

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

METHANEX CORPORATION,

*Claimant/Investor,*

*-and-*

UNITED STATES OF AMERICA,

*Respondent/Party.*

**SUPPLEMENTAL STATEMENT OF DEFENSE ON INTENT  
OF RESPONDENT UNITED STATES OF AMERICA**

Mark A. Clodfelter

*Assistant Legal Adviser for International  
Claims and Investment Disputes*

Barton Legum

*Chief, NAFTA Arbitration Division, Office  
of International Claims and Investment  
Disputes*

Andrea J. Menaker

David A. Pawlak

Jennifer I. Toole

*Attorney-Advisers, Office of International  
Claims and Investment Disputes*

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In accordance with the Tribunal's order of February 12, 2003 and Articles 19 and 22 of the UNCITRAL Arbitration Rules, respondent United States of America respectfully submits this supplemental statement of defense on the issue of whether California intended, by promulgating a ban on MTBE, to harm methanol producers such as claimant Methanex Corporation. This statement supplements the United States' Statement of Defense submitted on August 10, 2000, which continues to set forth the United States' position as to other aspects of Methanex's claim.

**I. PRELIMINARY STATEMENT**

1. In the First Partial Award, the Tribunal found that, on its face, California's ban of MTBE did not relate to methanol or Methanex. It therefore found Methanex's claim as pleaded in its original statement of claim to fall outside the scope of the

NAFTA's investment chapter and its own jurisdiction.<sup>1</sup> The Tribunal further found that Methanex's allegation that the measures were intended to favor ethanol at the expense of *MTBE* also did not satisfy the NAFTA's requirement that the measures relate to the investor or its investment for the chapter to apply.<sup>2</sup>

2. As the First Partial Award makes clear, for Methanex to meet the "relating to" requirement it would have to plead and prove that the measures were intended to harm *Methanex* or the class of *methanol* producers and marketers of which it is a part.<sup>3</sup> A showing that the measures were intended to address *MTBE* or *MTBE* producers would not distinguish Methanex's fresh pleading from its previous, failed efforts to make out a case within the Tribunal's jurisdiction.<sup>4</sup>

3. Methanex has utterly failed to meet the standard set out in the First Partial Award. It has offered no evidence suggesting that the measures were intended to harm Methanex itself. It has offered no evidence that the measures were intended to harm methanol producers generally. Instead, it argues at length that the measures were intended to favor ethanol over *MTBE* and attempts to conflate methanol and *MTBE* as being one and the same.

4. Methanex's assertions are patently lacking in support and are ripe for summary dismissal. *First*, Methanex's attempt to conflate methanol and *MTBE* is unsupported. Methanol is not used, and cannot practically be used, as an oxygenate in

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<sup>1</sup> See First Partial Award ¶ 150.

<sup>2</sup> See *id.* ¶ 154.

<sup>3</sup> See *id.* ¶ 157.

<sup>4</sup> See *id.* ¶ 154.

gasoline. Indeed, Methanex does not even suggest that it sells methanol for use as an oxygenate in gasoline. By contrast, MTBE – the use of which in gasoline is banned by the measures at issue – can be used, and is used, as an oxygenate in gasoline, as is the case for its competing product, ethanol. The supposed “binary choice” between methanol and ethanol posited by Methanex does not exist.

5. Methanex is, as the Tribunal observed in its First Partial Award, no more and no less than a supplier to MTBE producers. That fact, however, does not in any way establish that the California measures “relate to” Methanex for purposes of NAFTA Chapter Eleven.

6. Because MTBE and methanol are not the same, the remainder of Methanex’s assertions relating to ethanol and MTBE do nothing to establish the intent required by the First Partial Award.

7. Notably, the evidence Methanex has submitted to establish a supposed intent to favor ethanol over MTBE is irrelevant and insufficient, as a matter of law, to establish any intent to harm *suppliers* of MTBE producers, such as Methanex. Thus, the great bulk of Methanex’s assertions – that MTBE is a better product than ethanol, that the measures promoted ethanol at the expense of MTBE, that banning MTBE and permitting the use of ethanol lacked a sound scientific basis, and various other allegations of an intent to protect ethanol interests – do nothing to show the requisite intent to address producers of methanol such as Methanex.

8. The evidence proffered by Methanex in any event does not support the wild and strained inferences that it urges.

9. The purpose of California's government in banning MTBE was to prevent contamination of its citizens' drinking water by a chemical that made water undrinkable. The purpose was not to benefit ethanol producers, which had no presence in California in any significant sense in 1999 and still do not have such a presence today. Nor was the intent to harm, or even address, the methanol industry – an industry hardly even mentioned in the public process that led to the promulgation of the ban.

10. In short, nothing in the record before this Tribunal supports Methanex's assertion that the measures at issue were intended to address methanol producers in general or Methanex in particular. The record patently fails to establish that the measures at issue "relate to" Methanex. It therefore fails to establish the Tribunal's jurisdiction over this claim. It also, necessarily, fails to establish that the measures had the direct effect on Methanex required to establish proximate causation under international law and the NAFTA.

11. The United States wishes to underscore that the existence of this fatal flaw in Methanex's claim in no way suggests that it otherwise has any merit. It does not. Methanex has not established, and cannot establish, that the treatment it and its investments have received is any different from that received by any U.S.-owned producer or marketer of methanol, as required by Article 1102. Its claim under Article 1105(1) therefore fails on Methanex's own terms, and for the reasons the United States previously explained in its objections to admissibility. And Methanex has not even attempted to support its claim under Article 1110 of the NAFTA. Its claim, in short, is baseless on these grounds as well.

12. But the Tribunal need not address these questions. Because Methanex's submissions cannot support a finding that the measures "relate to" it within the meaning of Article 1101(1), its claims can and should be resolved at an early hearing limited to that subject, as the Tribunal anticipated in its First Partial Award.

## **II. OBSERVATIONS ON THE FACTS ON INTENT**

### **A. Relevant Factual Background**

13. The issue in this case is California's ban of the use of MTBE in California gasoline, which is to be phased out beginning on December 31, 2003. That ban is stated in regulations setting forth the standards for California Phase 3 Reformulated Gasoline ("CaRFG3 regulations").<sup>5</sup>

14. A number of other measures preceded and led to the promulgation of the ban. Because the purpose of the measures has been placed into question, we briefly review these antecedents and their purpose before addressing that of the ban itself.

#### **1. Senate Bill 521**

15. On October 8, 1997, California Governor Pete Wilson signed into law Senate Bill 521, which had been passed unanimously by the California Legislature, by a vote of 35 to 0 in the Senate and 79 to 0 in the Assembly. That bill, among other things, appropriated \$500,000 to the University of California for a study and assessment of the human health and environmental risks and benefits, if any, of MTBE.

16. Senate Bill 521 provided for the commissioned University of California study to be submitted to the Governor by January 1, 1999. The bill further provided that

the Governor would then be *required* to determine whether using MTBE in gasoline posed a risk to human health and the environment and, if so, to take appropriate action to protect human health and the environment from such a risk. The Governor's determination was to be "based solely upon the assessment and report submitted . . . and any testimony presented at the public hearings."<sup>6</sup>

17. The bill's purpose was as follows:

The Legislature hereby finds and declares that the purpose of this act is to provide the public and the Legislature with a thorough and objective evaluation of the human health and environmental risks and benefits, if any, of the use of methyl tertiary-butyl ether (MTBE), as compared to ethyl tertiary-butyl ether (ETBE), tertiary amyl methyl ether (TAME) and ethanol, in gasoline, and to ensure that the air, water quality, and soil impacts of the use of MTBE are fully mitigated.<sup>7</sup>

## **2. Executive Order D-5-99**

18. The UC Report, issued in November 1998, concluded that there were significant risks and costs associated with water contamination due to the use of MTBE. Specifically, the authors found that if the use of MTBE were to continue at its current level, there would be an increased danger of surface and groundwater contamination. The UC Report concluded that the cost of treatment of MTBE-contaminated drinking water sources in California could be enormous.

