex under Chapter 11 bringing before an Arbitral Tribunal a measure for arbitration under Chapter 11, and have they been met with respect to the current version of the California regulations which you gave us at Tab 41 in your opening? I think I will just ask you to address those questions, first.

MR. DUGAN: Whether all the specific procedural requirements, such as the waiver and things like that have been met, no, I don't think they have been met. Obviously we have not filed a waiver on that. But, if that type of formal procedural requirements need to be met, it seems to me that the way to do it is simple to grant an amendment to the claim. It's certainly allowed by the UNCITRAL Rules, and, in fact, as I said, the UNCITRAL Rules create a presumption that an amendment should be allowed, and there is nothing in NAFTA, as I see it, that would prevent that type of amendment.

But again, going back to your question, there is one point that I still want come back to because I think it's very important. The way that the Tribunal described the impact of the CaRFG regulation in its Partial Award, we believe, is not complete, because the way the Tribunal described...
it, it quite clearly does ban MTBE, but as we
raised in our February filing, February 2001
filing, other portions of the regulation had the

Now, the measure that we were complaining
of was one that banned alcohols such as methanol.
The measure as it exists today has precisely the
same legal operative effect. The only difference
is now it names it. In our mind, that is a
distinction without a difference, or a difference
without a distinction.

If the operative legal effect of the
regulations that we were complaining of in 2001 is
precisely the same as is now, the California has
changed its words in how it describes that
operative legal effect, why is there any need for
an amendment at all when we are complaining about
precisely the same set of regulations that do
precisely the same thing.

ARBITRATOR ROWLEY: But if Professor
Reisman is correct, that if the regulation, the
current version of the regulation is no different

than the original version of the regulation, and
the original version of the regulation could not
get you through the 1101 aperture, then why can it
get you through today.

And I don't want to put words in your
mouth, but these are the words that I--this is the
distinction I understood to you make in your
opening, and it was that the new version of the
regulations specifically names methanol as a target
of the regulation, and because it names methanol,
you say that or I think you've said that we no
longer had to worry about there being a showing of
an intent to harm methanol because methanol was
specifically named.

So, anyway, let me stop there. Am I right
on that?

MR. DUGAN: You're right, that's what I
said, and I still say that, and I say it for two
reasons. One is because we think it is conclusive
evidence of an intent to harm methanol producers;
and secondly, because again, and I don't see any

reason why we can't put forward this in the
alternative, we believe that this--California's
amendment of this measure to expressly name
methanol clearly satisfies the relating to/legally
significant relationship test that the Tribunal
posited in its Partial Award. We say it for both
reasons.

Now, you said that the regulation is the
same now as it was then. And I guess that's not precisely true. We would say the operative legal effect is the same now as it was then; i.e., that methanol was banned, but the regulation is different now because it does expressly name methanol. That's the difference.

ARBITRATOR ROWLEY: Yes, and I guess my point is that if there is a real difference, then is it not a different measure, and if it's a different measure, then in order to rely on it, because of it being a different measure, not for evidentiary purposes, as the President said you may be pushing on a reasonably open door for use of it

as evidentiary--evidence of intent, but if you're using it as a measure which, because it names methanol, we don't have to worry about intent, then you will have to get--you will have to, at the end of the day, convince us that an amendment is appropriate and that we have the power to make that amendment.

MR. DUGAN: Well, in terms of your power to make the amendment, I think the UNCITRAL Rules quite clearly give you that power. I don't think there is any doubt whatsoever about that. And, in fact, I don't have a copy of the UNCITRAL rule in front of me. I know Mr. Veeder does.

PRESIDENT VEEDER: Can I read it out because it actually highlights, I think, part of the problem we are addressing. I will read it out
and then I will make the point. During the course of the arbitral proceedings, either party may amend or supplement his claim or defense unless the Arbitral Tribunal considers it inappropriate to allow such amendment having regard to the delay in making it or prejudice to the other party or other circumstances.

The second sentence goes on, However, a claim may not be amended in such a manner that the amended claim falls outside the scope of the arbitration clause or separate arbitration agreement.

Now, the first sentence goes to discretion. The second goes to jurisdiction and power, even if we were with you as a matter of discretion.

And I think just to summarize, I think where we have gotten to, if this is part of your evidential case, i.e. it supplies evidence as to the intent of California relevant to the two measures you originally pleaded, as we said, subject to hearing the United States, you're pushing an open door as far as deploying this material. If you're saying that this is the same measure, but like Topsy, it grew up between 1999 and 2003, but it's the same Topsy because what was
implicit or necessarily there but not explicit is now explicit.

Again, it doesn't seem to us from what you're saying that you're applying for an amendment. You're just looking at the same measure, albeit in rather more developed form.

But if you're going to the third stage and saying this is not Topsy, this is a new measure, this is Tom but we haven't got Tom pleaded, the Amended Statement of Claim. We haven't got Tom identified in our Partial Award, and Tom is a new person in this arbitration, and it came effectively with your letter of the 13th of June.

Now, leave aside discretion, just think very hard how it is that we have power under Article XX or under our Partial Award to allow Tom to arrive, given also the terms of Chapter 11.

MR. DUGAN: Well, I think of the three personages that you just posited, Dick, Harry, and Tom in terms of the first one, only because you used Tom in terms of the first one we are obviously pleading it, if nothing else, as evidence of California's intent.

As far as the second one, was this Harry pleaded in October of 2002. We would say yes, Harry was quite pleaded October 2002. What we said then was CAFRB's latest amendments to the CaFRB
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7 regulations, which are to be adopted in December
8 2002, expressly identified methanol as one of the
9 alternatives to ethanol that are currently banned

11 PRESIDENT VEEDER: Give us the reference.
12 MR. DUGAN: Paragraph 122 of the Second
13 Amended Statement of Claim
14 PRESIDENT VEEDER: I will make the point,
15 but I'm sure it's well in your mind. This is
16 certainly a pleaded reference to the proposed
17 regulation, which was exhibited, and we have that
18 point. But in one view all this deploys is those
19 proposed regulations as evidence of intent. It's
20 not elevating it into a new separate measure, which
21 is the subject of your complaint under 1101.

1805

1 Now, we can go through the pleadings, and
2 we have looked at the Amended Statement of Defense
3 and the reply and the rejoinder, and the disputing
4 parties' opening oral submissions, but there is an
5 ambiguity in this Amended Statement of Claim as to
6 whether it was deployed as evidence or, as you say,
7 as a measure. And that's the point that troubles
8 us.

9 MR. DUGAN: Well, again, and I understand
10 what you're saying, but the measure that we are now
11 complaining of is in precisely the same language as
12 what we supplied to the Tribunal in October of
13 2002, and in essence what he said, we were
14 complaining about this particular regulation, and
15 this is what it's soon going to look like. And in fact, as a factual matter, it now does look like what we told the Tribunal it would look like. It has the same operative legal effect now as it did when we actually filed this Amended Complaint, because like I said, at that time it banned methanol, although it didn't name methanol.

1806

1 So, I guess in terms of your second category, is this the same measure that we've always been complaining of, we would say, yes, it's is the same measure we have always been complaining of. We have been complaining about a California regulation in different guises, or using different words that has the same legal effect, which is what we are worried about, which is the ban on methanol.

9 And this no more increases the ban on methanol than it was--than the previous versions did. The ban has been in place since we filed our First Amended Claim.

13 All this does is, again, no change in the operative legal effect. It uses different words, but it comes to precisely the same conclusion.

16 So, in that case we would say, to take your second category, that this is still Harry. Harry has got a different shirt on. That's all, but that different shirt makes a big difference in terms of how the Tribunal posited the relating-to test because now it expressly de jure relates to
methanol. So even though the operative legal
effect is the same in terms for purposes of the
test you posited, it's still Harry.

Now, to take your third category, to adopt
a belts-and-suspenders approach, we do formally
move to amend because we don't think that if we are
allowed to amend, we don't think there is any need
to resatisfy us, especially in a situation like
this where the legal effect is precisely the same.
I would submit to you it's within your discretion
to do so, and that there is no reason why we have
to meet all the various procedural requirements.

And finally, getting to the matter of your
discretion, I mean, if this were--the way you
posited the test, if this amendment were not
granted, then what would be the consequence would
be, I mean, if we were to lose the case and the
amendment had not been granted, then we would have
to refile the case and start the whole thing all
over again, and we would instantly meet the legally
significant test that you posited. And I submit

that that would be a tremendous waste of everyone's
resources if we were required to do that.

You have the amendment before you. We
identified in October of 2002 specifically what it
was, that it was coming, it has now come. We see no equitable reason whatsoever why it shouldn't be before the Tribunal.

So, to take your three categories, we will make all three arguments, and we think under any of those three arguments we're entitled to have this placed before the Tribunal.

ARBITRATOR REISMAN: I would like to understand the substantive implication of the introduction of RFG3, CaRFG3, and I'm still a bit puzzled by this. If RFG2, by implication, excluded any oxygenate that had not been the subject of a multimedia study, multimedia evaluation, and that was RFG2, and by implication that had to include methanol and everything else that's now listed in subsection four of RFG3, and the Tribunal did not find that that established the intent to harm and reached the threshold required under 1101, why did does the introduction of RFG3, with its explication now do that?

More specifically, a related question, if the Legislature says you cannot use another oxygenate until it has gone through a multimedia evaluation, and without discrimination lists all those others that have not gone through the multimedia evaluation, is that evidence of intent to harm those others?

MR. DUGAN: Well, it is in the context of
the record here because one of the principal pieces
of evidence that we say supports our case is that
Governor Davis ordered the State of California to
pay for the multimedia evaluation of one oxygenate,
namely ethanol. None of the others. He selected
out ethanol. He paid for the evaluation of that.
He ordered that the steps go forward to create an
in-state ethanol industry, and you know why we say
that he did that.

So, yes, it is a conditional ban in that
sense, but it is quite clear that in the totality
of the facts and circumstances that it was intended
by California to be in effect a permanent ban, and
that's why only ethanol was selected for evaluation
is because there was quite express favoritism to
ethanol that was not shown to any of these other
competing oxygenates.

But again to get back to the first part of
your question, if I could, I don't think the
Tribunal focused on the fact that the ban of other
alcohols was also in place, and the reason why I
say that is because what the Tribunal has expressed
is the rationale for why, as a de jure matter, the
methanol could not make a case unless it had this
significant intent to harm case is because the
measure that we were complaining about did not
expressly name methanol. And that appears, I
think, four or five times during the Partial Award.
I could take you through it, but I think it's abundantly clear that, in my mind at least, that was the principal reason why the Tribunal found no de jure relationship because the words weren't there.

Now, again, one final point. I may be beating a dead horse at this point. You asked what is the subsequent effect of this latest change for a methanol producer? There is none. It's been banned for use as an oxygenate conditionally to use the words of the United States, since for many years.

Subsequent--I mean, the substantive effect is really for this Tribunal because the Tribunal laid so much emphasis on the de jure aspect of the measure, that it didn't, de jure and ipso facto, ban methanol by name, and therefore this test was created. And we simply made the point, the measure as it exists now, does, indeed, do that, but in terms of its operative impact as a legal measure in California, it has no different operative legal impact.

ARBITRATOR REISMAN: I thank you for that clarification, which is very helpful.

Just could you remind me, when did the
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multimedia study of ethanol take place?

MR. DUGAN: The multimedia study of the ethanol took place, it began in 1999. It was ordered, I think, in paragraph 10 or paragraph 11 of Governor Davis's Executive Order of March 1999, and it took place in stages. The first stage was a lengthy study that was published in, I think, late December or early January of 1999. That study identified a number of very serious gaps with respect to the knowledge base of ethanol in groundwater in particular, and a further study took place. There was an addendum to the first study that I think was first published in February or March of 2000, and then the final portion of the study, the study of the fate and transport of ethanol in subsurface water was finally completed in October 2001.

PRESIDENT VEEDER: Just before we leave this topic, it would be very useful if the parties together or one or the other party could prepare for us the collection of different regulations. What we have is the proposed regulations in Volume 1, Tab 30 of the legal authorities to Methanex's Amended Statement of Claim. We understand that's the same document that appeared at Tab 41, at the front of Tab 41, Mr. Dugan, of your exhibits to your opening oral submissions. At the same time, you handed in the final version, and some of us added it to the back of Tab...
And as you said, that's the same document as was later appended in a different format to your letter of the 13th of June.

MR. DUGAN: I believe that's the case. I think it will be very useful for us to get the different iterations because I'm not precisely sure of that. I know in substance for what we were talking about it was the same, but it might not be complete.

PRESIDENT VEEDER: What we don't have the room, although we've looked for it, is the document that was before the Tribunal for the purpose of its First Partial Award.

MR. DUGAN: Okay. We will do that, then. Just let me warn you that the regulations themselves were very unclear, and there was a--I will dig this out for you as well. There was a clarification by the staff that they had intended to ban all alcohols except for ethanol, and then in the next iteration they did ban all alcohols except ethanol, but that was clearly their intent, but it's hard to derive from the language itself. But we will try to dig all that out and put together for you an interim set of the regulation as it developed over time.

(Pause.)

PRESIDENT VEEDER: Thank you, Mr. Dugan.

MR. DUGAN: Okay.
The second aspect of the Partial Award I would like to draw the Tribunal's attention to, it's now clear that the jurisdiction has to be based on the Findings of Fact that come out of this merits hearing and not the assumed Findings of Fact that the Tribunal assumed at the time that it issued the Partial Award. And Methanex would submit that there are two significant factual changes from what was assumed by the Tribunal at the time that it issued the Partial Award.

In the Partial Award, repeated references to methanol as merely a feedstock for MTBE, we think that a better, more accurate characterization of the market that was there is that methanol is a feedstock for RFG, just as ethanol is a feedstock for RFG. I think Mr. Burke conceded that the market, it's a continuous supply chain, that there is no distinction in the sense of continuity between the refiners and the blenders, and so I think the whole manufacturing process has to be taken into account.

And when viewed that way, ethanol and methanol are both feedstocks for the manufacture of RFG. And secondly, they both compete directly.
And I think that that's a signal fact that the Tribunal didn't assume at the time and wasn't aware of, that there was this direct competition between methanol and ethanol as oxygenates, and that the sale of one would, in some instances, result in the loss of contracts for the other, that type of direct one-to-one relationship.

PRESIDENT VEEDER: I think whenever you refer to testimony that we've heard, it would be very useful if you could give us the reference to the transcript.

MR. DUGAN: I will get back to that during my closing. It is in there. I just don't have it at my fingertips. I'm sorry.

So we think that once the Tribunal views the facts as we have developed them here, we think that the rationale for the specific intent to harm test may well disappear because if there is this existence of a direct competitive relationship between ethanol and methanol as oxygenates, then that in a factual way, as a factual matter, affects

the need for this specific intent to harm test. It creates a different set of facts that would affect whether or not or how the legally defined relationship is articulated.

Now, those are our two principal arguments why we don't believe the specific intent to harm test is any longer necessary in the case, that in essence it's moot. If those are two not accepted,
then we filed our formal Motion to Reconsider that we filed—well, we originally raised the issue in October of 2002, and we filed our formal motion back in January, and I don't propose to go into that in any great detail unless the Tribunal has any questions, and we just propose to rest on the papers with respect to that.

PRESIDENT VEEKER: We have a couple of questions, and we would like to raise it first by reference to your letter of the 14th of April, 2004. Do you have that letter before you? If you could turn to page four.

MR. DUGAN: Yes.

PRESIDENT VEEKER: You just referred to the formal motion to reconsider the Partial Award in October of 2002. Is that a reference to your November 2002 Amended Statement of Claim or some other request?

MR. DUGAN: No, it's a reference to the November 2002 Amended Statement of Claim where we raised in substance our objection to the—what we thought as the conflict between the like circumstances test and the specific intent to harm test.

PRESIDENT VEEKER: But if you could just turn to your Amended Statement of Claim where do we see a request?

MR. DUGAN: There is no formal request for
reconsideration in the Amended Statement of Claim.

We—I would characterize it most accurately as an objection to the test that the Tribunal adopted.

PRESIDENT VEEDER: Well, it's a criticism but no formal request.

MR. DUGAN: No, there was no formal request.

PRESIDENT VEEDER: When does the first formal request, according to you, arrive before the Tribunal, apart from the request that was made immediately after the Partial Award?

MR. DUGAN: Not until January 28th of this year.

PRESIDENT VEEDER: You've seen obviously the United States's objection as regards the timing of such a request. Do you have any further submissions to make?

MR. DUGAN: No. Beyond what we put in the correspondence, no.

PRESIDENT VEEDER: Okay. Thank you, Mr. Dugan.

Now, I think there are two other issues, two other preliminary issues I would like to go to before I start the actual closing. And those are the discovery issues. And I will touch upon them only briefly. And more as an indicator of how I
intend to approach it in the argument.

The first is our request for our third party evidence that we referred to a number of times throughout this. We made good faith requests for third party evidence, and at every juncture the U.S. blocked them and we are now faced with a situation where there are some fairly significant evidentiary deficiencies, most obviously what would be the testimony of the Andreases and Governor Davis, for example.

We believe that because the United States has blocked these, that the Tribunal should draw adverse inferences against them and I will make reference to those inferences as we go through.

Secondly, with respect to our request for the negotiating history of NAFTA, I just want to point out to the Tribunal that the negotiating history, at least in the form of draft texts, does exist. It has been produced by the United States in other cases. It's never been produced here. We believe that that negotiating history would quite clearly shed light on issues such as how to define national treatment, how to define like circumstances, how to define fair and equitable treatment, how to define international law.

And as I said, the Tribunal I think is entitled to those texts. I think it puts both us
and the Tribunal at a disadvantage that the United States produces them in some cases but not in others. And again, I will try to point out where I think that had they been produced, it would shed light on what the meaning of the specific treaty terms is, and ask the Tribunal to draw adverse inferences for the failure of the United States to produce any of this specific negotiating history.

Now, with that, I would like to turn to my actual closing.

PRESIDENT VEEDER: Just to make it clear, you're coming back to those two items later, aren't you?

MR. DUGAN: Well, I will be making reference throughout the--throughout my development

of the facts where I think the particular inferences should be drawn.

PRESIDENT VEEDER: But are you coming back to your motion for the traveaux?

MR. DUGAN: No. I mean, I think that the time for additional evidence is past, and so we are not renewing.

PRESIDENT VEEDER: Well, maybe not as far as we are concerned. We would still like you to develop why you think you need the traveaux for the interpretation of the particular provisions of NAFTA where you seek them given the Vienna Convention.
And we would also like to draw the parties' attention to a recent order made in another NAFTA proceeding by a Tribunal chaired by Professor Gaillard.

MR. DUGAN: Is that the Canfor proceeding?

PRESIDENT VEEDER: Yes.

MR. DUGAN: That's what I'm talking about where I believe the United States agreed to produce the negotiating texts in that one.

PRESIDENT VEEDER: We have a copy of the order, and I hope the parties have a copy of the order also. If not, we can distribute it.

MR. DUGAN: No, no, I have a copy of the order.

PRESIDENT VEEDER: It doesn't strike us as obvious that the United States had agreed to that.

MR. DUGAN: Well, perhaps I'm overstating it. The United States, I think what they said in the order was that they had no objection or maybe, perhaps the other NAFTA signatories had not objected to the release of the negotiating texts. Perhaps that's all they said.