19. To remedy the serious problems facing California's water supply, the UC Report recommended consideration of phasing out MTBE in gasoline over an interval of several years. The UC Report reached this conclusion in light of the substantial costs

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<sup>5</sup> CAL. CODE REGS. tit. 13 §§ 2262, 2262.6(a)(1) (West 2003).

<sup>6</sup> S.B. 521, 1997-98 Reg. Sess., § 3(e) (Cal. 1997).

<sup>7</sup> *Id.* § 2.

associated with cleaning up MTBE contamination if MTBE were not phased out, and the ability to achieve comparable air quality benefits without relying on MTBE.

20. As detailed in the Statement of Defense of the United States dated August 10, 2000, California held three days of public hearings on the UC Report in February 1999. The public comments indicated broad-based support for the conclusion that MTBE posed a serious threat to California's drinking water and that imposition of a ban on the use of MTBE in California gasoline was warranted.

21. On March 25, 1999, Governor Gray Davis issued Executive Order D-5-99 ("1999 Executive Order"). The basis for the order was stated as follows:

[T]he findings and recommendations of the U.C. report, public testimony, and regulatory agencies are that, while MTBE has provided California with clean air benefits, because of leaking underground fuel storage tanks MTBE poses an environmental threat to groundwater and drinking water.<sup>8</sup>

22. In accordance with those findings and recommendations, Governor Davis certified that, "on balance, there is significant risk to the environment from using MTBE in gasoline in California."<sup>9</sup> The 1999 Executive Order tasked the California Energy Commission (CEC), in consultation with the California Air Resources Board (CARB), with developing "a timetable by July 1, 1999 for the removal of MTBE from gasoline at the earliest possible date, but not later than December 31, 2002."<sup>10</sup>

23. The 1999 Executive Order did not, however, embrace ethanol as a preferred alternative to MTBE. First, the order directed CARB to request an immediate waiver of the federal oxygenate requirement from the Administrator of the U.S.

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<sup>8</sup> 1999 EXECUTIVE ORDER pmb1.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* ¶ 4.

Environmental Protection Agency. Such a waiver, if granted, would have permitted California to use reformulated gasoline that achieved air quality requirements without any oxygenate.

24. Second, the 1999 Executive Order directed several California agencies to prepare reports on the environmental and health effects of using ethanol as an oxygenate. These reports were to be peer-reviewed and presented to the Environmental Policy Council for its consideration by December 31, 1999. As the Governor noted in a certification made along with the 1999 Executive Order, he ordered this study of ethanol having “learn[ed] a lesson from [California’s] experience with MTBE and [recognizing the necessity of] carefully assess[ing] the environmental impacts of other oxygenates such as ethanol *before* committing to its widespread use in California’s gasoline supply.”<sup>11</sup>

### **3. Senate Bill 989**

25. On October 8, 1999, Governor Davis signed into law Senate Bill 989, which had been passed by the California Senate by a vote of 25 to 10, and in the California Assembly by a vote of 73 to 6. That bill was proposed by the Association of California Water Agencies, an association of 400-plus public agencies and mutual water companies responsible for most of the water delivered to California’s farmers, businesses and cities. Senate Bill 989 imposed stringent, new requirements on underground storage tanks to prevent leaks.

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<sup>11</sup> Certification of Human Health or Environmental Risks of Using Gasoline Containing MTBE in California at 2 (Mar. 26, 1999).

26. The bill also required the CEC and the State Water Resources Control Board to “develop a timetable for the removal of MTBE from gasoline at the earliest possible date.”<sup>12</sup>

27. “According to the author and supporters of the bill, this [bill was] intended to place into statute Executive Order D-5-99 issued by Governor Davis on March 26, 1999, and to enact several other provisions of law designed to protect groundwater and drinking water from MTBE contamination.”<sup>13</sup>

#### **4. The CaRFG3 Regulations**

28. Following a December 9, 1999 hearing, on June 16, 2000, CARB adopted the CaRFG3 standards, which included a prohibition on the use of MTBE in gasoline after December 31, 2002. The regulations also required sulfur and benzene levels in California gasoline to be reduced.

29. In granting its approval to adopt the regulations, CARB found that

MTBE is highly soluble in water and will transfer to groundwater faster, farther, and more easily than other gasoline constituents such as benzene when gasoline leaks from underground storage tanks and pipelines; even upgraded storage tanks are not leak-proof and future leaks from a small percentage of the thousands of gasoline storage tanks in the state will continue in the future; MTBE has been detected in the public drinking water supplies in South Lake Tahoe, Santa Monica, Los Angeles, San Francisco, Santa Clara, and other locations;

Along with toxicological concerns, low levels of MTBE in drinking water can be tasted and smelled by susceptible individuals with the taste characterized as solvent-like, bitter, and objectionable; the people of California will not accept drinking water in which they can taste MTBE;

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<sup>12</sup> S.B. 989, 1999-00 Reg. Sess., § 26 (Cal. 1999).

<sup>13</sup> See S. Comm. On Env'tl. Quality, analysis of S. 989, 1999-2000 Reg. Sess. (Apr. 12, 1999) (Comments: (1) Purpose of Bill), available at <[http://leginfo.ca.gov/pub/99-00/bill/sen/sb\\_0951-1000/sb\\_989\\_cfa\\_19990412\\_120039\\_sen\\_comm.html](http://leginfo.ca.gov/pub/99-00/bill/sen/sb_0951-1000/sb_989_cfa_19990412_120039_sen_comm.html)>.

Accordingly, the threat posed by MTBE to California's potential drinking water supplies, and the high estimated costs for the continuing costs of cleaning up MTBE groundwater contamination, make it necessary to prohibit the use of MTBE in California gasoline being supplied from production and import facilities on or after December 31, 2002 – the appropriate deadline identified by the CEC; . . . .<sup>14</sup>

## **5. Executive Order D-52-02 And The Amended CaRFG3 Regulations**

30. On March 14, 2002, Governor Davis issued Executive Order D-52-02 (“2002 Executive Order”) which directed CARB to take actions to postpone the ban on the use of MTBE in gasoline by one year. As the Order notes, this action was taken by the Governor in response to the U.S. federal government's denial of California's request for a waiver of the federal oxygenate requirement. Without that waiver, California would have been obligated to replace MTBE with ethanol, the only other viable oxygenate. However, as the Order noted, “the current production, transportation and distribution of ethanol is insufficient to allow California to meet federal requirements and eliminate use of MTBE on January 1, 2003[.]”<sup>15</sup> Thus, the Governor concluded that “[a]s a result [of the denial of California's waiver request], if use of MTBE is prohibited January 1, 2003, California's motorists will face severe shortages of gasoline, resulting in substantial price increases[.]”<sup>16</sup>

31. In a public statement released on the day he issued the 2002 Executive Order, the Governor expressed his unwillingness to maintain the original effective date of the ban when doing so would harm California's economy and motorists and would

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<sup>14</sup> CARB Resolution 99-39 (Dec. 9, 1999) at 6-7.

<sup>15</sup> 2002 EXECUTIVE ORDER pmb1.

<sup>16</sup> *Id.*

benefit the ethanol industry: “I am not going to allow Californians to be held hostage by another out-of-state energy cartel[.]”<sup>17</sup>

32. On November 8, 2002, CARB adopted amendments to the CaRFG3 regulations postponing imposition of the CaRFG3 standards and the prohibition of MTBE in California gasoline from December 31, 2002 until December 31, 2003.

**B. The Measures At Issue Do Not, And Were Not Intended To, Address Methanol Producers Or Methanex**

33. As the Tribunal held in its First Partial Award, California’s ban of MTBE on its face does not address or relate to Methanex or its investments.<sup>18</sup> There is simply no support for Methanex’s suggestion that the ban nonetheless was intended to harm methanol producers in general or Methanex in particular.

34. As demonstrated above, neither the ban itself nor any of the measures leading up to the ban suggests an intent to harm – or even address – methanol producers such as Methanex. To the contrary, the ban and the related measures each make clear that its purpose is to address the problem of MTBE contamination of California’s drinking water supplies.

35. As recognized by the Tribunal in its First Partial Award, governmental acts such as these are presumed to be regular under international law.<sup>19</sup> The statement of purpose expressed in each of the measures is therefore imbued with that presumption of regularity. As the International Court of Justice stated in the *Fisheries* case, “[i]n the

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<sup>17</sup> Press Release, Office of the Governor, Governor Davis Allows More Time for Ethanol Solution (Mar. 15, 2002).

<sup>18</sup> See First Partial Award ¶ 150.

<sup>19</sup> See First Partial Award ¶ 45 (noting “the legal doctrine of *omnia praesumuntur rite esse acta* . . .”).

absence of convincing evidence to the contrary, the Court cannot readily find” that these measures are other than what they purport to be.<sup>20</sup> Methanex has presented no evidence to overcome this presumption.

36. As the Tribunal anticipated in its First Partial Award, a multitude of individual actors were involved in promulgating the measures at issue as well as the other relevant measures.<sup>21</sup> The 1999 Executive Order, as noted above, was based on “the findings and recommendations of the U.C. report, public testimony, and regulatory agencies . . . that . . . MTBE poses an environmental threat to groundwater and drinking water.”<sup>22</sup> The seven authors of the UC Report, the members of the public who testified during the three days of hearings on the issue and the various regulatory agencies that submitted comments all contributed to the findings on which the Governor’s 1999 Executive Order was based. Seventy-three members of the California Assembly and twenty-five Senators voted for Senate Bill 989, which contained a provision concerning MTBE substantially similar to that of the 1999 Executive Order and which served as authority for CARB to issue the CaRFG3 regulations. All eleven members of CARB approved the measure at issue, which was drafted and presented by members of the CARB staff based on an extensive administrative record to which many members of the public and others contributed.

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<sup>20</sup> *Fisheries Case* (U.K. v. Nor.), 1951 I.C.J. 116, 140 (Dec. 18).

<sup>21</sup> See First Partial Award ¶ 158 (“In particular, decrees and regulations may be the product of compromises and the balancing of competing interests by a variety of political actors. . . . Where a single governmental actor is motivated by an improper purpose, it does not necessarily follow that the motive can be attributed to the entire government.”).

<sup>22</sup> 1999 EXECUTIVE ORDER pmb1.

37. For Methanex's claim to succeed, at least a majority of the individual actors playing a decisive role in the adoption of the measures would have to have been acting in bad faith in subscribing to reports, recommendations, bills, orders and regulations that stated their purpose as addressing the problem of MTBE contamination of California's drinking water supplies – when in fact, according to Methanex, the true purpose was to harm methanol producers. In short, Methanex's theory depends upon a vast conspiracy, involving hundreds of government officers, all of whom would have to have been acting in bad faith.

38. It is well-settled in international law, however, that bad faith may not be presumed. And Methanex offers not a shred of evidence to support the existence of any such conspiracy. The evidence that Methanex does present cannot withstand scrutiny. The facts demonstrate that no prejudice against methanol producers in general or Methanex in particular can be attributed to the government of California.

**1. The Record In No Way Supports Methanex's Assertion That The Measures Were Intended To Harm Methanol Producers**

39. Methanex's assertion that the purpose of the measures at issue was to harm methanol producers is based principally on speculation as to what Archer Daniels Midland ("ADM") officers may have said to gubernatorial candidate Gray Davis at an August 1998 meeting and on a witness statement by Robert Wright in which he purports to relate what unnamed persons told him concerning a supposed meeting with California Senator Burton. We address each of these in turn.

40. As a preliminary matter, Methanex's attempt to ascribe bad faith to Governor Davis in issuing the 1999 Executive Order is misguided as well as unsupported.

As the Order itself notes, the UC Report, public testimony and agency views all found that MTBE posed a threat to drinking water; and the UC Report recommended consideration of a phase-out of MTBE use in gasoline. Indeed, Methanex's own experts concede that Governor Davis issued the 1999 Executive Order in response to the UC Report's conclusion that MTBE posed significant risks and costs associated with water contamination.<sup>23</sup>

41. What would have been unusual, in light of these findings and recommendations and the public testimony that supported them, would have been for the Governor *not* to have issued the order he did. Issuance of an order entirely consonant with the findings, recommendations and testimony before the Governor (which was required by Senate Bill 521 to be the sole basis for his determination) can hardly serve as a basis for an argument that he acted in bad faith.

42. In fact, Methanex offers no evidence at all of bad faith on the Governor's part. All it offers is a copy of a purported draft itinerary for a trip by gubernatorial candidate Davis to Illinois to meet with ADM officers. Methanex does not attempt to authenticate the document or even to state where it came from – likely because it is a copy made from files of Regent International, duplicated without the company's knowledge or authorization.

43. Gubernatorial candidate Davis did indeed meet with ADM officers in August 1998. He disclosed the use of ADM's airplane to travel to that meeting, before his election to the governorship, on his campaign disclosure forms dated October 6, 1998.

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<sup>23</sup> See Exponent, Evaluation of UST/LUST Status in California and MTBE in Drinking Water, Executive Summary at xiii ("In response to concerns over possible MTBE releases in the environment, the California

The brief meeting, held over dinner, was a get-acquainted session with a potential corporate supporter of the candidate's campaign. There was no discussion of methanol at the dinner, nor was there any discussion of the benefits or detriments of ethanol as compared with MTBE. The mere fact that this dinner took place provides no support for Methanex's assertion that Governor Davis acted in bad faith in issuing the 1999 Executive Order. Methanex's sheer speculation based on that dinner does not even merit a response.

44. Nor can a finding of bad faith be based on the witness statement of Robert Wright, an officer of Methanex. That statement purports to describe what Mr. Wright was told by unidentified persons who supposedly held a meeting with Senator John Burton "shortly before Executive Order D-5-99 was issued."<sup>24</sup> It is evident that a statement such as this, based entirely on hearsay by unnamed persons, is inherently unreliable.

45. Moreover, the statement is unreliable because it lacks any context for the supposed remarks it sets forth. The Senator's alleged remarks could merely have been a frank assessment of the likelihood that Governor Davis would reject the findings and recommendations of the UC Report, the public testimony and the agencies consulted. Nor is it in any way clear that the Senator understood either what Methanex was or whether it produced methanol rather than MTBE. In short, such a slender reed as this statement certainly cannot serve as a basis for attributing bad faith to an entire government.

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legislature enacted SB 521 in 1997 . . . . [The UC Report] was a driving force in the governor's final decision to initiate such a ban.").

<sup>24</sup> Wright Aff., attested Nov. 4, 2002, ¶ 3.