PRESIDENT VEEDER: I think if both sides have got copies of it, we may want to come back to it, but I think we would like to hear you a little bit more at some stage. We don't want to take your submissions out of order, Mr. Dugan, as to why you think it's important to have the traveaux in this case.
MR. DUGAN: Let's start with the first issue in the case relating to. The Tribunal has read quite a bit of significance into the term "relating to." It may be that the travaux will indicate that the parties never read that type of significance into it. It may be that the parties would have indicated a wider scope for what the meaning of "relating to" is. If may be that there was a dispute between the United States and Canada on the one hand, and Mexico on the other, with the United States and Canada seeking to protect their investors at the time that this was negotiated and arguing for the widest possible scope for the term "relating to." And perhaps Mexico was arguing for a different scope. Perhaps there were different terms used in the drafts. Perhaps the striking of different terms and the adoption of the "relating to" language indicates that this was meant to be an expansive, an expansive legal phrase, rather than a restrictive legal phrase. We don't know obviously.

PRESIDENT VEEDER: Let me put the riposte to you and we'll come back to you. The time for such a request was before we made our Partial Award?

MR. DUGAN: Agreed.
PRESIDENT VEEDER: Was there such a request from Methanex for 1101?

MR. DUGAN: I believe there was--I'm not sure there was request for 1101, no. I know that we made a request prior to the Partial Award for certain portions of the negotiating history, but it may have been limited to 1105.

PRESIDENT VEEDER: I think if you have an 1101 request, we would like you to identify it before the Partial Award.

MR. DUGAN: I don't think we do, but certainly if only in terms of the relationship to the motion for reconsideration. And I think we did--I think we did make a request for the negotiating history for 1101 at the time that we asked for clarification. And this is in August 28, 2002. We said, indeed, it would be fundamentally unfair to accept the United States's argument that allow 1101 requires a legally significant connection while simultaneously allowing it to withhold evidence that very likely would shed important light on the proper meaning of that term. Accordingly, Methanex respectfully renews its request for an order compelling the United States to produce any potentially relevant segments of NAFTA's negotiating history. So, that was the request that we filed in August 28th, 2002, admittedly after the Tribunal issued its order with
respect to the First Partial Award.

And I think we have identified some of the other issues that we think would be relevant as well.

Fair and equitable treatment, Article 1105 has been the subject of enormous debate as to its meaning, especially in light of the FTC interpretation. We think that release of the negotiating drafts could well shed light on that.

If you recall, one of the issues that was raised was whether the concept of international law in 1105 is limited to customary international law where it includes broader forms of international law. And I think that there is evidence in the record from Mr. Aguilar that there was one draft that did include the word customary, but that that was struck. That's the type of thing, that's the type of negotiating history that I think would be relevant not just for Methanex, but to the Tribunal as well.

Similarly, the concept of like circumstances, how that is to be defined. There may be well be drafts that were proposed but not adopted that would shed some light as to how expansive or restrictive a legal term that is meant to be.

PRESIDENT VEEDE: Just to complete the procedural story, there was correspondence partially between the parties, disputing parties...
and the Tribunal about this request, and it was envisaged it would be dealt with at the procedural hearing in March 2003, and we would like your help as to how that particular request was pursued--of that hearing.

MR. DUGAN: I'm not sure the negotiating history was pursued, and frankly, we never received a response from our August letter, and we never received--

PRESIDENT VEEDER: We need to look at the letter from the Tribunal from the 25th of September, 2002.

MR. DUGAN: Perhaps I have misspoken now.

PRESIDENT VEEDER: Well, you need not do it now, but at stage we'd like some explanation as to this request having been made, the Tribunal having responded, the procedural meeting having been held here in March 2003, why wasn't it pursued by Methanex at that time.

MR. DUGAN: Frankly, it wasn't pursued by Methanex at that time because we thought that the Tribunal had absolutely no interest in granting it, and we had been making a number of requests for the negotiating history; a request for the negotiating history I think goes back to 2001.
PRESIDENT VEEDER: Mr. Dugan, we can go through this, and you are entitled to criticize the Tribunal. Please don't resist if you have criticisms to make, but it ought to be fair criticism. There was a request, and we dealt with it in the Partial Award. At the time of the Partial Award, as best as we can recollect, there had been no request from Methanex for any travaux relating to 1101.

MR. DUGAN: And I don't dispute that.

PRESIDENT VEEDER: I think you agree with that?

MR. DUGAN: I do agree with that.

PRESIDENT VEEDER: After the Partial Award there was such a request, there were further intonations for travaux. And if you look through the correspondence, the Tribunal indicated that it wanted that to be discussed with the parties at a procedural meeting which eventually took place in March of 2003. And before March 2003, if there is any criticism of the Tribunal, we would you like to specify precisely what it is.

MR. DUGAN: I don't have any precise or specific criticism the Tribunal, and as to what should have been raised in 2003, Methanex, in retrospect, probably should have raised it, but it was a matter of in litigation you pick and choose where you make your requests and where you fight.
your fights. And Methanex decided not to. I
decided not to at that point to raise that issue,
and the Tribunal didn't raise it, and the issue was
put to the side. That's quite clear.

President Veder: For now, please don't
assume the Tribunal is disinterested in your
application, which it is treating as a live
application. We have not determined it one way or
the other, but we do need your help this afternoon
as to why you still think it's relevant to have
traveaux on 1101, given that we made a Partial
Award on the meaning of Article 1101, and just let

me finish. If you can go through the other
requests, you're asking for the traveaux in
relation to 1102. You are not, I think, making any
request of present in regard to 1105 or 1110, but
you are in relation to Article 2101. Is that
right?

Mr. Dugan: I think that is right.

President Veder: So, we are looking at
1101, 1102, and 2101.

Mr. Dugan: Well, I mean it says that it's
not exhaustive if I could amend that and ask for
the history with respect to 1105, I would as well,
because I think that's a very important nearby this
case.

President Veder: And again, you've got
to make out a case for it.

Mr. Dugan: Okay.
You are going to make out a case for it.

The question of what fair and equitable treatment actually means, actually covers, has been, as I said, an object of quite a bit of dispute. There is dispute now, for example, about whether or not Professors Crawford's articulation of what it means in the waste management case is reflective of customary international law.

I think one of the things that we've argued is that 1105 is not limited to customary international law. It includes international law. That's what it says, and that's what it means, and we very much would like to see the negotiating text to see whether the word "customary" was included in one of the drafts, and then struck. We think if it was, that is persuasive evidence that the fair and equitable treatment must be in accordance with all aspects of international law, including, for example, WTO law, and that the protections of the WTO can to some degree be imported through 1105 if 1105 is meant to provide all the protections of all of international law, including treaty law, not just customary law.
Now, the United States has asserted that it doesn't, and they now have the FTC interpretation, which attempts to deliver the protection of that to customary international law. Methanex submits that if the phrase "customary" was struck from the negotiating history, then it's quite clearly the intent of the parties to include the protections of all of international law, not just customary international law. And if that's the case, then the FTC interpretation of 2001 is quite clearly an amendment. It's not an interpretation, and it's an impermissible amendment. It's not an interpretation.

We don't know that. And all the parties have been assiduous in trying to protect themselves with respect to what the negotiating history says, and I submit that one of the reasons why they do is because they now realize that, as drafted, it provides quite broad protections for investors, and that was the intent, we submit, of the parties, specifically of Mexico--I mean, of Canada and the United States, which at the time were looking for the protections that would be provided by NAFTA and looking for expansive protections just as they were in all other investment treaties that they were signing.

And that the arguments that are reflected in the FTC interpretation of 2001 are post hoc,
after-the-fact arguments that express nothing more than buyer's remorse; that United States and Canada didn't anticipate that they would be in this room as they are today, to the defendants in an important proceeding alleging very serious charges. They anticipated that American corporations would be in hearing rooms and the Mexican Government would be here defending these very serious charges. And finding themselves in the position of defendants, they are now retroactively attempting to restrict the scope of 1105 and the scope of fair and equitable treatment. They are trying to pretend that fair and equitable do not mean fair and equitable, and we say that's nonsense. Sir

Robert Jennings said that was nonsense, he said that was a preposterous argument. Now, could the negotiating history shed light on that? We believe that it could, but you're asking me to, in essence, speculate what's in the negotiating history. I don't know. But it's hard to believe that some concept, some expression of the potential scope of fair and equitable treatment was not raised during the course of the proceeding—during the course of the negotiation. Perhaps it wasn't. And if that's the case, then I guess we are left with trying to figure out what it means on its surface. But those are the types of things that we believe could well be useful in aiding the Tribunal
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16 to understand what fair and equitable means.
17 That's why we believe it's entirely appropriate for
18 the Tribunal to have that negotiating history
19 before it.
20 (Pause.)
21 ARBITRATOR REISMAN: As a matter of

1 international law’s interpretive methodology, what
2 is the relationship between text and traveaux under
3 the Vienna Convention, Articles 31 and 32?
4 MR. DUGAN: I don't have it in front of
5 me, and I can't quite remember what the precise
6 standard is, but I guess what I'm submitting here
7 is that the FTC interpretation of 2001 articulates
8 an interpretation of 1105 that I think is
9 inconsistent with the text of 1105.
10 ARBITRATOR REISMAN: Doesn't Article
11 31--Articles 31 and 32 deal with subsequent
12 agreement by the parties?
13 MR. DUGAN: I think 1131 deals with it--I
14 think it does, but the subsequent agreement is
15 agreement as to interpretation. And our point is
16 that if they are trying to substantively limit the
17 scope of 1105, they can only do that by formally
18 amending NAFTA, invoking all the known federal
19 legislative procedures that are required before an
20 amendment to an American treaty or a Canadian
21 treaty takes place, and that's what they have
avoided. There is no doubt that they have the power to restrict the scope of 1105 if the parties agree; but if they do so, adopting all the procedures that are known to the parties to exist, i.e. in the case of NAFTA it would have to be approved by Congress. It's a trade agreement rather than a treaty.

So, those are the procedures that had been bypassed here, and Methanex submits that unless those procedures are adhered to, if the changes that are proposed in the FTC interpretation are, in fact, an amendment, then it's invalid. And we submit that they are. That this was not a permissible interpretation as articulated, far too narrow—it attempted to far too narrowly restrict the scope of 1105.

PRESIDENT VEEDER: We also need your help to understand what you intend by the phrase "traveaux." We've looked to paragraph 20 of the procedural number five in the Canfor USA arbitration, and there was perhaps a rather

original definition of what traveaux might be. But given that you're asking for traveaux now, in respect to 1105 as well, we would like you to spell out what you think traveaux would be relevant in these arbitration proceedings.
MR. DUGAN: Well, approaching it from the lex arbitrii, the U.S. definition of discovery, I think the traveaux that would be relevant is the discovery that the U.S. would be liable to produce in an American court that would bear upon the meaning of these words, and in an American court that covers a lot of ground. It covers ground for everything. Obviously stuff that is legally privileged would not be covered. There is a question about certain other categories of documents, but material that is not legally privileged, such as letters back and forth between the parties, as well as negotiating texts, minutes of meetings between the parties, memoranda that are prepared for the negotiations. In the Loewen case, the United States selectively released I think one or two memoranda that did include extensive discussion of the issues to be negotiated. And it indicated, and I think it's a very accurate inference to draw from the existence of those memoranda, that there was an ongoing process where the United States would develop in writing and brief the negotiators in writing as to the consequences of and as to the meaning of various negotiating positions taken by the parties. And that process, I submit, must have existed, that there must be a long document trail as to many of these provisions and as to what they say. And it's that document trail that has been
partially disclosed in bits and pieces that we think would aid both the Tribunal and Methanex in articulating--sorry, Methanex in articulating this case.

PRESIDENT VEEDER: In making this request by reference to U.S. discovery, are you limiting your request of materials that were shared between the three negotiating parties to NAFTA?

MR. DUGAN: It certainly encompasses all that, but to the extent that there are--I would go beyond that. To the extent there are memoranda that were used by the negotiating teams in order to understand what the issues were in the negotiations, we believe that would be relevant as well.

It's quite clear it would be relevant. The question, I guess, is whether it's under traditional Rule 26 procedure, that's the type of thing that normally would have to be produced.

PRESIDENT VEEDER: Okay.

MR. DUGAN: Now, with respect to the third-party discovery, I think Methanex did on a quite diligent basis raise the issue of third-party discovery at periodic integrals. I think the first--the first request was filed in October of 2002, it was raised again at the March hearing, and it was raised again earlier this year. And every attempt or every time we were on the verge of

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taking the discovery, such as in January of 2002,

the U.S. objected, and we held off and waited for
the Tribunal to decide. And I think the record on
that is pretty clear that they used every possible
avenue to block that discovery.

And I think the normal common law
evidentiary inferences should be drawn, where a
party blocks discovery, then if there is a disputed
fact, and it can be shown that the testimony that's
been withheld would or the testimony that has been
blocked would shed light on the fact, then the
adverse inference should be drawn at that point.

MR. DUGAN: The 1782 stuff, that's
correct, which as I said we first asked for, I
believe, in October of 2002.

When you say block,
the implication is that when a party resorts to
objections available to it at law, that's blocking?

Well, arguably available to it
in law. There has been no showing that the

objections are, in fact, available to the United
States. The provision calls for broad discovery
powers in aid of International Tribunal which we
think this quite clearly is. This fits specifically within the scope of that, and we were faced with a position where had we gone to a Federal court while the matter was still pending before the Tribunal, I think it's virtually certain the Federal court would have done nothing, pending clarification from the Tribunal as to whether or not we had the power to go before the court.

And so, merely by making—you're reading 1782 as meaning that if you had--

ARBITRATOR REISMAN: If Methanex had turned to a United States court, the court would not decide until the Tribunal had endorsed your application?

MR. DUGAN: Until the Tribunal expressed its opinion about whether it was permissible or not, yes, as a practical matter.

ARBITRATOR REISMAN: Does 1782 say that?

MR. DUGAN: 1782 doesn't say that, but the case law expresses in many instances a preference for that, for finding out what the Tribunal actually--what the Tribunal's view is with respect to that particular type of evidence. It's not a necessity. It's not a legal necessity. There have been cases that went forward without Tribunal forward.

But in this case where the United States had objected to the Tribunal allowing us to go forward and where the Tribunal reserved judgment on
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12 it, I think that the United States would surely
13 have made the same objection to the U.S. court, and
14 the U.S. court almost certainly, in my judgment,
15 would have said, well, let’s see what the Tribunal
16 says. If the Tribunal blocks you from going
17 forward with this discovery, then I think the
18 Tribunal never would have issued it.
19 So it's key what position the Tribunal
20 takes, for all the obvious reasons. I don't think
21 the Federal court has ever ordered discovery,

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1 perhaps I'm wrong. I don't remember all the case.
2 I don't think it's ever ordered federal discovery
3 where an international tribunal has ordered a party
4 not to pursue it. So, I think the attitude of a
5 Tribunal in a 1782 proceeding is a key element, and
6 had the Tribunal adopted the position of neutrality
7 in January of 2003, when it first arose, then we
8 would have had time to pursue it. As it is now, I
9 just don't think we have time to effectively pursue
10 that avenue.
11 And again, it's because of the U.S.
12 objections. And we think that the U.S. should be
13 held to account for those objections.
14 ARBITRATOR REISMAN: When you say had the
15 Tribunal adopted position of impartiality or
16 neutrality. Can you explain that.
17 MR. DUGAN: Sure. In January 2002, we
18 raise the issue in October--we raised it again in
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October of 2002. We raised it again, I believe, in January 2003, and as I recall the documentary record, and I haven't reviewed it for a while, so I'm not entirely clear, I may be off in some of the details, the Tribunal at first adopted a position that it was appropriate for Methanex to go out and obtain this evidence if it wanted to. The United States then objected and said, no, that wasn't appropriate until there was an affirmative order from the Tribunal.

The Tribunal then sent out some letters, which we took as meaning that it wanted to review this issue at the March 31st hearing, the issue being whether Methanex could go off on its own without the endorsement of the Tribunal in response to the U.S. objection.

The issue was discussed at the March 31st hearing in considerable detail. At that point, the Tribunal issued an order, an oral order, to the effect that it wasn't minded at that point to, and I can't quite remember how it's phrased, to either allow or order the discovery requested.

PRESIDENT VEEDER: No, no, no. You may want to review this very carefully, and please don't hesitate to express any criticism that you
have in mind, but the Tribunal was never minded to require Methanex not to apply to a state court under 1782, so that was, I hope, always made clear. What was not made clear was whether the Tribunal should bless such an application; i.e., by granting you the approval of the Tribunal for such a request.

The other matter that we're going to invite to you raise, today if you can, is the way that 1782 and the Tribunal's rule under 1782, which is not explicit, ties in in this case with the IBA Rules, Article 4(10) and Article 3(8), which at one stage was an argument being raised by the United States as a qualification on your application in regard to 1782.

MR. DUGAN: Well, I guess taking the first issue, with all due respect, it certainly was not clear to Methanex that Methanex was free at that point to go forward with its own application. And in that respect, the Tribunal indicated that it would be issuing a letter or a decision shortly, and a decision was never issued, and I think had the decision been issued, perhaps at that point it would have been clear. But not having any affirmative decision or any decision from the Tribunal, we continued in the posture that we were in, which is consistent with our understanding that we were not entitled to go forward unless the Tribunal had said either it's blessed or you may do
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10 what you want. That was the position--
11 PRESIDENT VEEDER: We have to look back at
12 the transcript, but during the March 2003 hearing,
13 as I recall, it was your argument that you didn't
14 need the positive blessing of the Tribunal to make
15 an application under 1782. That was the argument
16 of the United States.
17 MR. DUGAN: Correct, but that we wanted
18 the blessing of the Tribunal.
19 PRESIDENT VEEDER: You wanted the
20 blessing, but you didn't need it.
21 MR. DUGAN: That's correct.

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1 And it was our understanding that the
2 Tribunal--the objection of the United States was
3 that we couldn't do it unless we had the blessing
4 of the United States--blessing of the Tribunal, and
5 it was that issue that was never decided. There
6 was a clear objection from the United States.
7 There was no decision, and the effect was,
8 certainly in our minds, to prevent us from
9 obtaining 1782 evidence.
10 Now, in terms of, you know--
11 ARBITRATOR REISMAN: As I understood the
12 sequence of events, the position of the Tribunal
13 was on the record that Methanex could proceed, that
14 it was not minded at that time to issue an
15 endorsement, that as to the question of whether it
16 would issue an endorsement it would take that under
advancement, but the general license of Methanex to proceed under 1782 was never in doubt.

MR. DUGAN: With all due respect, I don't believe that there is an expression toward that effect. And again, that would have required a ruling on the objection of the United States that we lacked that power, and there was no ruling on the objection of the United States that we lacked the power to go forward independently.

PRESIDENT VEEDEER: Mr. Dugan, do you remember the debate? I'm sorry to get back to the March hearing. We indicated that was something that this Tribunal could not decide. It had to be for a court to decide whether or not the Tribunal's blessing was required or not in the exercise of that court's jurisdiction.

MR. DUGAN: I will go back and read the transcript.

PRESIDENT VEEDEER: I will give you one reference which I do recall, which is that--this is the transcript for the 31st of March, and I'm reading from page 108, 109, what was said on behalf of Methanex was this:

We have always taken the position with the Tribunal that we didn't believe that the Tribunal's blessing was necessary
in order to invoke 1782, and then you
referred to your October letter. And you
concluded, In the best of all possible
worlds, we would prefer a Tribunal order,
but if the Tribunal, for whatever reason,
is unwilling to issue it, we believe that
under the statute we are entitled to go to
the District Court as an interested party
and seek to convince the District Court to
grant us this additional evidence. In
other words, while we would welcome a
Tribunal order, we don't believe it is
necessary for us to succeed at the
District Court level, and I don't believe
that position has changed.

Now, clearly, you wanted our blessing
because you thought it would help, but our
recollection is that you didn't say you needed it
to make the application.

MR. DUGAN: But we also wanted a ruling on
the U.S. objection, which is what we were expecting

would happen, and the U.S. had quite clearly made a
ruling--made an objection--and what we were afraid
of, without a ruling on the U.S. objection as to
whether we had that power, if we went into a
Federal court, the United States would make the
same objection that this is pending before the
Tribunal. It would be premature for this court to
take any position with respect to a 1782 request until the Tribunal has issued a decision on the U.S. objection, which it indicated it would be issuing soon. And so, that's why we didn't do it.

PRESIDENT VEEGER: Thank you, Mr. Dugan.

MR. DUGAN: Would this be an appropriate time to take a break and I could come back and begin the closing.

PRESIDENT VEEGER: I'm sorry if we have taken you out of turn. I think we should take a break. We have a shorthand writer who has taken down a lot of words this afternoon. Let's take a 10-minute break.

(Brief recess.)

PRESIDENT VEEGER: Let's resume.

Mr. Dugan, I'm conscious that we have been interrupting you, and we apologize for that, but it's certainly been very helpful to have this exchange with you, and we thank you for answering our questions, but we don't want to remove your allocation of time because of what we call injury time from the Tribunal. So, we can go beyond 5:30 this afternoon. Please don't feel that you have to speak any faster or truncate any of your submissions.

MR. DUGAN: Thank you. I appreciate that.

All right. To begin with, proceeding on the assumption that Methanex does have to meet the
standard set forth in the Partial Award, a specific intent to harm later in my presentation I will go over what evidence we think clearly supports that inference. So, it will come at a different portion in the presentation today.

Now, the first issue I would like to turn to is 1102, but before we actually turn to 1102, I think it's necessary to deal with the governing law issue and what law is to be relied upon by the Tribunal in resolving this.

Now, obviously, Article 1131, which we will put up as a slide, states quite clearly what the Tribunal is to rely upon. A Tribunal established under this section shall decide the issues in despite in accordance with this agreement and applicable rules of international law.

Now, international law usually includes under Article 38 of the ICJ, jurisprudence, international jurisprudence.

The U.S. argue that is WTO law and GATT law has no on place in this proceeding. So, in essence, what they want 1131 to say is this: A Tribunal established under this section shall decide the rules, the issues in despite in accordance with this agreement, and applicable rules of international law, except for WTO, GATT law, and national treatment because they decided that they really don't much like that law, and I
think to phrase it that way to expresses precisely
what's going on here. The United States is trying
to pick and choose which issues, which areas of
international law apply, and they can't do that.
Under 1131 the Tribunal is required to take into
account all of international law, not just
customary international law, but all of
international law. And that's the standard.
So, the U.S. statement that WTO law has no
place in this dispute is simply wrong as a matter
of the governing law.
Now, I'd also point out that in cases such
as Pope and Talbot, they rely on WTO law. So,
tHERE is traditional of NAFTA Tribunals relying on
WTO law, and we think it's perfectly appropriate
for the Tribunal to do so here.
Now, this also points out two other
issues. This is a place where negotiating history,
I think, could be very useful, to see exactly what
law does apply. We don't have that here. The
United States is arguing for interpretation of 1131

that can't be supported by the text of the
provision. And if that's the case, it seems to me
incumbent upon the United States to produce any
relevant negotiating history.
The second point I would like to make is I
don't think that the--even if there had been, for example, an FTC interpretation saying that WTO law has no role in NAFTA dispute, that the parties have the power to do that. This is a good example of what would be an impermissible amendment. The parties, by agreement, three parties who are defendants in numerous suits by agreement cannot issue an interpretation that reads a specific area of law out of the Treaty. They can only do that by formally amending the Treaty. That's too distinct and too important a deletion from the Treaty to be anything other than an amendment.

Now, the first point I would like to make is 1102, and what it is that 1102 prohibits. The U.S. argues that 1102 prohibits discrimination against foreign investments because they're foreign. Now, that's surely true. No one can dispute or quibble with that interpretation, but 1102 prohibits something else as well. It prohibits discrimination that favors a domestic industry. And again, what's the legal basis for this? The legal basis for this is the express language of 1102: A foreign investment is entitled to the most favorable treatment as a domestic industry receives. If the domestic industry is favored, then the foreign investor is equally entitled to that favored status.
So it's not simply discrimination against an investment because it's foreign owned, although we think that took place here. That's not all that 1102 prohibits. It prohibits favoritism. It prohibits economic protectionism. It prohibits precisely the type of behavior that we contend the United States and California engaged in here. And once again, the fact that California may have discriminated against U.S. methanol producers while it was favoring U.S. ethanol producers is irrelevant. And I think the case that best serves this point is the European Commission versus Denmark where they were trying to determine whether there was discriminatory intent in a Danish tax provision. Now, a statement there said, viewed by itself the tax system introduced by the Danish legislation contains incontestable discriminatory or protective characteristics. Although it does not establish any formal distinction, according to origin of the products, it is has been adjusted so the bulk of the domestic production of spirits comes within the most favorable tax category, whereas all imported products come within the most heavily tax category. These characteristics of the system are not obliterated by the fact that a very small fraction of imported spirits benefits from the most favorable rate of tax, whereas conversely, a certain proportion of domestic production comes...
21 within the same tax category as imported spirits.

1 It therefore appears that the tax system
2 is devised so that it largely benefits a typical
3 domestic product and handicaps imported spirits to
4 the same extent.
5 Now here, the California regulatory
6 scheme, the ban on MTBE, and the ban on all the
7 competing oxygenates, including methanol, largely
8 benefits the U.S. ethanol industry which, as we
9 have seen, produces 93 percent of the ethanol
10 consumed in the United States. And it handicaps
11 foreign methanol and MTBE to the same extent.
12 Now, one of the things that came out in
13 the hearing was testimony by Mr. Burke, I believe,
14 who testified at page 1425. The question was,
15 (reading):
16 So, if 47 percent of the methanol
17 operating capacity is domestically owned,
18 that would mean that the majority or
19 53 percent is foreign owned; is that
20 correct?
21 That's correct.

1 So, we are dealing here with an industry
2 that is majority foreign owned, and that's in
3 considerable contrast to the United States's
ethanol industry, and that's an important fact for the Tribunal to consider. Now, if 1102 prohibits favoritism to a domestic industry, then one of the key issues here obviously is whether California and former Governor Davis intended to, and did, in fact, favor the U.S. ethanol industry. So what I would like cover is the evidence of an intent to favor, and specifically the evidence that there was some type of implicit arrangement between Davis and the U.S. ethanol industry.

Now, as a preliminary point, we think that the evidence that was adduced during the hearing also shows fairly clearly that MTBE was singled out in contrast, for example, to benzene. Again, there was no doubt there was testimony to this effect. Benzene is a known carcinogen, and it's one of the worst components of gasoline.

Now, Dr. Happel, in response to a question about the NRDC listing of the most prevalent contaminants in California's water, the one that lists benzene but does not list MTBE, said she had done her own analysis, and she had come to a different conclusion. And what she said at 1208 of her testimony, and this is lines 11 through 16, (reading):

Use of the primary MCL value of 13
parts per billion for MTBE would show that the percentage of public drinking water wells with detections of MTBE at or above the primary MCL is nearly equivalent to benzene. By the use of this primary MCL, MTBE would rank 14th in this analysis.

Well, what's significant about that is that even their own expert concedes that benzene is a worse problem than MTBE. Now, if that's the case, what's California doing about benzene?

Nothing. They may be reducing it, but they're certainly not eliminating it. They're not taking benzene anywhere near as seriously as they took MTBE. And that's an important fact to consider because benzene is universally acknowledged to be more dangerous and damaging than MTBE is, because it is a carcinogen, a known carcinogen.

Now, there is no doubt that they could have acted, that California could have acted. It could have taken steps with respect to benzene. Burke testified again at page 1475, lines 6 through 13, (reading):

But you would agree that if the EPA can ask refiners to remove sulphur, it can ask refiners to remove benzene; is that correct?

Well, the EPA has asked refiners to reduce benzene content, and they could ask them to remove it too, couldn't they?
I suppose they could.

So, taking action against benzene was perfectly feasible for California to do. It didn't.

Now, he took the position that it was prohibitively expensive. But I would like to draw your attention to a chart that was shown to Mr. Burke during his cross-examination. This chart shows that the cost of taking 70 percent of the benzene out of gasoline, last number down there, was .67 cents per gallon, and right above that it shows that the cost of using ethanol in California was 3.9 cents a gallon.

So, it was approximately six times more expensive to use ethanol than it would have been to reduce benzene, and yet California showed absolutely no interest in meeting the benzene--in dealing with the benzene problem.

MR. LEGUM Mr. President, we would like to note our objection to this use of this document. It was offered for addressing the credibility of Mr. Burke's testimony. This is now being offered as primary evidence that if it was to be relied on, should have been submitted with Methanex's reply or before.
PRESIDENT VEEDER: I think we're going to need to look at the passage of Mr. Burke's evidence because we do recollect the challenge made to the United States and the way in which this document was allowed to be put to Mr. Burke.

MR. DUGAN: I don't think we have the actual passage. I don't know the actual passage where he was.

I will withdraw the document.

ARBITRATOR REISMAN: Could I get a clarification, please. Dr. Happel was testifying about groundwater and, as I recall, the issue there was whether or not MTBE undergoes ambient and transient bioremediation as does benzene; that if there is a spill, the benzene undergoes an intrinsic bioremediation, and that MTBE did not. Wasn't that the issue of benzene that the context in which she made that point?

MR. DUGAN: I don't believe it was. I believe what she was responding to was the

1 criticism that the MTBE was not as serious a contaminant as benzene was, and she took dispute--she disputed, she took issue with the NRDC chart and said that, no, in fact, under her analysis it was almost as serious as benzene and that it would have ranked in the chart of the top 24 contaminants.

And the question of biodegradation I think
is a different question. It's a precedent question, and the comparative rates of biodegradation would affect the contamination of drinking water. But I think that's what she was talking about, was where it ranked on the list of list of comparative contaminants of drinking water. So, I offer that for the purpose of just showing that even their expert recognized that the threat actually posed to drinking water which, remember is what the NRDC chart was intended to show, was still, even under their own expert's calculation, showed that benzene was worse as a contaminant in terms of its prevalence of California's drinking water than MTBE is. Now, California has not acted anywhere near as aggressively against benzene as it did against MTBE, and we ask the question why.

ARBITRATOR ROWLEY: Mr. Dugan, is there evidence before us that benzene was perceived to be a problem in California to the same extent, at the same time that MTBE was perceived to be a problem?

MR. DUGAN: No. There isn't evidence, and there is a reason for that, and that's the reason that we tried to set out, which is that the relying upon the two news stories that we put into the record, that ADM went about hiring people to stir up, to whip up hysteria about MTBE. Oxy Busters, that whole front organization that was described in the two articles, I think, and Methanex thinks,
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explains why MTBE was perceived to be a problem and benzene was not. It was because the ethanol industry stood to benefit if it could eliminate MTBE as a competitor, and there was no comparable U.S. industry that was interested in getting rid of benzene.

PRESIDENT VEEDER: Just for the record, in case we come back to it, Mr. Dugan, I think the reference to our ruling in relation to the document you've just withdrawn is at page 1466 of day six.

MR. DUGAN: I'm sorry, I wasn't aware of the ruling, so I--

PRESIDENT VEEDER: It was expressly put in by Ms. Callaway in her words--well, the comment was made, (reading):

Ms. Callaway, is this document in the record for the United States?

MS. CALLAWAY: No, it is not. It is used for credibility and goes directly to the conclusion regarding the cost of reducing benzene content. It was put in on the basis of credibility only and not as evidence of its contents.

MR. DUGAN: Well, I remember Mr. Burke's testimony. His witness statement was that the cost was prohibitively expensive. I think that to a
degree this undercuts that. So, if it's taken in
for the purposes of challenging Mr. Burke's
credibility, it seems to me it's properly before
the Tribunal.

PRESIDENT VEEDER: As an attack on his
credibility, but not as evidence on its own, that's
the point. But maybe you want to think about it a
little bit further.

MR. DUGAN: I understand. I will withdraw
the document, that's fine.

But our point, even without that document
is that they were, at worst, comparable problems
and yet California took no steps. It only singled
out MTBE, and there is no--there is no asserted
health or environmental reason why it would go
after one and not the other, and Methanex submits
that the reason is because of the favoritism that
was shown to the U.S. ethanol industry.

Now, turning to what is really in many
ways the central issue of the case, Professor, you
focussed during my opening on a critical aspect.

You asked me does Methanex contend that wherever a
political contribution is followed by governmental
acts favoring the contribution, is it invariably
corrupt, and I said no, of course not. It's a
question of the particular facts and circumstances
that surround the case. And that is the--that's
the situation here.

I think you have to start with the proposition that the U.S. now finally concedes, or it was forced into conceding because of the language in the Supreme Court decision, and the language of the Solicitor General and the words of Senators like Senator Rudman and Senator McCain that there do exist situations, instances in the United States of corruption, and that's the word the Supreme Court used, that are not criminal acts, there is no quid pro quo, but there are nonetheless corruption where contributions are given and favors are granted in return.

To use again Senator Rudman's words, money affects outcomes, and it was that type of corruption that the Supreme Court approved—it was that context in which the Supreme Court approved the McCain-Feingold campaign reform bill.

Now, if you start with the proposition that these types of instances do, in fact, exist, Methanex submits that look at the evidence in this case, and determine what conclusion you can arrive at. I think the only way a decision maker can determine whether this type of corruption exists in a particular case is to fairly weigh the evidence, all the evidence, all the facts and circumstances.

So, let's review the evidence here. First of all, let's start with the industry. The industry we are talking about is the U.S. ethanol
industry which the United States, by its own admission, and we put this slide up before, we won't put it up again, the General Accounting Office, the investigating arm of the United States Congress, said that the industry exists only because of political decisions. Without congressional approval of the tax credit, commercial ethanol production would cease. So, this is an industry that owes its very existence to political favoritism. It was created and it survives only because of continuing governmental favoritism. It was created and it survives only because of continuing governmental favoritism. It's not like the ethanol industry. It's not like the gasoline industry. It's not like the automobile industry. It's not like the corn industry. Those industries would exist without the Federal tax--regardless of Federal action.

PRESIDENT VEEDER: Just a correction to help us later. You said it's not like the ethanol industry. You meant like the methanol industry.

MR. DUGAN: That's correct. Thank you very much. It's not like the methanol industry. All those industries exist independent of a Federal grant of tax relief. The ethanol, the commercial ethanol industry does not. It exists only because, as Senator McCain put it, ADM has used--has traded its political contributions for
the tax subsidy.

Second, second point to take into account, who is making the contributions here? It's ADM and Vind, but certainly ADM with a company with an undisputed record of influence seeking and corrupt, indeed, illegal acts, all of which is in the record, and again, to use Senator McCain's words, ADM traded political contributions for the Federal tax subsidy.

And there is no doubt that that's what Vind and ADM looked for when they made contributions. Let's go, if we could, to Mr. Vind's own witness statement. He said, From time to time ADM and my companies jointly sponsored legislation encouraging increased use of ethanol and as part of this effort we jointly and independently supported various legislators and members of Congress whom we felt might support the expanded use of ethanol.

ARBITRATOR ROWLEY: Is this Vind at page 988?

MR. DUGAN: No, no, I'm sorry. This is Vind's witness statement, his written sworn statement that he put in prior to his cross-examination testimony.
ARBITRATOR ROWLEY: Is it part of your package?

MR. DUGAN: It should be part of the package of the--

ARBITRATOR ROWLEY: If you can refer us to tab numbers when you are--

MR. DUGAN: Certainly.

ARBITRATOR ROWLEY: That would be helpful.

Thank you.

MR. DUGAN: It's the last two pages of Tab 5.

PRESIDENT VEEDER: Which is what paragraph number?

MR. DUGAN: It's paragraph number four.

So, in Vind's own express words, what he and ADM were looking for was politicians who would support the expanded use of ethanol. That's what they wanted. That's why they made political contributions. And his testimony confirms that.

And this is from page--I believe it's page 975 of Mr. Vind's testimony, and it states, line 6, (reading):

You were looking for legislators who would support the expanded use of ethanol?

That is correct.

And it was to those legislators you directed your contributions; correct?

That's correct.

So it's clear what they were looking for.
Someone who would expand the use of ethanol.

He goes on, page 976, (reading):

THE WITNESS: I would raise money for legislators in California at the Federal level who supported the use of ethanol as a renewable fuel and expanded use of ethanol and expanded production of ethanol, that is correct.

Now, if you had a legislator either at the state level and Federal level and you gave them money but they refused to support the expanded use of ethanol, would you continue to raise money for them?

Probably not.

Again, I think Mr. Vind is making it as clear as he possibly can, not as he possibly can. He's making it quite clear that the intent is to give contributions in exchange for politicians who would give him expanded use of ethanol. And it was exactly in terms of what he was looking for with respect to then-Senator--Representative and Senator Torricelli. Page 988 of his testimony, line 15, (reading):

You were looking for help from Mr. Torricelli on your El Salvador?

I was looking for help from Mr. Torricelli on my problem in El Salvador, that is correct.
And you were also looking for help from Mr. Torricelli on the ethanol tax excise credit; correct?

Yes, I believe so.

So, Mr. Vind frankly admits what he's looking for. He's looking for legislators who will favor his interests, and that's why he makes contributions.

PRESIDENT VEEDER: Just to make it absolutely clear, somebody who makes a contribution to a politician looking for a quid pro quo, Mr. Dugan, by itself, that is not a criminal offense.

MR. DUGAN: No, that is not a criminal offense unless there is a quid pro quo. As I understand the criminal aspects of the law, unless there is an express quid pro quo.

PRESIDENT VEEDER: So if the politician is expressly or by some understanding agreeing to a quid pro quo that makes it an illegal act?

MR. DUGAN: By expressly doing so, that would make it an illegal act, unless clear about whether it would be illegal or implicit.

Remember, the Supreme Court went to great lengths to distinguish that type of quid pro quo.
illegality and other types of corrupt implicit agreements where, again, to use Senator Rudman's words, money affects outcomes, and it was that they were concerned within upholding the constitutionality of McCain-Feingold. But for purposes of what I'm trying get across is, that type of not necessarily illegal corruption does exist. And it's corrupt.

PRESIDENT VEEDEER: But it's not corrupt in seeking to give money to a politician to do something, and when he doesn't do it, to cease giving him money to it him. When I say him, I mean full campaign contributions, irrespective of the donor?

MR. DUGAN: Well, I mean, I think--without an express agreement, the money affects the outcomes, yes, I think that is corrupt, and I think that is exactly what the Supreme Court said. And I think that's exactly what the Solicitor General said.

And the fact that you can't prosecute it criminally because you don't have sufficient evidence of a quid pro quo connection does not mean that it's corrupt. When money affects outcomes, when a legislator favors an interest because he's received a large political contribution--

PRESIDENT VEEDEER: Forgive me, you are moving away from the donor to the donee. Mr. Vind, of this world, who gives political contribution
almost always is intending to affect the result of that politician's future acts?

MR. DUGAN: Right. And if the politician--

PRESIDENT VEEDER: That's the point. At that point, there is nothing morally or legally criminal or corrupt, is there, as regard the donor?

MR. DUGAN: There is certainly nothing criminal about it, but I would submit that's not necessarily true, and I think ADM is a good example. That makes contributions to politics of all parties because it expects that its money would buy it favorable outcomes.

PRESIDENT VEEDER: That point. Both parties, the point made by the Solicitor General is you're buying access.

MR. DUGAN: And not just access. To use the words of Senator Rudman, money affects outcome. It's not just access. It's attempt to influence the outcome of policymaking decisions through the use of money, and I think again the Supreme Court and the Solicitor General, Senator McCain, Senator Rudman quite clearly said that that's what happens. And they think it's corrupt, and they think it should be stopped. And one of the questions for this Tribunal to decide is: Is that unfair and inequitable? And we submit that it is. We think it's arbitrary and its unjust, and if it results in
favoritism for a local industry, then it's prohibited by NAFTA as an improper investment practice.