46. The remainder of Methanex's evidence falls into two categories: evidence that the measure at issue would benefit ethanol at the expense of MTBE,<sup>25</sup> and evidence of sentiments concerning methanol or MTBE expressed by various persons outside of the California government.<sup>26</sup>

47. The first category is irrelevant. As the Tribunal held in the First Partial Award, the fact that the measures address MTBE, or have the effect of benefiting ethanol, does not and cannot establish that the measures relate to producers and marketers of methanol like Methanex. As demonstrated in Part II(C) below, Methanex's attempt to conflate methanol with MTBE is without support. This category of evidence can do nothing to show that the purpose of the measures at issue was to address methanol producers.

48. The second category is equally irrelevant. The fact that officers of ADM, or politicians in states of the United States other than California, may have expressed various sentiments concerning methanol or MTBE does nothing to prove that California

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<sup>25</sup> See, e.g., Second Amended Statement of Claim ¶¶ 89-110 (alleging that MTBE is a better product, suggesting that the only rational explanation for the measure is to benefit ethanol over MTBE); *id.* ¶¶ 111-27 (providing history of relevant measures with emphasis on how such measures allegedly favor ethanol over MTBE); *id.* ¶¶ 128-32 (alleging that the waiver request shows that ethanol would be the primary beneficiary of the MTBE ban, even were the waiver to be granted); *id.* ¶ 133 (alleging that the postponement of the MTBE ban demonstrates that ethanol would benefit from the ban); *id.* ¶¶ 134-41 (alleging that MTBE is being replaced with ethanol); *id.* ¶¶ 146-57 (arguing that California wanted to promote an in-state ethanol industry); *id.* ¶¶ 158-61 (alleging that the MTBE ban promoted only ethanol as a replacement for MTBE); *id.* ¶¶ 162-65 (alleging that the technical changes made to the MTBE ban would benefit ethanol); *id.* ¶¶ 174-90 (arguing that other jurisdictions and politicians have traditionally protected ethanol); *id.* ¶¶ 191-201 (arguing that ban of MTBE, but not other dangerous chemicals, leads to the inference that California intended to benefit ethanol); *id.* ¶¶ 202-220 (arguing that ADM, an ethanol producer, sought passage of measures benefiting its product); *id.* ¶¶ 220-27, 229-33, 235, 237-38 (alleging that ADM sought to promote ethanol at a meeting with gubernatorial candidate Gray Davis).

<sup>26</sup> See, e.g., *id.* ¶¶ 134-37 (statements made by California refiners); *id.* ¶¶ 184-87, 266-70 (statements from U.S. legislators); *id.* ¶ 188 (statement by former U.S. EPA Administrator, Carol Browner); *id.* ¶ 189 (statement of the Renewable Fuels Association); *id.* ¶¶ 212, 228, 273-74 (statements made by ADM officials); *id.* ¶¶ 228, 279 (letter from Regent International); *id.* ¶¶ 271-72 (statements by public interest groups); *id.* ¶¶ 276-77 (statements from governors of states other than California).

officers shared those sentiments. This category of evidence also cannot establish that California intended to harm Methanex or methanol producers generally.

**2. To The Contrary, The Record Shows That California Harbors No Ill Will Toward Methanex**

49. Not only is the record devoid of any evidence of intent to harm Methanex, the record *belies* any intent on California's part to discriminate against Methanex. To the contrary, the record shows that Methanex was selected for participation in an important California initiative on fuel cells.

50. In April 1999, California initiated the California Fuel Cell Partnership, a collaboration of private industry and government, whose main objective is to promote the commercialization of fuel cell vehicles.

51. Currently, the California Fuel Cell Partnership has twenty partners, who contribute financially to the partnership and ten "associate partners," who contribute either expertise or equipment to the partnership. Full partners include the world's leading auto manufacturers, fuel suppliers, and fuel cell technology companies, as well as United States government agencies at the federal, state and local level. Associate partners include leaders in the energy industry, as well as three transit authorities. The California agency partners, which include the CEC and CARB, not only contribute financial resources, but also products and services as needed. The State of California is the largest single contributor to the California Fuel Cell Partnership's budget and is a charter member of the Partnership.

52. In March 2000, Methanex was selected by the California Fuel Cell Partnership to be the Partnership's only associate partner from the methanol industry. In

the process of selecting Methanex, the California Fuel Cell Partnership rejected applications for partnership from the American Methanol Institute and other smaller methanol companies. Methanex has touted its selection and participation in the Partnership in press releases.

53. The fact that Methanex was chosen to participate in a collaboration in which the State of California was one of the founding members and is the largest financial contributor evidences that California has no animus towards Methanex. Furthermore, that Methanex was chosen even though U.S. enterprises, such as the American Methanol Institute, were rejected demonstrates that California has no animus towards Methanex. This conclusion is buttressed by the fact that the very same agencies that coordinate the Partnership, the CEC and CARB, are the agencies that were principally responsible for the CaRFG3 regulations that Methanex is challenging.

**C. Methanex’s Attempt To Conflate Methanol With MTBE Is Without Support**

54. Contrary to Methanex’s assertions, methanol and ethanol are not “essentially interchangeable.”<sup>27</sup> Rather, as the Tribunal observed in its First Partial Award, “[e]thanol is . . . an oxygenate that directly competes with MTBE”; methanol is not.<sup>28</sup> Because methanol does not compete in the oxygenate market, Methanex’s suggestion that ethanol’s advantage is tantamount to methanol’s disadvantage is without merit. And, therefore, the bulk of the evidence offered by Methanex – which purports to show that the purpose of the measures at issue was to favor ethanol over MTBE – on its face cannot meet the standard for a showing of intent outlined in the First Partial Award.

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<sup>27</sup> Second Amended Statement of Claim at 25 (heading V(A)); *see also id.* ¶¶ 70, 159.

55. Methanex posits a “binary choice” between methanol and ethanol in three oxygenate markets: gasoline distributors, merchant oxygenate producers, and gasoline refiners.<sup>29</sup> As demonstrated below, the supposed “binary choice” between methanol and ethanol does not exist in reality in any of these three markets.

**1. Gasoline Distributors Do Not Have An Option Of Buying Methanol**

56. Presently, ethanol is widely used as an oxygenate in gasoline produced for distribution in California. Gasoline distributors located in California purchase ethanol from ethanol producers. They then combine the ethanol with gasoline basestock at distribution terminals. The two streams of product are combined as the tank trucks are loaded, an operation referred to as “splash blending.” The blended product then is distributed as CaRFG3 gasoline. For these distributors, only chemicals that can be used as an oxygenate *in gasoline* are eligible for blending. In the California gasoline-distributor market, only ethanol is splash blended at distribution terminals.

57. By contrast, methanol is not, and cannot practically be, used as an oxygenate in gasoline. Factors that impede methanol’s use as an oxygenate include its highly corrosive and toxic nature, its effect on the Reid vapor pressure of gasoline, and its lack of luminosity when burning. Contrary to Methanex’s allegation, methanol does not compete with either ethanol or MTBE as an oxygenate in California’s gasoline. Due to its chemical and physical properties, methanol cannot be used in conventional vehicles.

58. Indeed, Methanex’s new assertions that methanol competes with ethanol (and MTBE) as an oxygenate stand in stark contrast to its earlier conduct and statements.

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<sup>28</sup> First Partial Award ¶ 50 (citing Methanex Draft Amended Claim at 10-11).

59. *First*, Methanex has never suggested in its public disclosures to its shareholders that it has sold or marketed methanol as an oxygenate in gasoline. Nor has it suggested in such disclosures that the oxygenate market holds any potential for methanol other than as an ingredient used to manufacture MTBE.