ARBITRATOR ROWLEY: Mr. Dugan, as I understand your case at this stage, it is that California, as led by Governor Davis, did not act to cure a perceived problem because of the problem but it acted on the basis of Governor Davis' corruption, and the corruption being that he directed to the extent that he was able, California to act with the purpose of benefiting ethanol and with the purpose of disadvantaging foreign methanol producers.

MR. DUGAN: That's correct. And the key to it, we believe, are the decisions that we think show quite clearly that he acted to benefit the U.S. ethanol industry. Now, the third point is, who is receiving the contributions here? It was Gray Davis, Governor Gray Davis. Now, many people in California have labeled him the "coin-operated Governor." That's not Methanex's label. That's California's label. And Governor Davis was the object of a successful recall campaign that was one of the most
humiliating recalls in American political history, and there is evidence in the record that we have supported that one of the key factors in that recall was that perception of corruption, The Sacramento Bee newspaper. Is it simply a coincidence? Many people in California did not believe it was simply a coincidence. They thought that it can certainly be inferred from what happened that they thought that there was too much money affecting outcomes. Again, to use Senator Rudman’s words.

So, Gray Davis is not Mother Teresa. He’s in a different category.

Fourth, at the time of the secret meeting, ADM had not yet decided to support Gray Davis. They hadn’t made up their mind whether to support him, and we get that from Mr. Listenberger’s witness statement. This is paragraph two of Mr. Listenberger’s written witness statement. 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.

PRESIDENT VEEDER: He had already given him three campaign contributions?

MR. DUGAN: Yes, they’d given him minor contributions, but in California contributions of $15,000 are not big money, and I think that shows in terms of what they gave him after the meeting.
where they gave him at least another $150,000 after the meeting. And they were known for being very generous supporters for those whom they supported, and Davis knew that.

PRESIDENT VEEDER: Do we know, does the record show if they supported his opponents?

MR. DUGAN: I don't know whether the record shows that or not. I just don't know.

But in any case, the purpose of the meeting was for ADM to decide whether or not to support Gray Davis. As we now know, they jumped in and they supported him very, very heavily, very, very generously.

Now, fifth, the meeting was secret, and the United States placed up before you and will place it before you again the campaign reporting form in which ADM reported the use of an airplane, and as I think you pointed out, Mr. Veeder, this does not disclose where the plane was flying to or from. It simply says use of an airplane. It doesn't in any way disclose the existence of the secret meeting.

In addition, we have been unable to find any evidence that ADM ever disclosed the value of the dinner itself. In comparison to the next page where you see that Mr. Jack Cox reported dinner costs. We have never seen any dinner costs reported by ADM with respect to the dinner that
they hosted for Gray Davis, which was quite clearly a fundraising dinner.

So, we think the evidence is very compelling that they intended to keep this secret.

PRESIDENT VEEDER: Is there not a minimum cutoff below which you don't have to declare?

MR. DUGAN: That, I don't know, and perhaps that's the reason— I don't know. The cut-off here was $480, so I don't know. Perhaps that is the reason. Above that it's $426. Now, sixth, everyone agrees that ethanol was discussed at the meeting in Illinois. Listenberger agreed to it in his witness statement in paragraph five, in his transcript at page 775, lines two to four. Vind agreed to it in his transcript at 964 and 966.

So, there is no doubt that ethanol was, in fact, discussed at the meeting, and that's evidence of record that can't be denied. In addition, there is testimony that many of the people who were at the meeting were there because they had a connection with ethanol.

ARBITRATOR ROWLEY: Isn't the evidence that's before us benign on that point?

MR. DUGAN: The evidence before you is benign. There is no express evidence that there was any type of agreement and we don't assert that
there is any evidence in the record to that effect, but there is evidence that there were discussions of ethanol and that many of the participants who were at the meeting had fairly clear connections to ethanol, and ethanol only. Mr. Listenberger, for example.

Seventh, after the meeting, ADM did, indeed, decide to support Davis, and they gave him a hundred thousand dollars in 1998, and at least another 50,000 in 1999.

Eighth, other than ADM's obvious desire and Mr. Vind's express desire to expand the use of ethanol in California, there is no apparent link between Davis and ADM. ADM is an Illinois company. It's not a constituent of anyone in California. I don't believe it had any ethanol plants in California.

This was similar to Vind's approaching Torricelli. Vind was a California businessman who approached a New Jersey politician to give him help. It's the same thing here. You've got an Illinois corporation, a MidWest-centered corporation approaching a California corporation seeking help.

Now, did Davis take steps to benefit ethanol? Well, indeed, he did. First of all, he banned MTBE.
Second, and more importantly, he precipitously decided to use ethanol as its replacement. Now, the U.S. doesn't dispute that the evidence shows that Davis ignored all the other potential oxygenates and decided upon ethanol. You saw the list, the EPA list, Caldwell's list. None of those, there is no evidence, not a shred of evidence that Davis considered anything except ethanol.

And the most important step he took when he issued the Executive Order in addition to banning MTBE was to order California to evaluate ethanol as a substitute. That was the only oxygenate that he ordered California to initiate a study of and paid for this type of multimedia study in order to see whether ethanol would be appropriate. None of the other potential oxygenates did he order a similar study of.

**ARBITRATOR ROWLEY:** Can you just help me on this point. I cannot recall the evidence about the UC report.

**MR. DUGAN:** There was, but I think the thrust of the UC report, as I think one of the experts, I think it was Dr. Fogg, testified to was
that they recommended that the oxygenate be removed from RFG completely and that it be replaced with toluene. They did consider the possibility of replacing MTBE with ethanol, but they cautioned very, very strongly that it wouldn't be appropriate until all the adequate studies were done because they were cognizant of the potential impact, the cancer impact, the air quality impact, and the unknown impact on groundwater.

ARBITRATOR ROWLEY: Stopping you there, we have two competing possible theories. One is that after election Davis decides to recommend a ban of MTBE, and its possible replacement with ethanol and orders a study of ethanol, as recommended by the UC report. The other competing theory is that he does so not because of recommendation in the U.S. report, but because of corruption having received the contribution.

How do we balance those two competing theories, one being a corruption theory and the other being a theory as I described following of the UC recommendations?

MR. DUGAN: Again, I think it's a combination of all the facts and circumstances. But I think the first question is why did he select only ethanol? There were many other oxygenates that could have been used, and, in fact, Senate
Bill 521 identified a number of other oxygenates that the UC, University of California was intended to study as possible replacements. But Governor Davis did not order a study of any of them except for ethanol.

The UC-Davis report didn't tell him to only study ethanol, but there was absolutely—there is no evidence in the record as to why Governor Davis selected only ethanol to be studied. And why Governor Davis selected only ethanol to start the process of creating, to continue the process, to jump start the process of creating an in-state California ethanol industry. And that's a critical fact, that he selected ethanol and only ethanol to receive this obvious benefit, and didn't select methanol, didn't select any methanol blend, didn't select TAME or DIPE or any of the others. Not even the ones that the Senate had ordered the UC to evaluate.

Now, with respect to the waiver request, there are, I think, two pieces of evidence that it's important for the Tribunal to focus on. When he made his decision banning ethanol—I mean, banning MTBE and ordering the study of ethanol and ordering steps to be taken to create an in-state
ethanol industry, he also included the waiver request. But I would like to go back to a slide that we put up before because I think there is some focus there, there's some evidence there that the Tribunal should focus on. And this is Tab 9 in the books that you have.

One final aspect of an oxygenate waiver bears emphasis. Even without a waiver of the Federal RFG oxygen mandate, a significant portion of California gasoline would still contain ethanol. There is supposed to be a period there. That emphasis is in the original, but go on to the next phrase: The MathPro analysis indicates that from cost savings perspective, the optimal share of nonoxygenated CaRFG would be less 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.

So, from this, I think the only inference is that Governor Davis intended that oxygenate, that ethanol, as an oxygenate, would receive half the market in California, and I think that was an effort by Governor Davis to split the baby, but I think that Mr. Vind testified with respect to that as well, and corroborated what I speculated on in response to your question, Professor. Mr. Vind testified--Mr. Vind testified--Governor Davis, and I'm going up to the
If Governor Davis banned MTBE, that would expand the use of ethanol, wouldn't it?

That is true.

Did you talk to Governor Davis about that at the meeting?

I did not.

Did you ever talk to him about that?

I only talked to him after the fact, after he was elected Governor, when, at a birthday party held in his honor he came over to me and asked that I intercede with the oil companies and the ethanol producers to try to see if some accommodation could not be reached so that there would not be shortages of gasoline supply in the state of California, which was his fear.

And what did you do? Did you act upon that request?

I, in fact, did. I went to the Secretary of CalEPA, contacted at least one chairman of one major oil company, and I contacted people at ADM and some other suppliers of ethanol to try to see if I couldn't negotiate some type of compromise that would allow for perhaps some type of
shifting where the refiners could, in
fact, comply with Federal law. Federal

law requires the addition of oxygen to
gasoline in nonattainment areas. So,
the refiners in California were concerned
about not so much the use of ethanol, but
whether they had to be refinery-specific
or whether it had to be throughout the
entire state. So, that was the thrust of
my conversations in my meetings.
Now, he dates that as Governor Davis's
birthday after he was elected, and he later said he
was uncertain about the date, and that it was
after, substantially after the time when he was
elected. But I submit that it was on December 26,
which was Governor Davis's birthday, and it was in
the time period between the time Governor Davis was
elected and the time the ban went into place, and
that this request for compromise reflects precisely
what the Governor adopted. He gave half the market
to ethanol and the other half of the market, the
refiners were intended to be able to meet that with
the production of RFG without oxygenates, which is

why he asked for the waiver.
So, I think this is corroborating
testimony of precisely the type of political compromise that politicians often enter into, an allocation of the market to a favored interest without at the same time disrupting the supply economics for the citizens of California.

Now, the next piece of evidence is October of 1999, when Davis tells Congress that ethanol will be the replacement for MTBE, and if we could look at a timeline we prepared, and that is Tab 11, November 3rd, Davis elected Governor. December 26th, the date that we believe Davis and Vind discussed the compromise. January 4th, Pete Wilson, who was an opponent of ethanol, leaves office. Davis is sworn in. March 25th, Davis bans MTBE, asks for the RFG waiver, asks for an ethanol study, and again, a study of ethanol and only ethanol, and attempts to jump start the California ethanol industry. In October of 1999, Kenny of the California Air Resources Board, testifies to the United States Senate on behalf of Governor Davis that after MTBE is eliminated, the only feasible oxygenate will be ethanol.

Well, how did he know that? There had been no evaluation of any other oxygenate. There had been no attempt to evaluate any other oxygenates. This was, quite obviously, a precipitous decision to embrace ethanol without any consideration of the possible advantages of any
other oxygenate.

Now—and this statement was made before the evaluations had been completed. 1999, Cal EPA issues a partial health and environmental assessment of the use of fuel as an oxygenate. February 15th, 2000, Cal EPA issues an addendum to its December 1999 study.

October 2001, Cal EPA issues the final portion of the environmental assessment on the use of ethanol as a fuel oxygenate, the subsurface fate and transport of gasoline containing ethanol. And that's the one that shows that, in fact, ethanol does have a very damaging impact on the water because it increases benzene plumes by up to 150 percent.

But the key here is that you have these series of decisions favoring ethanol and announcing to Congress that ethanol will be the replacement for MTBE before any evaluation has been completed. That, in combination with the fact that only ethanol was selected for evaluation, we submit, is very strong evidence, compelling evidence, of favoritism towards ethanol, favoritism that's not justifiable on any environmental grounds.

Now, thereafter, California took specific steps to accommodate ethanol, steps that it did not take in any way to accommodate methanol or any of the other oxygenates.

Let me back up for a second. Let me go
back to this December 1999 CalEPA study. Again, this was two months after Kenny had announced to Congress that the only feasible oxygenate would be ethanol. In the 1999 study, acknowledged that there were very, very significant gaps in CalEPA's knowledge with respect to what ethanol would do to the environment. And I think it's useful to focus on those gaps in knowledge because they signify that CalEPA was not satisfied that ethanol would be environmentally benign.

As a result of the assessment contained in this volume, we have identified important knowledge gaps regarding the anticipated environmental behavior of gasoline containing ethanol. This Chapter summarizes those knowledge gaps and provides recommendations for future research that would improve decision making regarding the use of ethanol in oxygenated and reformulated gasolines in California. One of the most critical knowledge gaps is the nature of the interaction of groundwater and the air multiphase flow with ethanol containing gasoline in unsaturated zone. Understanding this process is crucial because knowledge gaps about the early states of overall flow and transport make adequate prediction of the
An important impact of ethanol on BTEX contamination is difficult. BTEX stands for benzene, toluene, ethylene, and, I believe, xylene. So, that’s the issue. They didn’t know what was going to happen to benzene.

And then you have on the next page, three more quotes from the 1999 study again identifying very significant gaps in the knowledge with regard to ethanol, and they ordered another study and the final study wasn’t completed until October of 2001, and that’s the next page, chart—Tab 13. Modeling results indicate a possible fourfold decrease in the mean benzene biodegradation rate as a consequence of ethanol biodegradation and associated electron receptor depletion. This could potentially increase benzene plume lengths by a factor of 2.5.

So, once the multimedia evaluation was finished, it turns out that ethanol may not be any better for the water than MTBE. That didn’t stop Governor Davis. He’d long since decided to shift to ethanol prior to the completion of these studies, and long after deciding that only ethanol would be studied.

And if you remember, one of the quotes that we put up, and I don’t have it readily to mind so I’ll just try to draw your attention to it, was a statement from I think either Gordon Schremp or...
Walter Hickcox in which he said that the detects of MTBE are way down, but there is no chance they are going to repeal the ban because there was too much political momentum behind it. And Methanex submits that the political momentum there was that Governor Gray Davis was intent on favoring ethanol. He was intent on ignoring all alternatives to ethanol, and he was intent on doing so until he received some type of devastating criticism after the fact from the environmental evaluators. And all of that shows, again, an intent to favor ethanol.

Now, additional evidence of intent to favor ethanol is how California accommodated ethanol but not methanol. There was testimony from Mr. Fogg, Dr. Fogg, this page 1285, line 4, (reading):

Is it your testimony that the increase in the oxygen capped at 3.7 was not done in part to accommodate the addition of ethanol?

The reason for doing so was to accommodate the ability of refiners to blend ethanol at 10 percent.

Now, would other oxygenate such as methanol have required the same type of accommodation?

Probably so.

I'm going to Burke's testimony. It starts on page 1437, line 18.
You state informal discussions with refiners and suppliers of splash blending systems did not produce a clear answer as to whether methanol can be used in the same systems that have been--that have been installed for methanol splash bending.

That's correct.

So, Burke is testifying that he doesn't know.

PRESIDENT VEEDER: Pausing because we'll have a problem I think, in a month or so. That was page 1347.

MR. DUGAN: I'm sorry. That was page--no, 1437, 1437 starting at line 18, carrying over to 1438, lines one, two, and three.

PRESIDENT VEEDER: I got it. Thanks.

MR. DUGAN: And then at the bottom of 1438, line 20, (reading):

But if the gasoline base stock was adjusted to accommodate methanol's pure effect on the RVP--and this is going over to 1439--the resulting gasoline would not be out of compliance with the RFG provisions; is that correct?

If refiners put in the extra investment and changes needed to make the
more difficult under applying blend stock
that I feel would be needed to blend in
methanol, that's correct. And they could
do it. There is no question about that.
So, the same types of accommodations could
have been made for other oxygenates, but they
weren't. They were made only for ethanol.

ARBITRATOR ROWLEY: Mr. Dugan, you make
your case turn on the contributions that were made
by ADM and the ethanol industry to Mr. Davis. Is
there evidence before us, or do we have knowledge
as to whether methanol producers and/or Methanex
made contributions to Governor Davis or his
predecessor?

(Pause.)

MR. DUGAN: I'm not sure.
I'm not sure. I'm frankly not certain
what the evidence is in the record. I think there
is evidence of one contribution by Methanex that
was rejected because Methanex is a Canadian
corporation, and it's not allowed under U.S.

campaign contribution laws to make contributions.
That contribution was not to Gray Davis. It was
not to Gray Davis or to anyone in California. The
check was--I don't know who it was to. The check
was returned, and Methanex has since adopted a
policy of not making any political contributions.

ARBITRATOR ROWLEY: Could you have one of your assistants just identify in the record what that evidence is so we can turn to it, if necessary.

MR. DUGAN: We'll do so.

ARBITRATOR ROWLEY: Thank you very much.

ARBITRATOR REISMAN: Mr. Dugan, the two corporations in the United States also had a policy of not making contributions?

MR. DUGAN: And actually--probably I should make that clear. Corporations in the United States can't make contributions, either. But corporations--

ARBITRATOR REISMAN: They have no PACs?

MR. DUGAN: I will check that.
MR. DUGAN: Right. And I think that that is a shorthand that many newspapers use. What they're really talking about is that there's something, and I'm speculating, but I know this is done as a matter of course, there is something like an ARCO Political Action Committee, and executives in ARCO make contributions to the Political Action Committee and then the Political Action Committee actually makes contributions to particular--and that's the way it is with ADM as well, so in terms of using that shorthand, when I say that ADM made contributions, I think that those are contributions from an ADM good government fund, or something like that, a Political Action Committee, as opposed from ADM itself, because it is illegal for corporations, as I understand it, to directly make contributions.

PRESIDENT VEEDER: Could you just help us on the pleading references and come back to it later, but it's our recollection that there is in the evidence two attempts by the Methanex U.S. subsidiaries to make political contributions which were returned because of the ownership by the Canadian parent; is that right?

MR. DUGAN: I don't think that is right, but let me check.

(Pause.)

MR. DUGAN: We will look up the cite, but
I'm informed that what happened is that a Methanex entity, whether it was Methanex-US or Mexican Canada is unclear, made a contribution drawn on a Canadian bank, and it was rejected because it was drawn on a Canadian bank. But we are checking to find out exactly what the facts are.

The next point, I think that it's important to consider in this whole evaluation of the facts and circumstances surrounding it is that the question of whether ADM did, in fact, benefit from the shift to ethanol, and I think the evidence is undisputed that it did.

Tab 16, in 2002, as it was starting to kick in, ADM clearly benefited—quote, We, ADM have reason to believe there is a very strong demand for ethanol, and we're in a strong position in the ethanol business.

Now, in addition to that, Mr. Listenberger, in his testimony acknowledged that ADM had benefitted, and this is from page 878 and 879, starting on line 20, (reading):

Will you admit that ADM's ethanol—you admit today as you sit here six years after having Gray Davis and five years after the MTBE ban that ADM's sales
of ethanol increased after that ban?
Yes, they did.
Mr. Listenberger further admitted--and
this is on page 876, (reading):
You would agree that the ban was good
for ADM's sales, wouldn't you?
It had the potential to be very good
for ethanol sales over the entire
industry, yes. In fact, ADM celebrated
this ban, didn't they?
I thought it was a good idea, so, by
thinking it was a good idea, you
celebrated, didn't you?
I suppose in our own way.
So, the evidence that ADM has benefited
and, in fact, celebrated when the ban was enacted,
I think, is irrefutable. This was very good for
ADM

Now, Methanex submits that once you accept
the premise that there are instances of political
corruption in the United States, where again to use
Senator Rudman's words, money affects outcomes,
that the evidence that I have just gone through,
the 11 factors, all points to that conclusion here.
This was an instance where ADM's money obtained
favoritism for ethanol in California just as, to
use Senator McCain's words, ADM traded its
political contributions for the political tax
credits.
This is very similar, identical in technique to that. That's what we believe the evidence shows.

And we don't think that is merely a prima facie case. We think that barring any rebuttal evidence, this is a conclusive case. Again, once you accept this premise that this type of corruption exists, this fits that pattern to a T. Why else would Gray Davis select ethanol and only ethanol for evaluation? Why else would Gray Davis announce that ethanol was the only feasible substitute when no one in California had bothered to evaluate anything else. Why else would they focus on ethanol and only ethanol as the possible replacement for MTBE?

The only possible reason that we could think of is because Gray Davis was doing his best to favor an interest that had contributed heavily to him.

Now, what's the evidence rebutting the conclusion that there was some type of implicit accommodation at the meeting? And again, go back to the circumstances of the meeting. Prior to the meeting, ADM had not decided whether to support it. After the meeting, he decided to support him—decided to support him quite heavily. The evidence from Listenberger, Vind, and Weinstein are neutral with respect to what
happened. Yes, there was some discussion of ethanol, but no discussion of MTBE or methanol. But it's important that each one admitted that ethanol was discussed and, more importantly, each one admitted that they didn't hear all the conversations that took place that night. Weinstein admitted it. Transcript 837, 16 to 20, 839, 17 to 840, 1. That was Weinstein, Listenberger admitted it, transcript 851, lines four to six, and Vind admitted it transcript 964, 1 through 10. Now, that brings up the question, one of the critical evidence questions in here: Why are Listenberger and Weinstein here testifying as to what happened at the meeting? Well, here is what Weinstein said. This is at page 847, (reading):

Well, do you honestly know why you're here? You are the witness for the United States rather than Alan Andreas?
I have no idea.

Do you know honestly why you are the witness for the United States rather than Marty Andreas?
I have no idea.

Again, what did Listenberger say? This is
And then it's August 17, 1998, less than two weeks later that Mr. Davis received a contribution of $100,000 from ADM; is that correct?

I have no idea.

If it were true, that would indicate that ADM assessed the candidacy of Mr. Davis and decided to support his candidacy; isn't that correct?

Again, I would have no involvement in that type of decision. I don't know.

So, what you have here is a classic case of empty chairs. Where is Governor Davis? He wasn't interested in coming. Where are the Andreases? They're not here. We tried to get them here. We weren't allowed to. We submit that there is no evidence rebutting the fact that there was an implicit agreement reached at that meeting that caused ADM to decide to support Governor Davis.

And the implicit agreement was reached that they would support him and he would expand the use of ethanol, and there is no evidence rebutting that. In fact, we will go one step further. The fact that this chair is empty, the fact that the Andreases are not here, the inference to be drawn from that is that were they here, they would confirm this story. That's the only inference you can take from the fact that they refused to come.
and that the United States has blocked our attempts
to get that evidence.

So what you have is a series of events,
pieces of evidence, the totality of the facts and
circumstances that point to the fact that this is,
indeed, one of those cases where that type of
corruption take place, and no evidence rebutting it
whatsoever.

Now, the U.S. has raised the question of ARCO. ARCO, we submit, is in a much different
situation. ARCO doesn't exist because there is a
Federal tax subsidy that keeps it alive. It exists

because there is a legitimate economic need for
gasoline and refinery. That's not the case for
ethanol.

Second, ARCO was a California constituent
that had refineries in California and had a
legitimate interest in meeting with Davis.

Third, ARCO is not ADM. ARCO does not
have ADM's notorious history of seeking out, for
example, the tax credits for ethanol. ARCO is not
ADM and it doesn't play the same role in the
political process that ADM does.

Fourth, ARCO's meeting was not secret. I
believe, and we weren't able to find this, but I
believe that there was a public report of the
refinery tour that Governor Davis or his
representative took.
And all those--all those facts, we think, point to a much different situation between ARCO and ADM. ARCO is not ADM. ARCO may not--well, ARCO isn't ADM and the fact that it didn't get anything in response for--in return for its contributions, ARCO has many, many different interests in California. It's a constituent in California. ADM is not. The totality of the facts and circumstances, once again, once you accept the premise, the Supreme Court's premise and Senator Rudman's premise that there are times when money affects outcomes, this was one of those times.

Now, with respect to 1102 there are other requirements that have to be met with. The first one of those is like circumstances. And here again, it would be useful to know what the negotiating history is with respect to like circumstances. We don't know. We have one phrase, unexplicated as to which the parties differed greatly. It would be useful to know what the negotiating texts, what the various drafts said about this.

Now, I think there are three aspects of the like circumstances test that are worth responding to. First, I don't think there is any longer any doubt that both methanol and ethanol
compete in a single unified market, and I think that the United States's economic expert, Mr. Burke, confirmed that. And this is quoting from page 1448, line two. I'm sorry, it's Tab 19. Was it your testimony that the gasoline supply chain is a continuous cycle rather than divided among refiners and blenders?

Yes, it's a continuous supply chain. So, the evidence supports the chart that we put up on the day that we opened in which we showed that both ethanol and methanol are oxygenates used in the production of RFG. They're used at different points in this continuous cycle, but the cycle should be viewed in the words of Mr. Burke himself as a continuous supply chain. And the fact that the oxygenates are used at different points in this RFG production process is simply not relevant.

ARBITRATOR REISMAN: Excuse me, I think the record shows Mr. Burke then said that is not correct. I'm looking at line--

MR. DUGAN: He went on to say that it's irrelevant--what I'm pointing at, I think what he contested was the fact that it's irrelevant where the oxygenate is inserted into the production process, but he agreed that it's one continuous supply cycle.
Now, second, there has been a lot of back and forth over the U.S. like products test. And the U.S. asserts that methanol and ethanol are not like products using the GATT/WTO test. But we believe the evidence shows that's simply not true. Both of them are alcohols. Both of them are oxygenates and both of them are used in the production of RFG as oxygenates. They are the two chemicals that produce the oxygenate in RFG or oxygenated gasoline.

In addition, both can be made for the same proposes. If you recall the testimony about pig manure. Both could be made from the same basic processes, and that's another thing that supports the fact that they are like products.

In terms of end uses, as we've tried to show, their end use in the context of this case is identical. Both are used for precisely the same purpose because they provide the oxygenate needed in RFG. The fact that they're used at different portions of the production process is wholly irrelevant.

Now, furthermore, in terms of the end uses what we tried to show is that the integrated companies have a binary choice. They can choose ethanol or they could choose methanol. So the end use of the products is similar or not precisely identical, but it does exist in the context of this
binary choice. In fact, going back to the
California regulation, the one that now bans
methanol by name, it identifies it as an oxygenate;
and, by implication, it identifies it as a
competing oxygenate, and that's why it banned it by
name, is because it's precisely the type of
oxygenate that could take the place of ethanol.

MR. LEGUM Mr. President, before we move
ton to a different subject, I would just like to
note our objection to the reference to the pig
manure. That was not offered as a part of
Methanex's case-in-chief, and I don't believe that
there is any competent evidence on that subject in
any event.

PRESIDENT VEEDER: Is there any evidence
on this pig manure, Mr. Dugan?

MR. DUGAN: I'm sorry, I thought that was
part of the record. Perhaps I'm mistaken.

PRESIDENT VEEDER: We had something about
digested pig manure. Is this the same point?

MR. DUGAN: This is the same point, yes.

PRESIDENT VEEDER: I'm not sure that's in
the evidence. I think it was a question put to the
witness.

MR. DUGAN: Okay. Then I'll withdraw it.

PRESIDENT VEEDER: Please don't take it
from me. If there is any evidence, I would like
you to identify it to us, but come back on it later
1 if you'd like.
2 I can also say that we have to give our
3 shorthand writer a break within the next ten
4 minutes or so, so when you come to a natural break,
5 Mr. Dugan, we could take another short break.
6 MR. DUGAN: This is actually a good point
7 to take a break.
8 PRESIDENT VEEDER: Let's take a 10-minute
9 break.
10 (Brief recess.)
11 PRESIDENT VEEDER: Let's resume.
12 MR. DUGAN: Thank you.
13 The next point I would like to go to, the
14 next chart I'd like to go is our binary choice
15 chart, and this is an extrapolation of the chart we
16 put in in the opening, and I will point out that
17 the last cite that Chairman Key's prepared witness
18 testimony to the Committee on Government Reform is
19 not actually part of the record. If the U.S. wants
20 to object, it's all available at the CEC Web site,
21 and it was used strictly to project the amount of

1 ethanol--I mean the amount of ethanol that will be
2 consumed in the future. And this just illustrates
3 that in terms of--they are competing uses, that
4 there is a binary choice and the long-term effect
5 of what will have happened is that ethanol will
replace methanol completely in terms of the alcohols that are used as oxygenates in California in the manufacture of RFG.

Now, turning to the next prong of the like-products test, consumer preferences, the consumer preferences analysis which was used in asbestos, does not support the United States here. But before we get into it, I think it's appropriate to point out that most WTO cases use the--do not analyze the question of an environmental justification in the context of consumer preferences or likeness. That's usually done at the stage after it's been established that there are like products and there is a denial of national treatment. At that point it then becomes the burden of the respondent state to justify the

purported environmental justification for a measure. And we think that's the appropriate way for this Tribunal to view it procedurally as well, to place the burden on the United States Government to justify the ban of methanol and, more importantly, the shift to ethanol as a responsible environmental measure.

But taking the consumer preference test at face value, the first point to be made here is that--and the consumer preferences comes out of the asbestos case, but the first point to be made here is that the consumers here are not consumers of
gasoline. They're not families that buy from gas pumps. The consumers here of these oxygenates, these competing oxygenates, are the integrated oil companies and the gasoline blenders, the ones who switched from methanol to ethanol or from MTBE to ethanol. Those are the consumers, not individual drivers.

And it's quite clear that their preference prior to the mandated ban was for MTBE and for methanol, respectively. Those were their oxygenates of preference. They dominated the market, and they dominated the market for a number of well-known reasons. So, if consumer preferences are to be important, they showed no preference for ethanol whatsoever.

Now, even if it were appropriate at this stage of the analysis to factor in the environmental and the health factors, again that doesn't help the United States. It hurts the United States, especially at the time that the ban was implemented and the shift to ethanol was made.

Now, recall that in the asbestos case, the competing products were different types of asbestos, one of which was far more benign than the others, think it's called crysolite (sic). So, there was a very clear difference between the two categories of asbestos in that case. The case here is that especially in 1999, it was well-known that ethanol far more dangerous to the environment and...
to health than methanol was. That didn't stop

Let's start with--go to the evidence. What was the evidence? What was known about ethanol's effect at the time that the shift was made? Well, and we put this up before. Under Pete Wilson, Governor Davis's predecessor, California had objected to the use of ethanol, and they'd objected to it on health and environmental grounds. The first one, again, was the veto message that Governor Wilson sent to the California Legislature when he vetoed a previous attempt to benefit ethanol. And one of the reasons why he vetoed it is that the last phrase of his veto statement, "especially when the consequences will foul our air." He was talking about ethanol.

Prior to that, when the EPA had attempted to implement a 30 percent set aside for ethanol, California had sued, and again he had sued on the grounds that the ethanol mandate would result in irreparable injury to the health and welfare of California citizens and to the environment.

So, prior to this ban and shift to ethanol, California did not believe that ethanol was a better product. In fact, they thought it was
quite clearly a worse product.

Now, similarly, even at the time when Davis made the shift to ethanol, the record in the case showed that ethanol could have some very, very damaging consequences, and what we have plucked out for you is the portion of the California report. This is the UC-Davis report itself that identifies the cancer risks of increased ethanol. And if you look at the third column, it says acetaldehyde, and footnote three, footnote three if you go to the next page refers to due to ethanol.

And if you go all the way to the bottom of page eight of Tab 22, you will see the reference that we have used repeatedly. Statewide change in cancer cases, acetaldehyde due to ethanol 38 to 2,800 additional statewide cases of cancer. That's what the UC-Davis report identified as the carcinogenic impact of switching to ethanol at this time.

And when Davis decided to evaluate only ethanol and when he decided in October of 1999 that ethanol was the only feasible alternative, this was the operative science, up to 2,800 additional cases of cancer. And the citation to that, that's 40 JS tab G is the original record for that. Similarly, we also put up before the slide from the October 2001 report that showed that shifting to ethanol is going to substantially
increase the benzene risk, the risk of benzene contamination. So, I don't think it can ever be reasonable be said, especially in 1999, the time that the shift was made, that methanol---that MTBE was a more dangerous product than ethanol. The cancer risk alone defies that conclusion.

Now, the third point about like circumstances that I think is useful to evaluate are the Pope and Talbot and the Feldman cases. We don't read them the same way as the United States does, not surprisingly. But we think in Feldman that there wasn't any evidence in Feldman that the Mexican cigarette manufacturers were competing with the cigarette resellers. There was an absence of evidence to that effect. And in Pope and Talbot, the competitive circumstances between Pope and Talbot's Canadian subsidiary and lumber companies in the other provinces was much different competitively because Pope and Talbot was in one of the provinces that was subject to a countervailing duty which triggered the whole quota system and the other one wasn't. So the nature of the competition, if it existed at all, was much, much different, and for that reason, we don't think that the two cases serve as a useful precedent.

I'm sorry, the previous citation to the cancer chart I'm told is five JS tab 40 G.

Now, if under Methanex's analysis it---methanol and ethanol are in like circumstances,
then I think it's quite clear that methanol didn't receive the same treatment as ethanol, and I won't go over that again. It has lost its California market. It's not entitled to sell ethanol as an oxygenate to RFG producers. And I think at this stage the burden shifts to the United States to justify the ban on MTBE and the precipitous shift to ethanol as a serious and valid environmental measures, and I don't think they can do that. We have just gone through some of the cancer issues. We have just gone through some of the water treatment issues, of the finding by California itself that the use of ethanol poses a very serious benzene risk to the drinking water of California, which is itself already a more serious risk than even by in the words of the United States's own expert, benzene is more serious risk than MTBE, and shifting to ethanol will only increase that risks.

But in addition to those, what is the other scientific evidence? We've put a lot in and there is a lot there, and I would like to pluck out a few highlights of the scientific evidence. First of all, was MTBE a good product? And this is just going to Dr. Fogg's testimony, page 1274, line 14.
And while, line 18, (reading):

While MTBE was the oxygenate of choice in 1996, the Phase II program reduced emissions of hydrocarbons by 17 percent; correct?

That is correct. And it reduced the emissions of oxides of nitrogen by 11 percent; correct?

That is correct. And during that same time period in 1996 when MTBE was the oxygenate of choice, carbon monoxide emissions were reduced by 11 percent; is that correct?

That is correct. And during the same time period sulfur oxides were reduced by 80 percent; is that correct?

That is correct."

I'm sorry, that was Simeroth, not Fogg.

Again, pages 274 and 1275. So, I think it's--and that's the United States's own expert.

It's absolutely unquestioned that methanol--that MTBE was a very effective pollution reducer.

Now, with respect to one of the critical scientific issues, I'd like to read from the Exponent report that's at 12 A, JS Tab C. And the summary there I think is the most important aspect
of it. In summary, the UC report significantly miscalculated the then-current impacts of drinking water sources and their prediction of substantially increased incidence and levels of MTBE detected in drinking water sources over time has not materialized. And we haven't put it back up again, but just recall that when Governor Davis extended the time period for the total ban on MTBE, in his Executive Order, he himself said that the detections of MTBE had decreased substantially. I think Walter Hickox and Gordon Schremp also stated that the detections of MTBE had decreased tremendously.

So in California's own words, the words of their own officials validate what Dr. Williams has said. During the period between 1999 and the time when the ban went into effect, MTBE detects in drinking water dropped tremendously or substantially.

She goes to state, (reading):

On the contrary, the incidents of MTBE in drinking water sources statewide was relatively low in 1998 and has not increased over time. The importance of this inaccurate assessment cannot be overstated because in the absence of adverse ecological effects, it appears to have been the sole basis for the Governor's finding of a significant risk.
to the environment.

Now, you heard from Dr. Happel, and she came in and she talked about 10,000 points of water polluted by MTBE. And I think that's telling because that's an example of the type of gross exaggeration that has accompanied this whole debate.

And I'm turning to page 1163, line 11, of Happel's testimony, and in her answer, (reading):

I'm looking to say in your database that the State Water Board--how many of the leaking tank sites that have been tested for MTBE have found MTBE in groundwater pollution in the groundwater? And the answer is 10,000.

And the question:

When you talk about groundwater pollution you're not looking at the MCL level; correct?

No, this is anything above one part per billion.

So it's any detect; correct?

Yes.

So, again, this 10,000 is based upon detects, most of which, the majority of which were of no concern to anyone. They are below the MCL.
for esthetic threshold and they're below the MCL for health. Nonetheless, it was the figure that was bandied about, and it did create an awful lot of hysteria.

Dr. Happel also admitted, and this is page 1260 line 20, (reading):

So, if you use the detect frequency method rather than the cumulative detect method, your charts would look different today, wouldn't they?"

She conceded that the charts would look different.

Testimony went on, page 1263, line 20, (reading):

In your conclusion, the 3 percent of the sources that you study were contaminated by MTBE; is that a correct statement of your findings?

No, we estimated the number of public supply wells that may have been contaminated using inadequate data. We came up with a range of .3. I think that's meant to be 1.2 percent of supply wells.

So, even by Dr. Happel's own admission with respect to drinking water sources, it was a very, very small percentage.
And similarly, no one now disputes that,
as we said in the opening, the UC-Davis study
bungled the estimate of the cost of cleanup.
Whitelaw himself candidly admitted that. And going
to page 1527, (reading):

QUESTION: Let me return to your
analysis of the UC report and the errors
you attribute to it. On page three of
your original report you concede that the
authors of the UC report erred by
including so-called sunk costs in the
water quality analysis; correct?
I concede?
You contend.
I observed. Everyone else had

observed that before I got the report.
Well, not everybody, but I mean a number
of people.
So, it was a blatant and serious error.
And finally, with respect to I think one
of the most important questions, was this the most
suitable choice for California to make, again,
recall that the language of SB521 required Governor
Davis to take appropriate choice. Didn't tell him
didn't require him to ban MTBE. And the fact that
it contemplated MTBE ban as a possibility in no way
means as a matter of legislative intent that he was
required to ban MTBE.

Now, the United States tries to make it
That's wrong. It wasn't the only realistic choice, and he was under no requirement whatsoever to ban the MTBE, and he certainly wasn't under any requirement to substitute ethanol without having adequately studied it, which is what he did. But going back to the testimony with respect to a more suitable measure, more appropriate action to protect the environment, Dr. Fogg admitted that banning the two-stroke engine would solve the problem--

ARBITRATOR ROWLEY: Could I just ask you a question here. I think you said that Governor Davis banned the use of MTBE before completing the study of ethanol.

MR. DUGAN: No. What I meant to say was--if I said that, I misspoke. What I have been trying to say is that Governor Davis decided to substitute ethanol as the replacement for MTBE before California had completed not only the evaluation of ethanol, but any comparative evaluation of any other oxygenates. That's the critical decision that he made. That's the second critical decision he made was to select ethanol and to select it on a final basis, which is what he told Congress, before the ethanol-specific evaluation had been completed.

But more importantly, to select ethanol as
the only oxygenate to evaluate. And to ignore all
the other potential oxygenate competitors. That's
the important part of the process, the two-step
process, first ban MTBE; second, select ethanol
preferentially over all its competitors.
Does that answer the question?
Now, turning to Fogg's testimony, this is
page 1265, line 16, (reading):
And you would agree that by
preventing the use of a two-stroke engine,
you're preventing the release of gasoline
from the two-stroke engine into the lake?
You are taking the source of MTBE out of
the water body?
Yes.
So, Dr. Fogg agreed that that was an
appropriate solution for solving the surface water
problem and that, in fact, was the solution that
was adopted.
Similarly, Dr. Happel, page 1202,
(reading):

So, banning MTBE doesn't stop
gasoline release into the groundwater; is
that correct?
Banning MTBE does not affect the
ability of the UST tank, the underground storage tank, to prevent releases.