60. *Second*, Methanex has repeatedly acknowledged in these proceedings, and again in its most recent fresh pleading, that methanol is not a competitor in the oxygenate market.<sup>30</sup> To the contrary, as Methanex has acknowledged, the market essentially has been winnowed to two competing chemicals: ethanol and MTBE.<sup>31</sup> Indeed, prior to filing its Second Amended Statement of Claim, Methanex had never before suggested that methanol may be used as an oxygenate in gasoline.

61. *Finally*, Methanex's own evidence does not support the assertion that methanol is or can be used as an oxygenate in California gasoline. Indeed, Methanex itself states that the blending plants' choice includes only a "*theoretical option*" of buying

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<sup>29</sup> Second Amended Statement of Claim at 29-31.

<sup>30</sup> See First Macdonald Aff. ¶ 8 ("Gasoline blenders and distributors may oxygenate their reformulated gasoline with any oxygenate available on the merchant market, including ethanol, MTBE, ETBE and TAME. Typically, gasoline blenders have relied upon either MTBE or ethanol to meet their oxygenate needs."); see also Second Macdonald Aff. ¶ 15 (noting that, "[f]or integrated refineries, the choice is either to buy methanol and produce MTBE, or to buy ethanol for either the production of ETBE or for splash blending. For blenders and distributors, the choice is to buy methanol-based MTBE from merchant producers, or to buy ethanol."); *id.* ¶ 19 ("Before the ban was announced, other oxygenates simply could not compete with MTBE's cost-effectiveness and other benefits under 'level playing field' conditions."); *id.* ¶ 22 ("Direct use of methanol as an oxygenate was also not seriously considered before the MTBE ban was announced because it made greater practical sense to convert methanol to MTBE, which is easier and more advantageous to blend with gasoline than either methanol or ethanol."); *id.* ¶ 28 ("Before the MTBE ban was announced . . . methanol was not seriously considered [as an oxygenate], as it was more advantageously used to make MTBE.").

<sup>31</sup> See Second Amended Statement of Claim ¶ 57 (In this case, "essentially only two competing products [*i.e.*, MTBE and ethanol] are vying for the same customers in the same market . . ."); Second Macdonald Aff. ¶ 14 ("Although blenders and refiners have always had the choice between all four oxygenates, subject to their technical requirements, these blenders and refiners have primarily chosen MTBE or, to a much lesser extent, ethanol.").

methanol for use as an oxygenate that could be splash blended with gasoline.<sup>32</sup> Instead, Methanex's evidence shows only that: (1) as a technical matter, methanol belongs to a class of chemicals known as oxygenates; and (2) methanol can be added to gasoline.<sup>33</sup> Neither of these propositions, however, establishes that methanol competes, or can compete, in the market for oxygenates in California's gasoline.

62. Methanex's Senior Officer sums up the point well: "For blenders and distributors, the choice is to buy . . . MTBE from merchant producers, or to buy ethanol."<sup>34</sup> There is no binary choice between methanol and ethanol in this market.

## **2. Merchant Oxygenate Producers Do Not Face A Choice Between Methanol And Ethanol**

63. Merchant oxygenate producers manufacture oxygenates for resale to gasoline refiners and distributors. There are essentially two categories of merchant oxygenate producers in the United States: ethanol producers and MTBE producers. In the California gasoline market, merchant MTBE is sold only to gasoline refiners, and ethanol is sold only to gasoline distributors. MTBE and ethanol are produced using very different processes.

64. Ethanol used as an oxygenate is produced from renewable, biological materials. Corn is the most common raw material for ethanol production in the United States, although a wide variety of biological materials can also be used. Most ethanol production in the United States is centered in the Mid-West, which is also where much agriculture in the United States is based.

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<sup>32</sup> See Second Amended Statement of Claim ¶ 82 (emphasis added)

<sup>33</sup> See Second Macdonald Aff. ¶¶ 7, 12.

<sup>34</sup> *Id.* ¶ 15.

65. MTBE is produced by reacting methanol with isobutylene. A little more than one unit of methanol goes into every three units of MTBE. The producers buy methanol and produce isobutylene and react them at their facilities to produce MTBE. Most merchant MTBE manufacturers are located on the Gulf Coast, where much of the petrochemical industry in the United States is based.

66. Thus, there is no “binary choice” facing merchant oxygenate manufacturers. Ethanol manufacturers buy corn or other biological materials to make their oxygenate. MTBE manufacturers produce isobutylene and purchase methanol to make theirs. Neither can use the inputs used by the other.

67. In its discussion of the supposed “binary choice” facing merchant oxygenate producers, Methanex refers to merchant producers of the ether ETBE, pointing out that ETBE is produced by reacting ethanol with isobutylene. Methanex’s reference to ETBE is a red herring for two reasons.

68. *First*, as Methanex itself acknowledges, “there are currently no ETBE producers in the United States.”<sup>35</sup> There is currently no market for ethanol as a feedstock to produce ETBE for use in California gasoline. Ethanol and methanol can in no sense “compete” in a market that does not exist.

69. *Second*, there will be no such market in the future. The ban at issue, when it goes into effect, will prohibit the use of ETBE in gasoline just as it will ban the use of

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<sup>35</sup> See Second Macdonald Aff. ¶ 13; see also *id.* ¶ 15.

MTBE in gasoline.<sup>36</sup> As a result, contrary to Methanex's assertions, there is not and will be no "zero-sum" competition between methanol and ethanol in this market.<sup>37</sup>

**3. Gasoline Refiners Do Not Have A Choice Between Methanol And Ethanol For The Same Reasons**

70. Some vertically integrated gasoline refiners produce MTBE for use within their refineries using an isobutylene source generated by the refining process. They are commonly termed "captive" MTBE manufacturers because they use, rather than sell, the MTBE they produce. Such plants produce relatively small amounts of MTBE and the availability of isobutylene dictates their capacity. Like merchant MTBE producers, captive producers generally buy methanol to manufacture MTBE. There are captive MTBE producers throughout the United States. A number of them are located in California and supply the California gasoline market. In 2000, about 15 percent of the MTBE used in California gasoline was produced by captive plants located in California.

71. Ethanol does not compete with methanol in the market for captive producers of MTBE. As noted above, ethanol is not used to produce MTBE. There are no producers of ETBE for use in California gasoline, whether they be captive or merchant. Nor will there be any after the CaRFG3 regulations go into effect, because they ban ETBE just as they ban MTBE.

72. Methanex's suggestion that captive refiners may choose to splash blend either methanol or ethanol instead of producing MTBE is without support.<sup>38</sup> As addressed in Part C(1) above, methanol is not used as an oxygenate. As a result, the

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<sup>36</sup> The ban on ETBE is conditional in that, under the California regulations, it cannot be used as an oxygenate without its first undergoing a multimedia study.

<sup>37</sup> Second Amended Statement of Claim at 20 (heading IV(C)); *id.* ¶ 304.

captive refiners do not have a choice of “buying methanol” for splash blending, as Methanex suggests.<sup>39</sup>

**D. In Any Event, Methanex’s Suggestion That The Measures’ Purpose Was To Benefit Ethanol Is Without Merit**

73. The foregoing discussion establishes that the purpose of the measures at issue was not to harm or even address methanol producers or Methanex. On this ground alone, Methanex has failed to demonstrate that the measures “relat[e] to” it or its investments within the meaning of NAFTA Article 1101(1). The Tribunal thus lacks jurisdiction over Methanex’s claim.

74. As demonstrated above, there does not exist a binary choice between ethanol and methanol in the oxygenate market. The United States nevertheless observes that the record in any event does not support Methanex’s assertion that the purpose of the measures at issue was to benefit ethanol at the expense of MTBE. Although a future ban on the use of MTBE in California gasoline may have the consequence of benefiting ethanol producers, benefiting such producers was not California’s *intent* in adopting the ban. California adopted the ban on MTBE in gasoline in order to address contamination of its drinking water. Contrary to Methanex’s allegations, California did not adopt the ban as a gift to the ethanol industry. The record simply does not support the strained inferences and arguments that Methanex attempts to draw from it.

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<sup>38</sup> See Second Amended Statement of Claim ¶ 79.

<sup>39</sup> See *id.* ¶ 80.

**1. Campaign Contributions From And Contacts With Executives From The Ethanol Industry**

75. Methanex's allegations concerning then-gubernatorial candidate Davis's meeting with executives from ADM provide no support for the assertion that Governor Davis issued the Executive Order to benefit the ethanol industry.

76. Political campaigns in the United States, particularly for governorships of major states such as California, are expensive. It is therefore commonplace in the United States for candidates for elected office to meet with constituents and potential contributors who may support their campaign. There is nothing improper or even remarkable about a political candidate receiving contributions from individuals or companies or meeting with potential supporters.

77. No inference as to Governor Davis's motivation may be drawn from the mere fact that he received campaign contributions from ADM, any more than such an inference can be drawn from the fact that a broad base of supporters, including ARCO (an MTBE producer) and other petrochemical companies and interests, Zenith Insurance Company, Ameriquest Capital Corporation, the California Teachers Association, and the California State Employees Association, among many others, all made contributions to his campaign.

78. Nor may any inference as to an official's views be drawn from the mere fact that Governor Davis or any other official met with potential supporters or lobbyists. The fact that a political decision-maker is willing to listen to the views of an interested party does not necessarily mean that the decision-maker agrees with those views. Indeed, the participants in the alleged meeting that Methanex claims took place with Senator

Burton supposedly included three lobbyists hired by Methanex, one lobbyist hired by an MTBE producer and one lobbyist from a trade association. Bad faith can no more be inferred from candidate Davis's meeting with executives involved in the ethanol industry, including ADM and Regent, than it could be inferred based on an alleged meeting between Methanex's lobbyists and Senator Burton.

79. It is significant, in considering the inferences that Methanex urges the Tribunal to draw from these meetings and contributions, that Methanex disavows any suggestion that Governor Davis engaged in any illegal activity either during his campaign or while in office. Specifically, Methanex states that it is not alleging that Governor Davis solicited or received any bribe, which would constitute a federal offense.<sup>40</sup> Therefore, Methanex does not contend that Governor Davis issued the Executive Order in return for receiving campaign contributions from ADM or anyone else. Furthermore, all of Governor Davis's campaign contributions, including those made by ADM, were disclosed pursuant to law.

## **2. Supposed Reaction To "Public Hysteria" Over MTBE**

80. Methanex also suggests that bad faith can be inferred from the fact that the California measures accorded with strong public concern over the problem of MTBE contamination. Methanex describes that strong public concern as "public hysteria" inspired by environmentalists and ethanol producers.<sup>41</sup> Methanex's suggestion that this supports a finding of bad faith is untenable.

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<sup>40</sup> See Second Amended Statement of Claim ¶ 143; First Partial Award ¶ 70; Transcript of Hearing on Jurisdiction and Admissibility (Uncorrected) at 486-88.

<sup>41</sup> See Wright Supp. Aff. ¶ 4 ("The assault on the use of MTBE in California has been the product of a well financed, organized, negative media and public profile campaign orchestrated by Archer Daniels, Midland's top executives [and industry allies], and the resulting hysteria.").

81. In democracies like those of the NAFTA Parties, the public sometimes will act directly in deciding matters of public policy, such as when referendums are held. In most cases, however, the public does not act directly. Rather, it elects officials who act on its behalf. Those officials are entrusted by the public to act as its representatives.

82. The Governor of California is, of course, one such elected official. As such, it is the Governor's responsibility to take public opinion into account when making decisions. Like any elected official, the Governor may sometimes choose to take action that a majority of his constituents disfavor. It is, however, unremarkable that an elected official, such as the governor of a state, would gauge public opinion when formulating positions on matters of public policy. And it is entirely legitimate for an elected representative to take action demanded by the citizens of the state he represents. Indeed, Methanex's contention that the Governor issued the 1999 Executive Order in response to public concern that MTBE was contaminating California's water supply supports the conclusion that the Governor's actions were taken in response to those concerns, and not with the intent to harm any company or industry.

83. In effect, Methanex urges this Tribunal to find that California acted in bad faith merely because Methanex's views were not upheld in the court of public opinion in California, while views that it attributes to environmentalists and the ethanol industry prevailed. It is not the place of this Tribunal, however, to second-guess the democratic process in California. To put the point in legal terms, the United States is not responsible for the views expressed by any private person on the issues of the day, whether those views be expressed by environmentalists, MTBE producers or anyone else – and whether or not the public finds those views persuasive.

### 3. Lobbying By Ethanol Supporters

84. As an initial matter, Methanex's evidence of lobbying by an ethanol industry supporter is inconclusive. Although Methanex claims that this lobbyist drafted certain essential legislation, Methanex nowhere offers any evidence from which one could conclude whether the California legislature adopted this lobbyist's initiatives.

85. In any event, Methanex's allegations concerning the ethanol lobbyist's advocacy in the legislative process provide no basis to infer an intent by California to benefit ethanol producers. Lobbyists regularly urge and propose the adoption of measures by the legislature; no negative inference may be drawn from such advocacy.

86. Nor may any inference as to the legislature's intent be inferred from remarks made by any single legislator.<sup>42</sup> For this reason alone, remarks made by Senator Mountjoy in the debates leading to the enactment of SB 521 are of no consequence. In any event, Methanex's reliance on those remarks is misplaced. Read in context, the Senator's statements reflect his concern that MTBE poses a threat to the environment, and in no way are indicative of an intent to discriminate on the basis of nationality.<sup>43</sup>

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<sup>42</sup> See First Partial Award ¶ 158.

<sup>43</sup> Methanex, quoting the Senator's remarks out of context, suggests that Senator Mountjoy displayed discriminatory intent by referencing the foreign origin of MTBE. See Wright Supp. Aff. ¶ 3. Read in context, those remarks display no such sentiment. Rather, aware that MTBE travels rapidly in water, does not biodegrade, and is very difficult to remediate, Senator Mountjoy cautioned that "[i]f a tanker were to spill, MTBE could not be contained like other gasoline components. The effects of MTBE on coastal marine life, or any aquatic life, are unknown. MTBE is shipped from Latin America, Saudi Arabia, Malaysia, Canada, and other places from around the world. We have no technology to remediate a spill from one of these vessels." See Letter from Senator Mountjoy to Governor Wilson, dated Sept. 22, 1997, attached at tab 4 to Wright Supp. Aff.

**4. California's Request For A Waiver And The 2002 Executive Order**

87. The 1999 Executive Order states Governor Davis's intent to remedy the threat of MTBE contamination of California's drinking water supply. The Governor's intent *not* to benefit the ethanol industry is also apparent on the face of the Executive Order and in a press statement issued by the Governor simultaneously with his promulgation of the Executive Order.