Dr. Happel, page 1196, line three:

And you would agree that if less gasoline is released into those groundwater sources, that would be less contamination of any kind; is that correct?

Yes.

Now, at the hearings that took place after the report was issued, there was a particularly eloquent statement from one of California's water officials, and this is found at Tab 26, and this is a statement from Bill Robinson, the Director of the Upper San Gabriel Water District Division Number Four. He testified that, quote, The ancient Egyptians had the technology to preserve corpses for thousands of years, and our state Legislature can't give us underground storage tanks that don't leak. That's the solution to the problem. If the Legislature will fund that, the underground storage tank program, they can avoid billions of dollars in cleanup costs. Just avoid the costs. It's a no-brainer decision to make.

That was a California water official who repeated what Methanex believes is the obvious conclusion that should have been reached.

PRESIDENT VEEDE: Can you just give us the reference in the exhibit bundles?

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MR. DUGAN: We'll find it and cross-reference it to the exhibit bundles. So, we think that reviewing the whole national treatment issue, the four points, first of all, we think it's especially because of the competitive relationship between ethanol and methanol that they are, indeed, in like circumstances. Secondly, that methanol does not receive the same competitive opportunities that ethanol does because it can't sell methanol as an oxygenate in California to RFG manufacturers.

And third, that the U.S. cannot justify both the MTBE ban and the shift to ethanol on an environmental basis. The record to do that simply isn't there, especially the shift to ethanol. It can't be justified as an environmental measure. Now, with respect to our allegations of corruption, that is not necessary to prove an 1102 violation. We have offered that evidence because we believe that that conclusively explains why 1102 was violated. It explains why Governor Davis took the acts that he did, but that proof is not necessary. All we have to prove is like circumstances, disparate treatment, and that the United States cannot meet its burden to justify the ban and the shift to ethanol as an environmentally sound measure.
Once we prove those three things, Methanex believes it has proved a violation of 1102, regardless of whether the Tribunal was satisfied that it was done for corrupt purposes.

Now, the cross-reference citation for the Egyptian mummy quote that I just read you is 11 JS Tab 2 01.

Now, turning to Article 1105, fair and equitable treatment, Methanex proffered Professor Crawford’s synthesis of fair and equitable treatment because Methanex submits that this is compelling evidence of the present state of customary international law of fair and equitable treatment. It’s what the customary law is now. The waste management decision came after the FTC alleged interpretation of 1105, and it took that into account. It factored that into account.

Professor Crawford noted that customary international law is an evolving standard. He noted that the parties, the NAFTA parties had agreed that is an evolving standard, and taking into account all the developments in development of the concept of fair and equitable treatment, this was how he had--this was how he did articulate the present content of the fair and equitable standard,
and we believe that this is as concise and as persuasive an articulation of that standard as exists anywhere.

ARBITRATOR REISMAN: The reference in Professor Crawford's statement or award to discriminatory treatment is what equalizes, that makes the evidence that you marshalled with respect to 1102 relevant to 1105.

MR. DUGAN: That's one of the headings, not the only heading, and I will get to that, if I can.

ARBITRATOR REISMAN: But that is why the evidence that you marshalled of 1102 is relevant to 1105? There may be other evidence?

MR. DUGAN: Yes, with the same evidence that I think supports 1102 supports a violation under 1105, a number of different headings, one of which is discrimination.

But turning to exactly what Professor Crawford said, he refers to conduct that is arbitrary, grossly unfair, unjust, or idiosyncratic. And we submit that what happened in California was precisely that, that whenever a political official implicit return for political contributions favors one competitor and shuts another competitor out of the market, that that's arbitrary, it's grossly unfair, it's unjust, and it's idiosyncratic because it's a policy decision that's made not on the merits of the underlying
situation, but because of a desire to favor one particular interest, an interest that had contributed to that person. Similarly, it's discriminatory for the reasons that we just talked about.

Now, the United States has said there is no general rule against discrimination. I submit that the way that Professor Crawford has articulated the current state of the law, with respect to fair and equitable treatment that some forms of discrimination are, indeed, illegal under international law. They are unfair, and they are inequitable. And we further submit that the type of discrimination that Methanex faced in California at the hands of Gray Davis is precisely that type of discrimination that is illegal under the fair and equitable treatment standards.

ARBITRATOR REISMAN: You stated some forms of discrimination are violations of international law. You mean violations of customary international law?

MR. DUGAN: Violations of the fair and equitable standard that is included as an express textual pretension in Article 1105.

ARBITRATOR REISMAN: Let me make sure I understand. 1105, this interpretation liberates 1105 from customary international law. Just look at the words fair and equitable. And you derive
from it that discrimination would be a violation of fair and equitable treatment. It doesn't take you back to customary international law.

MR. DUGAN: I think it may take you back to customary international law. I'm not quite sure how Professor Crawford articulated the link between this articulation and customary international law and whether he fully accepted the FTC interpretation that it was wholly dependent on customary international law.

ARBITRATOR REISMAN: It's your position that a state may not discriminate between national and aliens under customary international law?

MR. DUGAN: It's certainly our position that a state may not discriminate on the facts of this case between an alien and a domestic interest because of political contributions, that that is a violation.

ARBITRATOR REISMAN: I don't think that addresses the problem the Tribunal had with 1105. First, does--if 1105 incorporates customary international law, does customary international law prohibit a state from treating aliens and its own nationals differently?

MR. DUGAN: I think it depends on the
circumstances. I don't think that there is a
blanket prohibition, and I think again, in some
circumstances, it does prohibit it.

ARBTRATOR REISMAN: Can you give us
authority for, international authority for
circumstances in which it has been held that
customary international law prohibits differential
treatment?

MR. DUGAN: No, I can't, not offhand, but
I mean in terms of authority that customary
international law prohibits discriminatory
treatment, I think this is evidence of it, the fact
that it is articulated, as including discrimination
is itself evidence, that international--customary
international law, as it has now developed,
prohibits some types of discrimination. There is
no attempt by Professor Crawford to detail
precisely what types of discrimination, but I think
this does recognize that some discrimination is,
indeed, a violation of 1105 under the customary
international law rubric of it.

Does that answer your question?

ARBTRATOR REISMAN: I'm not sure, but I
appreciate your response.

MR. DUGAN: Now, the other two principles
that I think are articulated here are the complete
lack of transparency and candor in an
administrative process. And I think that that's
precisely what was violated here as well. I think
that Governor Davis's shift is his ban on methanol and his unjustified shift—his ban on MTBE and his unjustified shift to ethanol were the result of a completely nontransparent process, that they were motivated by attempts to favor the interests of political contributors, that there was no candid disclosure of why the shift was being made, especially the shift to ethanol, the precipitous shift to ethanol, that these are the same types of government dealings that were called into question in Metalclad, for example, the one that required, that found the transparency was one of the most important or was an important objective of NAFTA, and I think that the same issues are in play here. If, as we assert, what was going on behind the scenes was an attempt by Davis to favor one of the groups that had supported him then that type of background undisclosed favoritism violates the principles of transparency and candor that Professor Crawford has identified here as being part of the fair and equitable standard.

ARBITRATOR REISMAN: I would like to understand the quotation from waste management, since it is being presented now as in effect the only authority we have for the proposition that you're making.

MR. DUGAN: I'm sorry, for which proposition precisely?
The proposition that discrimination between an alien and a national is a violation of customary international law or at least 1105. I just want to go back, since we're looking at that, Professor Crawford lists all of those things and then says and exposes the claimant to sectional or racial prejudice, and that's cumulative. Does he mean--I'm asking you. I don't know. You're citing the case to us. Does that mean that he is suggesting that this list of horrors, arbitrary, grossly unfair and so on, must accumulate with the additional factor that it exposes the claimant to sectional or racial prejudice, or do they stand alone?

MR. DUGAN: I think they stand alone, and I think that he didn't use a comma between "discriminatory" and "and," as is often the case, but I think there is a comma implied there, and I think each one of these is a separate heading, a separate principle. Take, for example, grossly unfair. I think to a degree that concept—that encompasses the concepts of natural justice, I mean of denial of justice, although I see that's also mentioned below, but I think if there were a showing that a particular situation, a particular outcome at hands of a government were grossly unfair, that that, in and of itself, would be
enough to sustain a violation of the requirement of fair and equitable treatment, even if it didn't culminate in an episode of sectional or racial prejudice.

So, I think it is quite clearly from the way it's expressed a stand-alone principle, not tied to the last segment.

Now, one last point. This 1105 claim is independent of the 1102 claim. It doesn't require a showing of like circumstances, and it doesn't require a showing of disparate treatment. If under Professor Crawford's analysis Methanex can show that Davis's switch to ethanol was arbitrary and grossly unjust, there is no need to meet the requirements of Article 1102.

Now, with respect to Article 1110, Methanex does, indeed, have a very serious 1110 claim. That was its original claim, and it's always maintained that claim. Methanex alleges that California expropriated Methanex's California market share, its customers in California, which

substantially interferes with its ability to do business in California and interferes with its expectations of what it was going to be able to do in California. And I don't have it as a chart, but I would like read to you what I think is the test for an expropriation that was articulated in the
Metalclad case. Expropriation of NAFTA includes not only open, deliberate, and acknowledged takings of properties, such as outright seizure or formal or obligatory transfer of title in favor of the host state, but also covert or incidental interference with the use of property which has the effect of depriving the owner in whole or in significant part of the use or reasonably to be expected economic benefit of property, even if not necessarily to the obvious benefit of the host state. That's the Metalclad standard. And we think that's applicable here precisely, that what California did was it took Methanex's California market share, the sales that it had been making to the refiners such as Chevron, and Tosco and Valero, and it interfered with Methanex's ability to do business in that market, and it gave that market share to the U.S. ethanol industry, and that is a significant deprivation of Methanex's market share in the United States. It's a complete deprivation of Methanex's market in California, and that was not a reasonably to be expected outcome. Methanex could not expect that California would precipitously and without any environmental justification shift to ethanol. And as a consequence, that seizure of its market in California and turning it over to the U.S. ethanol industry meets the criteria of an uncompensated and
in fact illegal expropriation in California.

Now, I won't go over what we've already put in the record about market share, customer base, and goodwill being precisely the types of intangible property that's protected by Article 1139 of NAFTA. We'll rest on the record with respect to that.

Now, I would like to turn now to the

question of the intent to harm foreign methanol producers and how that intent should be inferred from the evidence in the record, the inferences that should be drawn.

Methanex believed that the test articulated by the Tribunal in the Partial Award is met here. The Tribunal can infer an intent to harm based on two legal principles, two very well developed legal principles. The first is the principle of foreseeability. It's a well established principle of law that an actor intends the reasonably foreseeable consequences of his actions.

Second, where two entities compete directly for the same thing, in the same market, an intent to harm one is the same as an intent to harm the other. And because we believe we have shown—I'm sorry, if I mangled it, I think you understand what I'm saying, that an intent to benefit one is an intent to harm the other.

I think we've shown that methanol competes
directly with ethanol for the same market, the market being the use of oxygenates in the production of RFG in California. And if that's the case, if there is this direct competitive link, then any attempt to benefit one, by definition, by legal operation, harms the other. It has to, because there is no other consequence that can result from that.

Now, turning to the first principle, foreseeability, as I said, I think it's a standard principle of law in all municipal systems and in international law as well, that intent to cause harm will inferred where that harm is natural, probable, and the foreseeable consequence of taking a particular action.

We have a quote from Prosser and Keeton on torts that very concisely sums it up. Where the known danger ceases to be only a foreseeable risk and becomes in the mind of the actor a substantial certainty, the actor is presumed to cause the dangerous result. The restatement second of torts.
knows that the consequences are certain or
substantially certain to result from his act and
still goes ahead, he is treated by the law as if he
had, in fact, desired to produce the result.

Now, in terms of the damage to Methanex,
the question of whether the damage is foreseeable,
I think, cannot be disputed. And we have included
here a slide that the United States, from the
United States's own EPA report in 1993, in which it
not only recognized the harm to foreign methanol
producers was foreseeable, it actually foresaw the
harm that a set aside for ethanol would inflict on
foreign methanol producers. Again, the primary
impacts of this proposal include, and I'm skipping,
the impacts on the various oxygenate and fuel
industries affected. And it goes to say, and I'm
selectively quoting here, the revenues and net
incomes both corn farmers and ethanol producers
should rise significantly due to higher corn and
ethanol demand in prices, respectively. Revenues
and net incomes of domestic methanol producers and
overseas producers of both methanol and MTBE would
likely decrease due to reduced demand in prices.

Now, again--

ARBITRATOR ROWLEY: Can you remind me of
the date of this quotation.

MR. DUGAN: The date of that quotation is
in 1993. But again, the mechanics--
ARBITRATOR ROWLEY: And can you help with the fact that it is five years before, or six or seven years before the measures in question?

MR. DUGAN: It was, indeed, before that, but I think that the fact it was before that is irrelevant because the market dynamics did not change, and it was foreseeable and, indeed, foreseen, that a shift of 30 percent of the market to ethanol would have a primary impact on foreign methanol producers. For the same reasons that the United States could foresee that shift in 1993, it was foreseeable in 1999 that the ban on MTBE and the precipitous shift to ethanol would have precisely the same easily foreseen impact on foreign methanol producers. It was foreseeable, and because it was foreseeable, it's entirely appropriate for the Tribunal to infer that it was intended.

ARBITRATOR REISMAN: I just want to understand that. It seems rather sweeping to say that foreseeability in the determination of the aggregate consequences of the public policy are deemed to be intent. Under the interpretation that you're proposing, the last sentence of this excerpt, oil refiners could experience transition costs due to an intentional--additional requirement, also requires us to assume there was an intention to create higher transitional costs for oil refiners, which would also be actionable.
MR. DUGAN: I'm not sure it would be actionable, but if I could just--

ARBITRATOR REISMAN: But you would still say that this is deemed to be intent because the public policy analysis indicated the aggregate consequences.

MR. DUGAN: Well, I mean, I think you could restrict it to the particular facts of this case. The Tribunal has posited a very specific test, a very specific intent to harm case under what it believe to be the facts of the case when it issued the Partial Award. As I said, we believe the facts are different, but I think you can confine it to the particular facts of this case. There is no general liability for acts which result in consequences that are foreseeable under either international law or U.S. regulatory law as far as I know.

The fact that a particular consequence can be understood as having been intended because it was foreseeable does not create a cause of action under U.S. law that I know of. But I think that for purposes of analyzing this case, where the Tribunal has said that inferences are, indeed, permissible, that this is a permissible inference.
and, in fact, I think it's impossible to deny that this is a permissible inference when the common law is so clear that it is, indeed, a permissible inference, and because where the evidence I believe is so clear it was foreseeable and indeed foreseen by the United States.

Now, in addition, the second piece of very important evidence about the foreseeability of the harm to Methanex, I think, is the statement by Senator John Burton. The two statements by Senator John Burton.

PRESIDENT VEEDER: Before you go to that, a silly point on the wording of this document. Rely upon this as formal admission, binding on the United States regardless of the evidence. That's your primary purpose in referring to this document.

MR. DUGAN: Well, reply at a minimum as extremely persuasive evidence, if not a binding admission.

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PRESIDENT VEEDER: Just look at the last sentence. Revenues net incomes of domestic methanol producers and overseas producers of both methanol and MTBE would likely decrease. Why are domestic producers of MTBE covered by that sentence? Why is that omitted?

MR. DUGAN: I don't know. I suspect it was just an oversight by their part, and I don't think that omission in any material way affects
their conclusion, the fact that they foresaw a shift to ethanol of 30 percent of the market would have a very damaging impact on foreign methanol producers.

And again, what happened in California, of course, was a hundred percent shift to ethanol, and if a 30 percent shift to ethanol would have a damaging impact, then it stands to reason that a hundred percent shift would have the same type of damaging impact.

Now, the second point, the second piece of evidence from which you can find foreseeability are the two comments Senator Burton made to the Methanex representatives, and the methanol representatives in the famous meeting where he told them that you're blanked and he said to sell Methanex stock short.

Professor, you raised the question, well, isn't that capable of two interpretations? Doesn't that mean simply that you're going to lose? And in thinking about it, I think the appropriate response is that when it's phrased in that way, it means two things. It means you're going lose, and you're going to be harmed. Both of those meanings are contained within that statement. And, Mr. Veeder, you asked the question, but is he an actor? And we would agree that certainly with respect to the formal processes, he was not an actor.

But, his knowledge reflects two things.
It reflects the foreseeability of harm to Methanex from the MTBE ban, and it reflects to a degree the knowledge of how the California government was going to act. It reflects to a degree the knowledge of how Governor Davis was going to act. I think you can infer from his statement that it was fairly common knowledge that Governor Davis was going to implement the ban against MTBE.

And again, if our submission that the date on which Mr. Vind had his conversation with Gray Davis about the compromise, can't you work out a compromise so that the ethanol producers get some, and the refiners' concerns about supply are satisfied, that would have taken place a month before, which is further evidence that Governor Davis had already made up his mind and further evidence that knowledge about the ban is spreading. So, we think from this it shows two things: Again, foreseeability and the state of Governor Davis's mind, that it was known that this was going to have a damaging impact on methanol producers, and foreign methanol producers, as well. So, it is a good piece of evidence for foreseeability, and from foreseeability we argue that you can, and should, infer an intent to harm
If Governor Davis had been considering the MTBE issue, the UC report leading up to his election and, indeed, had been tending towards a decision or had even reached a decision that it would be, if elected, his recommendation would be that MTBE be banned and that ethanol be studied as a substitute all prior to the dinner and receipt of donations from ADM would that affect your case?

MR. DUGAN: If he had decided that all prior to the dinner?

ARBITRATOR ROWLEY: Yes.

MR. DUGAN: It would depend--

ARBITRATOR ROWLEY: I said prior to the dinner and/or receipt of the earlier donations.

MR. DUGAN: I understand.

Not necessarily. It would certainly make more difficult from an evidentiary point of view, but recall here that Davis sought out ADM and he sought out ADM, I think, and Mr. Vind testified because he wanted money from ADM.

Now, if he made the decision in anticipation of a rich stream of contributions from one of the largest contributors in the nation, then, no, it wouldn't affect our case. I think it would make the evidentiary inference to be drawn much harder, but it wouldn't affect the case. I think what's critical here is that the sequence of
events is that based on the evidence ADM had not
made that decision. ADM certainly had not made
that decision, and it made the decision after the
meeting in Illinois, and we submit it made the
decision based on something that happened at the
meeting in Illinois. And what happened, again, we
submit, was there was some type of implicit
agreement that Governor Davis would expand the use
of ethanol.

So, I think the only concern we would have
under those facts is an evidentiary concern and not
a theoretical concern.

Does that answer the question?

ARBITRATOR ROWLEY: It helps, thank you.

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MR. DUGAN: All right. Now, turning to
the second principle on which we think that it's
appropriate for the Tribunal to infer a specific
intent to harm, we've tried to show that--I think
we have shown that this is a market where there is
a binary choice, at least with respect to the
integrated oil companies. Prior to the ban they
chose methanol. Now they choose ethanol in order
to manufacture their RFG. And we think in those
circumstances where there is a direct competitive
link, where it's a zero-sum game, where the
competitor gets the whole pot or none of it, that
that competitive link alters the types of
inferences that can be drawn.

Now we think that almost--that most, and
perhaps all antidiscrimination regimes recognize
that an intent to favor one competitor demonstrates
by definition at a harm and intent to harm the
unfavored competitors. And it appears--it's almost
self-evident, if do you have a pot of--a zero-sum
game where someone is favored, then someone by

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definition is going to be disfavored, and intent to
favor the one has to be construed as an intent to
favor the other.