88. In the 1999 Executive Order, the Governor directed California officials to seek a waiver of the oxygenate requirement in the federal reformulated gasoline program. That requirement mandates that gasoline contain two percent oxygen by volume. California, however, believed that it could achieve air quality standards without using any oxygenate at all and sought the waiver on this basis. If the waiver were granted, therefore, the result would likely be that oxygenates, whether ethanol or MTBE, would be much less frequently used in California reformulated gasoline.

89. The Governor also explained, in a press statement released simultaneously with the 1999 Executive Order, that he had ordered a study of the possible risks and benefits of ethanol so that California would not make the mistake of rushing to replace MTBE with ethanol without knowing the consequences of doing so.

90. On April 12, 1999, Governor Davis wrote a letter to U.S. EPA Administrator Carol Browner seeking the waiver. Thereafter, CARB corresponded with U.S. EPA on a number of occasions, providing scientific and economic information in support of the waiver. When California failed to receive a response to its request, the Governor wrote a second letter to Administrator Browner stressing California's urgent

need for a decision on the waiver. This was followed by yet another letter from the Governor to President George W. Bush, urging a waiver of the federal oxygenate requirement.

91. On June 12, 2001, the U.S. EPA denied California's request for a waiver of the federal oxygenate requirement. In response, the Governor challenged the denial in federal court.

92. California's relentless pursuit of a waiver of the federal oxygenate requirement demonstrates its absence of intent to benefit the ethanol industry. As Methanex concedes, a grant of the waiver sought by California would *harm* the interests of the ethanol industry, as sellers of gasoline in California would not be compelled to add ethanol to gasoline to comply with the federal oxygenate requirement. As Methanex notes, "the U.S. ethanol industry bitterly opposed the waiver."<sup>44</sup>

93. In addition, Governor Davis issued the 2002 Executive Order, which postpones the date of the ban on the use of MTBE in California gasoline by one year. As the Executive Order notes, the Governor took this step because implementing the ban without the federal oxygenate waiver in place would require California to use large quantities of ethanol as a replacement oxygenate, which, in the near term, would negatively impact the supply and availability of gasoline in California. In his accompanying statement, the Governor made clear that his intent was not to benefit the ethanol industry: "I am not going to allow Californians to be held hostage by another out-of-state energy cartel."<sup>45</sup>

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<sup>44</sup> Second Amended Statement of Claim ¶ 131.

<sup>45</sup> Press Release, Office of the Governor, Governor Davis Allows More Time for Ethanol Solution (Mar. 15, 2002).

94. Not surprisingly, ethanol advocates opposed and criticized the issuance of the 2002 Executive Order – and the MTBE and methanol industry loudly applauded it.

95. As demonstrated above, California had no intent to benefit ethanol through the MTBE ban. In California's view, reliance solely on ethanol would be costly, lead to an increase in air pollution and deny refiners a choice. California made every effort to avoid relying on ethanol, and continues to fight for the oxygenate waiver. Methanex's claim that California intended to benefit ethanol producers is baseless.

#### **5. California Regulatory Action On Ethanol**

96. Various regulatory actions taken by California with respect to ethanol also demonstrate that California is not motivated by an intent to benefit ethanol producers.

97. The technical changes made to the CaRFG3 regulations highlighted by Methanex did not benefit ethanol.<sup>46</sup> The regulatory amendment permitting 3.7 percent oxygen by weight for gasoline containing no more than ten percent by volume ethanol merely accounted for potential differences in gasoline density. CARB mandated that any emission increase associated with the higher oxygen content would have to be fully offset by emission benefits from other changes to the gasoline so there would be no increase in nitrogen oxide emissions. Furthermore, the Reid vapor pressure provisions in the CaRFG3 regulations did not provide treatment for gasoline with ethanol that was any different from that provided for gasoline with any other oxygenate or non-oxygenated

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<sup>46</sup> See Second Amended Statement of Claim ¶¶ 123, 162.

gasoline. Nor did this provision permit increased emissions from gasoline containing ethanol.

98. Contrary to Methanex's suggestion, California has not hesitated to take appropriate regulatory action opposed by ethanol producers. For example, in December 1998, CARB made a finding that removed the statutory exemption that allowed California gasoline blends containing ten percent ethanol to exceed CARB's Reid vapor pressure standard controlling evaporative emissions. This determination was vigorously opposed by ethanol advocates.

99. Similarly, in August 1998 CARB eliminated the wintertime oxygenate requirements everywhere but in six counties in Southern California because it found that that requirement was no longer necessary to achieve health-based carbon monoxide standards. As a result of this change, refiners eliminating MTBE in gasoline sold, for example, in the San Francisco Bay area – which is not subject to the federal reformulated gasoline oxygen requirements – do not need to use ethanol as an oxygenate in that gasoline during any part of the year.

### **III. POINTS AT ISSUE**

#### **A. The Measures At Issue Do Not “Relate To” Methanex Or Its Investments**

100. The measures at issue do not fall within the scope of the Tribunal's jurisdiction as circumscribed by Article 1101(1). The scope of NAFTA's investment chapter for the claims at issue here is limited to “measures adopted or maintained by a Party *relating to*: (a) investors of another Party; [or] (b) investments of investors of

another Party in the territory of the Party.”<sup>47</sup> As the Tribunal held in its First Partial Award, “the phrase ‘relating to’ in Article 1101(1) NAFTA signifies something more than the mere effect of a measure on an investor or an investment[:]. . . it requires a legally significant connection between them . . . .”<sup>48</sup>

101. The measures relate to the use of MTBE in California’s gasoline. On their face, they do not relate to suppliers of producers of MTBE that incidentally may be affected by the ban. On their face, the measures do not relate to Methanex or to methanol producers and marketers like Methanex and its investments.

102. Nor was the purpose of the measures indirectly to address methanol producers or Methanex. The purpose of the measures was to protect California’s drinking water supplies from a contaminant – MTBE – that made those supplies undrinkable. There is simply no support for Methanex’s allegation that the measures were intended to harm methanol producers.

103. For these reasons, and those set forth in greater detail above, the measures at issue do not “relat[e] to” Methanex or its investments within the meaning of Article 1101(1). Methanex’s claims therefore fall outside of the scope of NAFTA’s investment chapter and this Tribunal has no jurisdiction under that chapter to hear those claims.

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<sup>47</sup> NAFTA art. 1101(1)(a)-(b) (emphasis added).

<sup>48</sup> First Partial Award ¶ 147.

**B. Methanex's Claims Fail Because Its Supposed Injuries Are Too Remote**

104. The same facts that show there to be no legally significant connection between the measures and Methanex or its investments also establish that Methanex's supposed injuries are too remote to support a claim under the NAFTA's investment chapter.

105. As demonstrated at length in the United States' submissions on jurisdiction and admissibility, international tribunals have repeatedly dismissed claims where the claimant's alleged injury resulted solely from an action's adverse effect on a person with whom the claimant has a contractual relationship. For example, as the International Court of Justice recognized in the *Barcelona Traction* case, "[c]reditors do not have any right to claim compensation from a person who, by wronging their debtor, causes them loss. In such cases, no doubt, the interests of the aggrieved are affected, but not their rights."<sup>49</sup>

106. The facts before this Tribunal establish precisely such a scenario: Methanex and its investments are but contractual counterparties with the MTBE producers to whom the measures relate. Any impact of the measures on Methanex and its investments – an impact that Methanex in any event has not attempted to prove – would derive entirely from the measures' effects on MTBE producers that have bought methanol from Methanex in the past. As demonstrated in the submissions on jurisdiction and admissibility, a showing such as this cannot establish a claim under the NAFTA's investment chapter.

107. The evidence that demonstrates this fatal defect in Methanex’s claim is essentially coterminous with that which establishes the Tribunal’s lack of jurisdiction under Article 1101(1). While doing so is perhaps not necessary to dispose of the case, the United States suggests that the Tribunal include this issue as one to be addressed at the hearing on whether the measures “relate to” Methanex or its investments.

#### **IV. STATEMENT AS TO NEW JURISDICTIONAL OBJECTIONS**

108. With the one exception described in the following paragraphs, the United States does not assert any objection to the Tribunal’s jurisdiction in addition to those previously stated. This statement should not, however, be construed as in any way limiting the United States’ ability to challenge whether Methanex has proven any element of its claim that might otherwise be considered as jurisdictional – for example, the fact that Methanex has put forward no competent evidence of its ownership of either of its alleged “investments” in the United States.

109. The United States objects to the Tribunal’s jurisdiction to entertain Methanex’s claim to the extent that it is based on the prohibition on the use in California gasoline of oxygenates other than MTBE.

110. For three years, the cornerstone of Methanex’s claim has been its “complain[t] against US measures taken by the State of California restricting the use of MTBE in gasoline in California.”<sup>50</sup> For the first time, in its fresh pleading, however, Methanex notes that the regulations “went beyond merely banning MTBE” by prohibiting

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<sup>49</sup> *Barcelona Traction Light & Power Co., Ltd.* (Belg. v. Spain), 1970 I.C.J. 3, 35 at ¶ 44 (Judgment of Feb. 5).

<sup>50</sup> First Partial Award ¶ 22.

the use of any oxygenate in gasoline other than ethanol unless that oxygenate undergoes a multi-media evaluation.<sup>51</sup> Methanex also observes that the regulations conditionally prohibit the use of *methanol* as an oxygenate in California gasoline after December 31, 2003.<sup>52</sup> Methanex's fresh pleading does not make clear, however, whether this observation is offered in support of Methanex's assertion that the ban on MTBE was intended to harm methanol producers, or whether it is intended to support a new claim. In any event, Methanex's new observation cannot support a claim for two reasons.

111. First, as demonstrated at length above in Part II(C), methanol is not, and cannot be, used as an oxygenate in gasoline. As a matter of fact, therefore, Methanex's new observation is of no consequence.

112. Second, it is far too late for Methanex to assert a new claim in these proceedings. In its Partial Award, the Tribunal made clear that "[t]he fresh pleading must not exceed the limits of Methanex's existing case (pleaded and unpleaded); and [it did] not intend Methanex to make any new claim in its fresh pleading."<sup>53</sup> The only possibility left open by the Tribunal was that "a fresh pleading from Methanex re-stating part of its *existing* case could survive [the jurisdictional] challenge."<sup>54</sup>

113. Article 20 of the UNCITRAL Arbitration Rules requires that a Tribunal deny a party permission to amend its claim where the amended claim would fall outside of the Tribunal's jurisdiction. Methanex has not complied with the NAFTA's jurisdictional prerequisites for asserting a new claim such as this. Moreover, pursuant to

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<sup>51</sup> Second Amended Statement of Claim ¶ 22.

<sup>52</sup> *See id.*

<sup>53</sup> First Partial Award ¶ 162.

<sup>54</sup> *Id.* ¶ 79 (emphasis added).

Article 20, permission to amend may, in any case, be denied having regard to delay and prejudice to the other party, as is evidently present here.

**V. STATEMENT AS TO EVIDENCE THE UNITED STATES INTENDS TO PRESENT**

114. As contemplated by the Tribunal's scheduling order of February 12, 2003, the United States offers the following statement as to the evidence that it intends to present in support of the factual case set out in this supplemental statement of defense. This statement should be understood as a complete, but provisional, indication of the evidence the United States intends to present. The United States reserves the right to modify or supplement the evidence indicated at the time when it submits the evidence in question.

**A. Witness Statements**

115. The United States presently intends to submit witness statements from the following persons on the following subjects:

**1. Bruce Burke**

116. Bruce Burke is a Vice President of Nexant, Inc., one of the nation's principal consulting firms for the petroleum and chemical industries. We anticipate that his statement will show that methanol is not used as an oxygenate in gasoline, and there are important practical reasons why it cannot be so used. We anticipate that his statement will also demonstrate that there is no "binary choice" between methanol and ethanol in any of the three markets identified by Methanex.

**2. Roger Listenberger**

117. Roger Listenberger is the Western Marketing Manager, Ethanol, for Archer Daniels Midland and one of the persons who attended the August 4, 1998 dinner that included then-gubernatorial candidate Gray Davis. We anticipate that Mr. Listenberger's statement will describe that dinner meeting.

**3. Dean Simeroth**

118. Dean Simeroth is the Chief of the Criteria Pollutants Branch of the California Air Resources Board. We anticipate that Mr. Simeroth's statement will discuss the background of certain CARB regulations on ethanol, and show that Methanex's assertion that those regulations favor ethanol are without merit.

**4. Richard B. Vind**

119. Richard B. Vind is the Chairman and Chief Executive Officer of Regent International and one of the persons who attended the August 4, 1998 dinner that included then-gubernatorial candidate Gray Davis. We anticipate that Mr. Vind will describe that dinner meeting, and also establish that a number of documents presented by Methanex in these proceedings were secretly copied from his offices without permission.

**5. Daniel Weinstein**

120. Daniel Weinstein is the Managing Director of Wetherly Capital Group and one of the persons who attended the August 4, 1998 dinner that included then-gubernatorial candidate Gray Davis. We anticipate that Mr. Weinstein's statement will describe that dinner meeting.

121. Of these witnesses, Messrs. Listenberger and Vind are among the persons listed in pages 2 through 4 of the Annex to Methanex's October 4, 2002 Request for Evidence.

**B. Documentary Evidence**

122. The United States anticipates that it will introduce the following documentary evidence:

- a. Portions of the legislative history for relevant bills, including SB 521 and SB 989;
- b. Public comments and various regulatory agency documents relating to the publication of the UC Report;
- c. Portions of the administrative record for the CaRFG3 regulations;
- d. Documents related to the California Fuel Cell Partnership;
- e. Documents related to California's request for a waiver from the federal oxygenate requirement;
- f. Campaign contribution disclosure forms from Governor Davis's 1998 campaign; and
- g. Public statements made by Governor Davis, industry associations, and companies, including Methanex.

Each of these categories of documents is publicly available.

123. The United States respectfully submits that the categories of requested documents set forth in pages 5-8 of Methanex's Annex of Requested Evidence are so unqualifiedly broad as to encompass tens or hundreds of thousands of pages, including all of the documentary evidence outlined above.

**VI. RELIEF SOUGHT**

124. For the foregoing reasons, and those set forth in its previous submissions and pleadings, the United States respectfully requests that this Tribunal render an award: (a) in favor of the United States and against Methanex, dismissing Methanex's claims in their entirety and with prejudice; and (b) pursuant to paragraphs 1 and 2 of Article 40 of the UNCITRAL Arbitration Rules, ordering that Methanex bear the costs of this arbitration, including the United States' costs for legal representation and assistance.

*Respectfully submitted,*

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Mark A. Clodfelter

*Assistant Legal Adviser for International  
Claims and Investment Disputes*

Barton Legum

*Chief, NAFTA Arbitration Division, Office  
of International Claims and Investment  
Disputes*

Andrea J. Menaker

David A. Pawlak

Jennifer I. Toole

*Attorney-Advisers, Office of International  
Claims and Investment Disputes*

UNITED STATES DEPARTMENT OF STATE  
Washington, D.C. 20520

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