And I think the U.S. itself recognized
that in their statement on July 12, 2001, which is
Tab 31. Just quoting the highlighted sections, why
would California have any interest in injuring
foreign owned producers if not to benefit U.S.
domestic ethanol industry, quoting selectively
there? And I think that's the gist of it. As the
U.S. itself at least implicitly recognized, these
are two sides of the same coin.

Now, again, this principle, it's not a
novel principle. Methanex is not putting it
forward in the absence of very considerable legal
support. If you turn to Tab 32, the statement has
been--this is from the WTO decision: If there is
less favorable treatment of the group of like
imported products, there is, conversely, protection
of the group of like domestic products.

Professor--and I think one particularly
good articulation of the theory is found in the Bacchus Imports, Limited, case. That was a United States Supreme Court case dealing with what's known as the dormant commerce clause, which is a prohibition on the type of economic protectionism that we are talking about. It's internal to the United States. It's not a rule of international law, but the analog is very, very close to what's being dealt with here.

That case involved a tax law that the State of Hawaii had passed which exempted two locally produced liquors from a general Hawaii tax, but the tax was applied to all other beverages originating in state or out of state. Hawaii argued that it didn't intend to discriminate against products from out of state. It merely intended to favor a couple of domestic products, and urging that there was no discriminatory intent on the part of the state legislature because the exemptions in question were not enacted to discriminate against foreign products, but rather to promote a local industry.

The Supreme Court rejected that, and they rejected that using language that I think is very, very relevant here: Virtually every discriminatory statute allocates benefits or burdens unequally.
Each can be viewed as conferring a benefit on one party and a detriment on the other in either an absolute or relative sense. The determination of the constitutionality does not depend upon whether one focuses on the benefited or the burdened party. A discrimination claim by its nature requires a comparison of the two classifications, and it could always be said that there was no intent to impose a burden on one party, but rather the intent to confer a benefit on the other. Consequently, it is irrelevant to the commerce clause inquiry that the motivation of the legislature was the desire to aid the makers of the locally produced beverage rather than to harm out-of-state producers. Now, again, we think that there is ample legal precedent for this type of inference drawing, and we believe that the United States has itself adopted this type of inference drawing in the positions it's taken in trade cases. This was the--actually, this was the position taken by the United States in the Japan measures affecting consumer photographic film and paper. Regardless of whether Japan has sought to hinder imports or merely help domestic producers, the direct consequences of its actions were to diminish opportunities for foreign photographic material manufacturers and to distribute their products. By creating distribution channels open exclusively to
domestic manufacturers, Japan intentionally enhanced competitive opportunities for domestic manufacturers to the detriment of imports. Again, two sides to the same coin. And that's precisely the case here. You have a binary market where in 1999, methanol completely dominated the market for oxygenates used by integrated oil companies in the production of RFG. Now, it has no market share of that whatsoever. That has all shifted to ethanol, and it shifted to ethanol because of Davis's actions in precipitously selecting ethanol as the favored replacement. Now, that's a zero-sum game. Integrated oil companies have to buy oxygenates in order to comply with the requirement to produce RFG, and by intending to favor domestic ethanol industry, Governor Davis, by definition, intended to harm all its foreign producers because the two are opposite sides of the same coin. And it's because of the competitive relationship, the direct competitive relationship between the two products. Next, I would like to turn to the question of Methanex's ownership of investments in the United States, and--

PRESIDENT VEEDER: Just before do you that, we are not pressing you, but can you give us some rough estimate of how far you've got, and how
MR. DUGAN: I suspect I'll need about an hour and 15 minutes.

PRESIDENT VEEDER: That will take us up to 7:00.

MR. DUGAN: About that, yes.

PRESIDENT VEEDER: It's when you rest that we go beyond seven because that, for administrative reasons, very much the last time we can sit without making special arrangements.

MR. DUGAN: No. I will certainly do my best. I think I can get it done by seven. I will certainly try.

PRESIDENT VEEDER: We're not pressing you. You must take the time you need, but if you need longer, I think you need to tell us. Seven o'clock is still okay.

MR. DUGAN: I don't think I will need longer.

PRESIDENT VEEDER: Let's work on that basis. We'll need another short break I think just to give the stenographer a little rest.

MR. DUGAN: Now is as good a time as any, if you want to do it now or we can do it later.

PRESIDENT VEEDER: Let's do it now.
MR. DUGAN: Okay.

(Brief recess.)

PRESIDENT VEEPER: Let's resume.

Before we do so, could we review administrative arrangements for tomorrow. On one view, in the light of today, we should start earlier. On another view, because it may be that time has been removed from the United States in preparing for tomorrow, we should start later. We should ask the United States as to what their preference would be. It has to be one or the other.

MR. LEGUM: It's the latter of the two. We would prefer to start a bit later, around 2:30 is what we are proposing.

PRESIDENT VEEPER: If we did that, we would have to be pretty sure of finishing before 7:00. Is that still your intention?

MR. LEGUM: It is, indeed.

PRESIDENT VEEPER: And we ought to allow quarter an hour at the end for various housekeeping matters so that would probably mean 6:45. Does that make a difference to your answer?

MR. LEGUM: No, no, it doesn't.

PRESIDENT VEEPER: So, 2:30 tomorrow. We will continue until 7:00. Does that cause any difficulties, Mr. Dugan?

MR. DUGAN: No, that's fine.
PRESIDENT VEEDER: Mr. Dugan, let's go on.

MR. DUGAN: Okay. Thank you.

Next, I would like to turn to the question of Methanex's ownership of investments in the United States. The U.S. asserts that Methanex has not shown that it actually owns any U.S. investments. Now, Methanex—from Methanex's point of view, this is an entirely frivolous argument, and the Tribunal shouldn't be wasting any time on it, and neither should the parties.

The U.S. asserts, quote, the United States, as a respondent in this billion dollar case, has the right to insist on evidence of ownership as authoritative as what would be required in a corporate transaction.

Now, the U.S.--

PRESIDENT VEEDER: You're quoting from what?

MR. DUGAN: I'm quoting from transcript page 577, lines 6 to 11.

The United States cites absolutely no authority whatsoever for the fact that they're entitled to a certain level of evidence with respect to a particular point that's in dispute. And actually it's not even in dispute. And we submit that they're not. They're simply making that up. They're not entitled to evidence as authoritative as if included in a corporate
What's on the record here is that Methanex has provided ample, credible, uncontradicted evidence of its ownership, and that's an end to it.

Let's go to Mr. Macdonald's witness statement. This is what he said: Methanex owns several companies in the United States. Of these, there are two principal operating entities: Methanex Methanol Company, Methanex-US, which is responsible for methanol sales and inventory; and Methanex-Fortier, Inc., which is responsible for methanol production. Methanex-US is a Texas general partnership owned by two companies, Methanex, Inc., and Methanex Gulf Coast, Inc., both incorporated in the State of Delaware. Methanex indirectly owns 100 percent of the shares of both partners. Methanex-Fortier is also incorporated in Delaware, and Methanex also indirectly owns 100 percent of the shares in this company. While the U.S. apparently is part of a scorched-earth litigation approach questions these facts, I'm pleased to assure the Tribunal of the very real and legal existence. In fact, I'm a director and vice president of each of these companies.
So, there you have sworn testimony from a director and officer of the companies as to the ownership that's there.

Now, the U.S.--and he further provided a detailed chart that specifically corroborates these statements. We submit that there is actually no basis to challenge them. They didn't even bother to cross-examine Mr. Macdonald. This is uncontroverted, clearly competent evidence as to who owns these companies, and that should be an end to it.

Now, even beyond that, they say there is no additional evidence of that. If you see at the next page, this is a chart from Methanex's annual report. It's a simplified chart, but it shows the same thing.

Now, again, this was filed with the United States Securities and Exchange Commission under penalty, criminal penalties, if it's fraudulent or wrong. The U.S. ignored this completely, and insisted time and time again that Mr. Macdonald produced more and more evidence of the evidence of ownership.

And finally, the United States has not asserted any reason to disbelieve anything that Mr. Macdonald has said. It has done nothing. It's provided no evidence to rebut anything that Mr. Macdonald has said. This is sheer vexatious litigation with no basis in the record whatever.
Now, that said, this is a good time to talk about costs. Methanex believes it's fully entitled to all costs and fees in this case because of this type of vexatious litigation tactic. The no-investment argument was frivolous. It never should have been brought, and it should have never been pursued. And the same was true at the jurisdictional stage. If you recall, the United States, I think, launched a number of jurisdictional challenges, either six or seven, and lost most of them. And the reason it lost most of them is it didn't belong at that stage. I never heard of a proximate cause challenge to the jurisdictional phase, and on its face it seems to be frivolous. Proximate cause analysis is so entirely bound up with the facts of the case that bringing it at that stage can only be considered as vexatious and frivolous.

Now, just because this is unusual case with unusual allegations under a novel legal instrument that's only been around for 10 years in an area of law that's developing, that doesn't justify putting up frivolous argument after frivolous argument, and we think that's has been the case here. And we think because of the way the United States has conducted this litigation it should be liable for all the costs and fees.

Next, I would like to go to the question.
of damages, and the first point I would like to make--and I don't think this is rebutted by the United States--the most obvious element of damages here is that Methanex has now lost its California market. It's lost its customers in California.

Prior to the time of the ban, it used to sell to Chevron and Valero and Tosco and the other integrated oil companies, all of which are set forth in the record. Now it cannot sell to them. That loss of revenue, that loss of customers, that loss of market share is an obvious damage to the corporation, and United States does nothing really to refute that.

Secondly is the drop in the share price, and the United States says that Methanex keeps coming up with different theories, and Methanex, in response to United States, went back and looked at the one period that the United States had proffered, which was in late January, early February, 1999, to see what was the cause of that decline. And it turns out from the record, which is copiously described by Mr. Macdonald in his affidavit, that drop was caused by the MTBE ban, as well.

So, in terms of damage to the corporation reflected by the stock price, we, in essence, break
it up into three segments: We have the preemptive
drop of approximately 21 percent in late January
and early February—and again, the evidence is in
the record that the MTBE ban was very much on the
minds of investors at that time—we had the
immediate drop of 10 percent on the day after the
ban was announced; and we have the same drop of
15 percent over the next 10 days. And the total of
those cumulate to approximately 30 percent.

And that is a fact which shows very, very
severe damage to Methanex as a corporation. And
there is no showing—you will see at the right-hand
side of that that the price has since climbed back
up. That's because of the price of methanol has
gone up. But there has been no showing that the
damage that was inflicted upon Methanex by the MTBE
ban has been fully recovered. The United States
simply hasn't shown it.

And a generalized showing that the share
price has increased is not a particularized showing
that there has not been a fact of damage. That, I

think, is conclusively established by the drop in
the share price that we tied to analyst reports and
we tied to the timing of the MTBE ban.

Now, the U.S. also asserts that a drop in
share price is not a damage to a corporation. It's
a damage to the corporation shareholders. And as a
matter of law, we think that that's just not true.
I'm skipping over a couple of exhibits that show fairly graphically the drop in the share price, but if I could get to the legal issues--and this is Tab 40--these are some quotes from some authoritative sources.

Diminution--

MR. LEGUM: Mr. President, these are authorities that have never been before offered to the Tribunal or to the United States, and we object to their being introduced at such a late date.

PRESIDENT VEEDER: Are all these new, Mr. Dugan?

MR. DUGAN: They are new, but I didn't--I had no idea that I didn't understand that the closing argument was limited to legal sources in direct. This is not evidence. This is law. And it's always been my understanding that you can put in new law at any stage up to the closing.

PRESIDENT VEEDER: Could we just raise a preliminary issue we would like to discuss with you, which is that we ordered bifurcation, and we decided in our order last summer to put off all issues of quantum. Does that affect your argument?

MR. DUGAN: Well, if the Tribunal is willing to rule there is, in fact, damage, what the United States--the position that the United States is taking is that there is no damage whatsoever and, therefore, the case can't proceed. We agree...
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15 with you completely that quantum has been put off,
16 but we are trying to respond to the U.S. argument
17 there has been no damage at all.
18 PRESIDENT VEEDER: So, you have got to
19 establish the probability on the balance of
20 probabilities. It's all or nothing.
21 MR. DUGAN: Exactly.

1981

1 PRESIDENT VEEDER: And that gets you
2 through the bifurcation.
3 MR. DUGAN: Correct, which gets us to the
4 next stage. We are just trying to show that from
5 the evidence in the record that the only thing the
6 Tribunal can conclude is that there was, in fact,
7 damage to the corporation. How much we have not
8 attempted to show.
9 PRESIDENT VEEDER: Before we look at this
10 to make a ruling, could you talk us through the new
11 legal materials. We are looking at Tab 40.
12 MR. DUGAN: This is Tab 40. These are
13 things like the encyclopedia of private law of
14 corporations that show, as a matter of law, a
15 damage--a drop in the share price is a damage to
16 the corporation.
17 PRESIDENT VEEDER: These are all U.S.
18 legal materials?
19 MR. DUGAN: These are all U.S. legal
20 materials, yes.
21 PRESIDENT VEEDER: Just looking at these
abstracts, and in the absence of some injury suffered by the corporation, can the corporation recover for a diminution in its share price?

MR. DUGAN: I think it depends on the circumstances. We're involved in a proceeding where we hope to recover not for the damage—not for the decrease in the share prices. We are offering this--our calculation of damages is not based on the decrease in the share price. The calculation is based on an entirely different market analysis.

We proffer this as evidence of the fact that the drop in the share price is both a legal injury to the corporation and that it's evidence of the injury that the corporation suffered because of the MTBE ban.

And again, this is evidence that under some legal analysis, a drop in the share price is considered to be a direct injury to the corporation, and an injury which the shareholders can recover from derivatively.

PRESIDENT VEEDER: Mr. Legum, I don't recall if we ever actually addressed whether new legal materials can be brought in at this stage.

MR. LEGUM: I don't believe there has been a specific ruling on that, either.
PRESIDENT VEEDER: Are there any other legal materials tonight that you are going to introduce tonight that are new, Mr. Dugan?

MR. DUGAN: There is one source on proximate cause to Prosser and Keeton.

PRESIDENT VEEDER: What tab number is that?

MR. DUGAN: That would be Tab 52.

MR. LEGUM: I believe Tab 41 also reflects the new materials.

MR. DUGAN: Tab 41 as well, but that's the same thing we're arguing about right here. But the Prosser and Keeton description of proximate cause, I think, has been included in the legal materials before this. It's—certainly the basic description, I think, has been included.

PRESIDENT VEEDER: Mr. Legum, given we may take some time to debate this, we are minded it to let it in. If it causes a difficulty to the United States in presenting this tomorrow, we will obviously hear you sympathetically tomorrow.

MR. LEGUM: Very well, but in the meantime, I'm assuming that Methanex will be providing us and the Tribunal with fuller copies of these authorities?

PRESIDENT VEEDER: Well, this is the difficulty. I think these are sound bites and they don't go very far as sound bites, particularly...
since they are limited to U.S. legal materials.

Were you intending to put in the full report, Mr. Dugan?

MR. DUGAN: We could certainly put in the full report.

PRESIDENT VEEGER: We're not necessarily asking for you to do that, but I'm asking whether you intend to do that.

MR. DUGAN: We'll do that. We'll provide

And can you get those to the United States tonight?

MR. DUGAN: We could get them to the United States tonight, yes.

PRESIDENT VEEGER: I think they are more important than us tonight. They've got to have a chance to consider these new materials.

And again, if the United States has any new legal materials tomorrow, it's useful to get them over to Mr. Dugan before we start at least at 2:30.

MR. LEGUM: I don't think we will, but if we do, we will.

MR. DUGAN: All right. I won't read each one of these individually. The first one, I think, states the principle very concisely. Diminution in the value of corporate stock resulting from some depreciation or injury to corporate assets is a direct injury only to the corporation. It is...
merely indirect or incidental injury to an individual shareholder.

And we submit that, applied here, that principle shows that the diminution in the value of Methanex's stock resulting from the MTBE ban which eliminated its market in California is a direct injury to the corporation, and that that--applying that principle to the facts of the Methanex share drop conclusively establishes the fact of damage to Methanex.

Now, whether or not that damage has been mitigated by the rise in the share prices as a result of the change in the price of methanol, is no way a showing that that damage has been alleviated; and the fact of the matter is, it hasn't. And that fact of damage is enough to establish the level of damage needed to get through to the second phase, the bifurcated phase, of the hearing.

Now, the U.S. also argues that the drop in the debt rating that Methanex quite clearly suffered is not damaged because Methanex didn't issue any debt, which is true. But again, Methanex would submit that whenever a corporation has to suffer a public downgrading of its debt rating, and

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when that downgrading is expressly tied to an MTBE ban, that alone is a fact of damage. The quantum of that damage may be very difficult to quantify, but a decrease in the debt rating, if nothing else, causes reputational harm. It undoubtedly has a carryover to the damage inflicted on the share price, but that alone is a fact of damage that's sufficient to establish damage for purposes of 1116.

Next, the U.S. does not dispute that the shift to ethanol in California has resulted in a permanent loss of 6 percent of world demand. The statements of Pierre Choquette that they cited illustrate that. And if you will turn to Tab 42, Mr. Choquette talks about the reduction in MTBE consumption in the United States is taking place, but, of course, it's overshadowed by supply constraints, so it's hard to see the impact of the

First of all, he doesn't say it doesn't cause any problems. He said it's overshadowed by supply constraints. But, more importantly, he talks about a loss of demand of 750,000 tons per year, and that's 50 percent of the market in 2002. If you double that, it's 1.5 million tons per year in permanent demand loss. That's the impact of the ban in California on the global supply market.

Now, there is no doubt that methanol is a
global commodity, and the price responds to those types of things quite quickly. And what we have cited next at Tab 43 is testimony from Mr. Burke, (reading):

> Well, methanol is a globally traded commodity; do you agree with statement?
> Yes, I would.

> So, demand changes in one region ultimately affect the global supply and demand balance for methanol; you would agree with that?

> Yes.

It's a global commodity, and any commodity market which use loses 6 percent of demand has lost a very significant element of demand.

Now, the next chart which is taken from a Methanex annual report, I think, illustrates this. You see this is the price history for methanol, and you can see that it's very, very volatile. It's always been like that. Like many commodities, it's volatile. It could go up and down sharply.

Now, at the present time we're in a strong market, but the fact of the matter is with 6 percent extra demand, the only inference the Tribunal can draw is that the price would be much higher. That's what happens: supply and demand. And you will see that the price of methanol went much higher in 1994, and Methanex submits that but for the 6 percent drop in demand
caused by the shift to ethanol in California that the price of methanol would be approaching what it was in 1994. Methanex would be making more revenues and a lot more profits because the price would be higher.

Now, to get to some of Mr. Choquette's statements that we believe the United States took out of context, this is one of the statements that they quoted, and the full statement says this: There is no new news related to MTBE. It—-the loss of the California market—-just happens to be coming at a time where it's unlikely to have any significant impact.

Now, that's the part they quoted. But he went on to say, The impact of what might happen in California over the next year, but, you know, the longer term that the California MTBE ban would be a factor. Now, that's Mr. Choquette saying the long-term effect of the California ban is going to be a factor. United States attributed almost prophetic status to everything Mr. Choquette says. Methanex submits that here he recognizes that in the long term it's going to be a factor, and quite obviously it's not going to be a good factor; it's going to
be a damaging factor.

Similarly, next slide, page 46, the United States quoted the portion of the--this quote that's not highlighted, or it's not bolded: We don't expect the impact of such a change to have much of an impact on pricing, if at all. But, if you take the whole statement in context, he's obviously talking about a short-term analysis. And again, many of these comments are made at either quarterly earnings conference calls or investor--investor meetings where the emphasis is almost always on the short term. As we look forward to the switch to ethanol over the next year or so--so, by the end this year, sometime early next year--in our view, the current supply-and-demand environment, and it goes on to quote the statement. This is very much a short-term analysis, not a long-term analysis. And in the long term, Mr. Choquette expressly recognized that there would be damage to Methanex. Again, there was a selective quotation

1992

from Mr. Macdonald's affidavit. If you read the full quotation, he focuses--the last sentence: In other words, pricing is currently robust due to supply limitations compared to the underlying demand. That emphasis is supplied, but I think it illustrates the point. You can't extrapolate from what's happening right now in the market what's going to happen in the future. Methanol is very...
volatile. The bottom could fall out of the market next month; and in that case, there could be buckets of red ink at Methanex, and the red ink will be even greater, the losses would be even greater, because at this point the methanol market has lost 6 percent of demand. And in a commodity market, and in global commodity market, that is a huge drop in demand that at the margins has a tremendous impact on the price, it has tremendous impacts on the revenues of Methanex, and it has a tremendous impacts on the profits of Methanex.

Now, with respect to Fortier, the next exhibit is the statement issued by--or I guess the 1993 annual report issued by Methanex at the time that it idled Fortier, and Fortier was not shut down in 1999, and this says exactly what happened to it. In Fortier, Louisiana, we reached a new understanding with our partner, Cytec. As a result, we now have hundred percent ownership and gained much needed flexibility. This plant will remain shut down until market conditions are more favorable. So, that's why it was idled, because it was waiting for better market conditions.

Now, again, the next slide is from Methanex's 2002 annual report, which the United States notes is filed with the SEC, subject to the stringent requirements of accurate reporting imposed by the securities laws. Limiting or eliminating the use of MTBE in gasoline in
California or more broadly in the United States will reduce demand for MTBE and methanol in the United States and negatively impact the viability of MTBE and methanol plants such as our Fortier facility in the United States.

So, that's a securities law acknowledgment of the continuing impact of the MTBE ban on the viability of Fortier.

Now, what we have next in the book are two selections from Mr. Macdonald's third affidavit, and they're put in here just to show that all the while that Fortier was shut down, it was still being carried as a potentially--as a plant that could potentially be reactivated if the price went up. And this is paragraph 10 of Macdonald's third affidavit: We have spent approximately 5 million CAFRB cash per year over the past several years since idling the plant to maintain our ability and flexibility to reopen the plant. And while it would be accurate to say that a significant portion of this expenditure was to meet contractual obligations, it's also a fact that the structure of such payments was specifically tailored to maintain our ability to restart the plant.

Similarly, on the next page, Mr. Macdonald puts in testimony--and again, this testimony is
uncross-examined and uncontradicted. It's one thing for the United States to speculate on what might have happened when Methanex did a particular act. It's another thing to try to bring out through cross-examination. They chose not to do that. And so this stands effectively unrebutted and uncontradicted.

Paragraph 12, Mr. Macdonald puts in evidence as to why Fortier was finally and permanently shut down. On February 18, 2004, at a regular meeting of our executive leadership team of which I'm a member, Methanex took the decision to cease all discretionary payments related to our Fortier and Medicine Hat, Canada plants and to proceed toward permanent abandonment of those assets. In arriving at this decision, our discussion included both aspects of the economic outlook for our remaining North American assets, namely gas price and market demand. The permanent loss of California MTBE demand with the ban now having been fully implemented and the losses triggered by bans in other states was a substantial consideration in our decision.

Again, Mr. Macdonald's testimony is uncontradicted, uncross-examined, and it has to be accepted as evidence of why Methanex finally decided to permanently close Fortier.
And I think if you put this together with the evidence about the 6 percent loss in demand and the volatility of the market, the reason is quite clear. But for the California ban, there would be 6 percent more demand. With 6 percent more demand, the price for methanol would be much higher. If the price for methanol was much higher, they wouldn't have decided to close Fortier.

So, it's Methanex's position that the ban in California had a direct link to the final closure of Methanex-Fortier.

Now, if the United States has said no, the reason why Methanex-Fortier was closed is because plants in the Gulf cannot make money because the price of gas is so high, and they're half right.

1997

The price of gas is very high, but that doesn't mean plants there can't make money. Plants make money if their price exceeds their costs, if their revenues exceed their costs.

And one of the pieces of evidence that the United States pointed to in showing how dire the situation is for the methanol industry of the United States was the statement of Mike Bennett. It's at Tab 51. And it says that 34 percent of U.S. capacity has been permanently closed, which is true, but the converse of that is also true: 66 percent of permanent capacity remains open---most of that is in the Gulf states---and there is no reason to believe they aren't making money;
otherwise, they would be closed, too. And again, if the price were high enough, Fortier could have made money, regardless of the high cost of gas. And the price is not higher because of the 6 percent drop in demand caused by the California MTBE ban.

The JS cite for that particular exhibit is 1998

16 JS tab 48. That's the Mike Bennett quote. Now, Methanex believes that all five of those indicia of damage are sufficient to establish a very serious damage to the corporation. And again, the chart that the United States showed you showed an increase in share price and decrease in methanol price in recent years. There hasn't been any showing that that wiped out the damage. We know that we have very significant damage in 1999 when the price dropped--the price of the stock dropped precipitously, and we know that the debt rating dropped precipitously, or dropped. The U.S. cannot show that that damage was eliminated. A cyclical rise in the price of methanol does not necessarily eliminate all the damage that was inflicted at that time.

Now, would our damage calculation now be different from what it was in 1999? Almost certainly, but what that difference is, we don't know. It remains the fact that Methanex was damaged in 1999-2000, and remains damaged, and
that's enough to satisfy the criteria at this stage
and see the case through to the quantum stage with
respect to damages.

Now, with respect to proximate cause, the
chart we put up is just a plain vanilla
description, a legal description of what is
proximate cause from Prosser and Keeton, a
well-known treatise in the United States. It's
described--proximate causation is described as some
reasonable connection between the act or omission
of the defendant and the damage the plaintiff has suffered.

Now, two principal points with respect to this. Again, going back to the California market, it's a binary choice market. And I won't put the slide back up there, but from the slide that we put up previously, it shows it quite clearly. In 1999 and 2000, Methanex and the methanol industry sold a lot of methanol into California. Now it sells none. 1999, Methanex had customers in California. The integrated oil refineries who bought methanol

for use in making RFG. Now it has none.

And we showed you the Valero contract, and
directly as a result of the California MTBE ban,
Valero stopped buying methanol from Methanex.
That, we contend, far more than meets the requirement of some reasonable connection between the act of the defendant and the damage the plaintiff has suffered. It's not just a reasonable connection. It is direct cause and effect. The ban went in place, our customers disappeared. We submit that that satisfies any criteria for proximate cause.

In addition, we submit that the permanent drop of 6 percent demand and the admission by the United States expert that this is a global commodity market, that the ordinary understanding of any global commodity market is that when you have a 6 percent permanent drop in demand, that's going to permanently affect the price, at least until as long as the capacity is taken up. But that type of permanent drop in demand will have a corresponding impact--in fact an exaggerated impact--because it is a volatile commodity market that will continue to cause damage to Methanex for some period of time.

ARBITRATOR REISMAN: One clarification going back to Fortier. Fortier did not supply California; is that correct?
MR. DUGAN: Fortier did not supply California, that's correct.
ARBITRATOR REISMAN: So, why would the drop in demand in California affect Fortier? I can understand why it would affect Medicine Hat, but
MR. DUGAN: Because it's a global market.

ARBITRATOR REISMAN: No, global market is simply a concept, but if Fortier does not sell under these circumstances to California--Fortier has a segmented customer base; it doesn't sell to California. Why is it that when California no longer purchases MTBE or allows MTBE Fortier suffers, what is the proximate relationship there?

2002

MR. DUGAN: Perhaps you reject the notion of a global market, but when there is a decrease in demand, the plants that don't get reopened are the ones that operate at the margins. And again, had the price but for the California ban, the demand for MTBE would be higher. If the demand for MTBE were higher, the price would be higher. And if the price would be higher, Fortier could perhaps reopen. That is the logical consequence. And it's because it is a global market. It is a pricing factor because the MTBE ban has had such an impact on the price of methanol and depressed it below what it otherwise would be. That's what's contributed to the closure of Fortier.

Just so you don't misunderstand, the sales into California were sales from Methanex-US, the other main Methanex company.

ARBITRATOR REISMAN: Which is a marketing company?
MR. DUGAN: Which is a marketing and distribution company, which has real assets. It has a fleet of rail cars. It has leases where it stores it.

ARBITRATOR REISMAN: I'm glad you raised that point. I would like to get a clarification on that, if I may. I don't mean to interrupt your presentation, but since you raised it, Methanex-US did not, as it were, receive supplies at a depot in Texas and then transship them to California. The supplies were shipped directly from Medicine Hat to California?

MR. DUGAN: But I think they were shipped and may have been stored in inventory in California, in Methanex-US's inventory in California.

ARBITRATOR REISMAN: But they came directly from Canada as opposed to supplies that might have been produced in Fortier, which would have been sent from the U.S.--from Methanex investment in the United States which would have been sent directly to California. Do they--do the imports from Medicine Hat qualify as investments just because you have a marketing center in Texas?

MR. DUGAN: Well, I think the way we
approach the question is that Methanex-US, the
distribution and marketing arm is quite clearly an
investment in the U.S. It has all the requisite
properties needed to be an investment in the U.S.
It has assets, real assets, and intangible assets.
It has employees. It has income. It transfers the
income to its parent corporation.

There is no reason whatever to doubt that
it is a very substantial company, and that's laid
out in the MacDonald affidavit.

ARBITRATOR REISMAN: Yes, and I understand
that, and that seems to be beyond any question.

MR. DUGAN: Right.

ARBITRATOR REISMAN: My question, to put
it in more general terms, is where an investor
establishes an investment, does that investment
transform anything that it regularly effectively
imports into the United States into an investment
by some sort of association or affiliation?

MR. DUGAN: Well, I don't think it
transforms the imports into an investment, and
that's not our case. Our case is that Methanex-US
is an ongoing concern. It's an ongoing operation
with a going value--going-concern value. And that
consists of not just its tangible assets such as
its rail cars and its storage depots, but it's
also--the assets of the corporation include its
customer base, its goodwill, its customer list, and
its market share. And it was those assets of the
investment that were damaged by the MTBE ban. It was the elimination of that market share—that list of customers, if you will—that damaged Methanex-US.

Now, again, it's an active operation, and if you had a situation where simply assets were coming—imports were coming straight into the country without any corresponding U.S. investment, to manage the sale and the distribution of those assets, it would be a much different situation, but obviously that's not what we are faced with here.

Now, the U.S. also makes the point that NAFTA—that Chapter 11 is not meant to apply to cross-border trade, but there had been a string of cases saying the various chapters of NAFTA are cumulative, and you could have a situation that involves both cross-border trade and investment, and I think that's precisely what the situation is here.

So long as Methanex meets the criteria for bringing a claim under Chapter 11, the fact that the original source of the products is Canada and not Fortier is irrelevant. If we can show a damage to our investment assets in the United States, then we meet the legal criteria for bringing a Chapter 11 claim and it's simply irrelevant where the assets originated from.

And if, indeed, Methanex has or Canada is
entitled to protections under other Chapters of NAFTA for the cross-border trade, that is also irrelevant. The question here is whether Methanex-US, as a U.S. investment with real assets,

both tangible and intangible in the United States has been damaged. If it has been, then it meets criteria for a Chapter 11 claim.

Now, I have actually got only about 10 minutes, I think.

Now, one point I would like to make, I have spent a lot of time today in the opening pointing to what we think is one of the more significant--what is the most significant factor, and that is the shift to ethanol. That's Governor Davis's decision not just to ban MTBE, but to shift to ethanol.

His decision in the Executive Order in March 1999 to evaluate only ethanol, and Mr. Kenny's statement to Congress in October of 1999, prior to the time that any evaluation was completed, that ethanol was going to be--was going to be, will be, I think is the phrase, substituted for MTBE because it's the only feasible oxygenate. Now, we have made that point that there was this precipitous shift to MTBE without any
environmental justification, without any rational justification whatsoever for quite a long time, and you know what Methanex's position is as to why they shifted so precipitously to ethanol. But I've never heard the U.S. response. I never heard the U.S. explain what it could possibly be meant by Mr. Kenny when he said in October of 1999 that ethanol was the only feasible alternative. We never heard an explanation from the United States as to why Governor Davis selected only ethanol as an oxygenate to evaluate in March of 1999. And that's a very, very important point for our case. It's a very, very important piece of evidence.

And the United States has a habit of simply ignoring inconvenient and stubborn facts and then waiting to the last moment to come up with some purported justification for what really happened. We think, as a matter of the requirement of UNCITRAL for an opportunity, a fair opportunity, to present our case that if they come back tomorrow and try to explain why Mr. Kenny said in October of 1999 that ethanol was the only feasible oxygenate, or if they come back tomorrow with some explanation as to why Governor Davis selected ethanol and only ethanol for evaluation in March 1999, that we should have a chance to respond to that, however briefly. We never heard their explanation, and we think we are entitled to respond to it, whatever it is.
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Now, the last thing I would like to draw the Tribunal's attention to is the chart that the United States itself put up with respect to a statement of Mr. Macdonald, in which they said that this was somehow evidence of improper intent. We think that's virtually perverse. We think what it shows is something entirely the opposite.

Mr. Macdonald stated that a lot of the energy today in the U.S. is on energy security, and methanol has pounced on that, said Michael Bennett, senior vice president of technology for Methanex. The voice of methanol has not been heard in that debate, he said. Our strategy, as a company, was to get involved through an international trade dispute.

And then he goes on, and this is the important point: That's the only forum where we have an opportunity to even get a hearing, because the media and the rhetoric of the ethanol lobby had made it difficult for the facts to be heard, he said.

And that's precisely the point. Methanex agreed to open this hearing--it didn't have to, and it agreed to open this hearing--before there were any rulings, before the FTC interpretation, because I think it's important for this to be an open hearing and for the facts to get out.

PRESIDENT VEEDER: But just don't forget the point you might want to make. When this case
started, it wasn't intended to be an open hearing.

MR. DUGAN: That's my point, and we agreed to open it up because we thought it important to be aired publicly, the facts with respect to what ethanol has done be heard publicly, and that is the reason Methanex changed its position and agreed to it.

But more importantly, and here is the key to this: Methanex did not believe that it would get a hearing, much less a fair hearing, in California from Governor or Davis for all of the obvious reasons that had been presented here. Methanex did not believe it would get a fair hearing from the United States Government. The Federal Government itself created the ethanol industry with the Federal tax subsidy in 1977, and since then has continued the subsidies and put in place a whole range of programs designed to protect and cosset the ethanol industry, including, for example, the 54 percent gallon import duty. Methanex did not believe it could get a fair hearing from the Federal Government, either. Methanex did believe it could get a fair hearing from a neutral international tribunal, where it could present the facts, it could present the law, and it could respectfully ask for a decision on the merits, independent of the
political pressures that exist in California and in Washington, D.C., and that's why it brought this case to this Tribunal.

And that's what it asks for here: A fair hearing and a decision on the merits of case, independent of the politics of ethanol.

Thank you.

PRESIDENT VEEDER: Thank you very much, Mr. Dugan.

Just before we wrap things up because we still have a little time, the matters on which you are going to come back to us, Mr. Dugan, was a package of the relevant California regulations, the three sets of regulations: the original, the proposed, the ones as they came into force.

MR. DUGAN: Right.

PRESIDENT VEEDER: And I think also in answer to my colleague, Mr. Rowley, you were going to come back with some answers regarding political contributions.

MR. DUGAN: Right. I think I could answer that now, actually.

And this is—I'm citing footnote 78 from the U.S. rejoinder, and I have no reason to believe this is not true. Methanex Management, Incorporated, a subsidiary of Methanex Corporation, made a $10,000 donation to the Democratic National
Committee and a $15,000 donation to the Republican National State Elections Committee one week apart. They were returned, even though Methanex Management, Inc., a U.S. couple, I believe, because they were drawn on a Canadian bank. Thereafter, Methanex has made no more contributions to the -- any politician in the United States and has a corporate policy against it.

And we are going to get the cases to the United States tonight. I assume you would like them by E-mail?

MR. LEGUM: That's okay.

PRESIDENT VEEDER: Could we go through as housekeeping matters certain matters which we need to address. You're still pursuing your application

to maintain the three exhibits which you adduced in evidence in response to the amici submissions. These are Tabs 3, 13, and 14 of volume one to your response to the amici submissions which were opposed by the United States. If you have anything to say further beyond your written submissions on that, we would gladly hear you.

MR. DUGAN: I do not.

PRESIDENT VEEDER: In regard to your motion regarding the traveaux, we have asked you some questions and you have done your best to answer them. Do you need any more time to elaborate on your answers further?
MR. DUGAN: No, we do not.

PRESIDENT VEEDER: Canada and Mexico have not yet intimated they want to address us orally at this hearing, but they have intimated that they would like to put in possibly further written submissions under Article 1128 after this hearing. If they did so, would you be minded to want an opportunity to respond to those written submissions?

MR. DUGAN: We would like an opportunity to respond. I'm not sure that we will, but we would like an opportunity to respond, number one. But number two, I would like--the signatories have had a tendency to comment on factual matters in the case. I believe that the Article gives them the right to comment on the interpretation only, and we would request the direction from the Tribunal that if they are going to comment that their comments be limited to an interpretation of the Treaty itself.

PRESIDENT VEEDER: Next, although the transcript has been splendidly produced and prepared, there are occasional mistakes which we can see. What we have in mind, and will address this tomorrow with both parties, is a procedure for correcting any significant errors. We are not concerned with obvious errors or minor matters, but we would want a fairly prompt timetable for notifying errors between the parties and agreeing.
where they can, certain corrections; and where they can't agree, parties can notify us with respective corrections. But we will come back to that tomorrow, if you could think about your position about that.

The other matter is costs which you touched on. We need some information about costs from both parties, and what we are minded to do is asking for the parties in a fairly short order to produce their respective figures broken down at least in part with any submissions in support of the quantum of costs to date. And we also envisaged there would be an opportunity for each party, disputing party, to comment on the other side's figures. So, we need to build that timetable into the future program after this hearing.

Subject to that, unless anybody has something to raise now, we will adjourn until 2:30 tomorrow afternoon, anticipating that we shall finish by seven that evening.

MR. LEGUM That sounds very good, but there is one matter that the United States will raise tomorrow at the close of the hearing, and I might as well provide advanced notice so everyone...
has a chance to think about it, and that is that we will request the Tribunal to enter an order closing the proceedings subject to further order from the Tribunal. I think after the last hearing there were a succession of posthearing submissions and it would be best if we maintain—if the Tribunal maintained control over further submissions that were received.

PRESIDENT VEEDER: You have in mind Article 29 of the UNCITRAL Rules?

MR. LEGUM: Yes.

PRESIDENT VEEDER: We'll come to that, certainly.

MR. DUGAN: I would just like to note that what I think you're referring to is the issuance of the FTC interpretation that came after the close of this jurisdictional phase, and that's what triggered the back and forth. And I would like to reserve for the record our right to respond to any purported interpretation issued by the FTC.

PRESIDENT VEEDER: Mr. Dugan, you are quite right. That's what Mr. Legum had in mind, but we could address that tomorrow. Of course, it's not a complete closure. The Tribunal always has the right to reopen, having closed the hearing to the parties under Article 29(2).

But if that's all, we will stop here.
Thank you very much, Mr. Dugan. And we will start again tomorrow at 2:30.

(Whereupon, at 6:40 p.m., the hearing was adjourned until 2:30 p.m. the following day.)

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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

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