

**IN THE MATTER OF A CLAIM UNDER CHAPTER 11, SECTION A
OF THE NORTH AMERICAN FREE TRADE AGREEMENT**

And

**IN THE MATTER OF AN ARBITRATION UNDER
UNCITRAL ARBITRATION RULES**

B E T W E E N:

METHANEX CORPORATION

Claimant

**1800 Waterfront Centre
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Canada V6C 3M1**

**By its Solicitors,
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and

**THE UNITED STATES OF AMERICA
as represented by the DEPARTMENT OF STATE**

Respondent

**The Executive Director
Office of the Legal Advisor
US Department of State
2201 C. Street N.W.
Room 5519
Washington, D.C.
USA 20520**

STATEMENT OF CLAIM

CLAIM

THE PARTIES

1. The claimant, Methanex Corporation (“Methanex”), is a company originally incorporated under the laws of Alberta and then continued under the *Canada Business Corporations Act*. Methanex is a producer and marketer of methanol with production facilities located in North America, New Zealand and Chile.
2. Methanex Methanol Company (“Methanex US”) is a Texas general partnership of two companies, Methanex Inc. and Methanex Gulf Coast Inc., both incorporated under the laws of the State of Delaware. Methanex owns, indirectly, 100% of the shares of both partners. Methanex Fortier, Inc. (“Methanex Fortier”) is a company incorporated under the laws of the State of Delaware. Methanex owns, indirectly, 100% of the shares of Methanex Fortier.
3. The respondent, United States of America as represented by the Department of State, is the governmental body, under the provisions of the North American Free Trade Agreement (“NAFTA”), with responsibility for responding to arbitration claims arising from actions taken by the federal and state governments of the United States of America (“United States”).

FACTS

Nature of Methanex’s Business

4. Methanex’s sole business is the production, transportation and marketing of methanol. Methanol is a liquid petrochemical made from feedstocks containing carbon and hydrogen. Approximately two-thirds of the methanol produced is used in the production of

formaldehyde, acetic acid and a variety of other chemical intermediates which are used for the manufacture of a wide range of products including plywood, particleboard, foams, resins and plastics. The remaining one-third of methanol produced is for the fuel sector, principally for use in methyl tertiary-butyl ether ("MTBE"). As of 1998, Methanex owned production facilities in Chile, New Zealand, Canada and the United States with an annual aggregate production capability of approximately six million tonnes of methanol.

5. In the United States, Methanex owns a methanol production facility located in Fortier, Louisiana ("Fortier"). In March 1999, Methanex was a joint venture partner in Fortier with Cytec Methanol Inc. ("Cytec") whereby Methanex held 70% of the shares of Fortier, with the remaining 30% being held by Cytec. Methanex has subsequently acquired Cytec's interest in Fortier and Methanex now indirectly owns 100% of the shares of Fortier. Due to market conditions, Fortier temporarily shut down its operations in early 1999 and continues to be idle as at the date hereof. As a result of the measure detailed herein together with similar measures being threatened elsewhere in the United States, the current oversupply in the methanol industry will be extended in time thereby resulting in a further extension of the Fortier plant closure.
6. Methanex sells methanol in every major market around the world. In 1998, Methanex marketed in excess of six million tonnes of methanol (approximately 4.5 million tonnes were produced in Methanex facilities and 1.5 million tonnes were purchased from other international methanol producers). This represented approximately 23% of the world market in methanol. Methanex US purchases methanol from Methanex for marketing in the North American market.
7. Approximately 40% of Methanex US' sales of methanol in the United States are to third parties who use methanol for the production of MTBE. In 1998, Methanex US sold 797,412 tonnes of methanol in the United States. Approximately 132,000 tonnes were sold directly to California refineries for MTBE production. The balance of the methanol sales was to refineries, other MTBE manufacturers and other consumers located throughout the United States. In 1998, an estimated 860,000 tonnes of MTBE, representing approximately twenty

percent of California MTBE requirement, was supplied to California from United States Gulf Coast producers.

8. Methanex US, the business of Methanex US, Fortier and the business of Fortier are investments in the United States of America as defined in the NAFTA.

Reformulated Gasoline

9. The principal uses of MTBE are as an oxygenate and as a source of octane for gasoline. As an oxygenate, the clean-burning properties of MTBE significantly reduce harmful emissions from internal combustion engines such as those used in motor vehicles.
10. In 1990, Congress enacted Clean Air Act amendments (the “CAAA”), calling for new air-quality standards and setting limitations on motor vehicle emissions to meet the air-quality objectives in areas of the country which suffered significant air pollution, principally larger metropolitan centers. In particular, the CAAA sought to reduce carbon monoxide emissions, volatile organic compound emissions, and toxic air pollutants from vehicles by adding oxygenates (among other requirements) to gasoline (reformulated gasoline, hereafter “RFG”). The CAAA required a minimum 2% oxygen by weight standard in RFG. To meet the oxygenate requirements, petroleum refiners are permitted to blend in to gasoline a number of oxygenates including MTBE, fuel ethanol, ethyl tertiary-butyl ether (“ETBE”) and tertiary amyl methyl ether (“TAME”).
11. The CAAA does permit individual states to receive a waiver from the federal program provided the state adopts standards that are equally as stringent as the CAAA standards. California received a waiver in 1994 and set its own standards for reformulated gasoline (“CARB RFG”). While there is no oxygenate requirement in CARB RFG, oxygenates are added to the gasoline sold in southern California and Sacramento

12. MTBE quickly became the oxygenate of choice for the petroleum refiners. Its blending qualities and ease of transport has resulted in MTBE being the most widely used oxygenate, capturing over 80% of the RFG oxygenate market in the United States. RFG accounts for approximately 30% of the total gasoline consumption in the United States. In 1998, California represented approximately 40% of the United States RFG market.

13. As a result of the CAAA air-quality standards and the use of MTBE as an oxygenate, air pollution in the United States has been dramatically reduced in those areas mandated to use RFG. Specifically, there have been substantial air emission reductions in carbon monoxide, volatile organic compounds, nitrogen oxides and various air toxics, including benzene and 1,3-butadiene. Benzene and 1,3 butadiene are listed by the International Agency for Research on Cancer as Group 1, known human carcinogens.

UST Legislation

14. The *California Code of Regulations*, and in particular, Section 2610(x)(1) of the *Underground Storage Tank Regulations* (the “Regulations”) define UST as any one or combination of tanks, including pipes and connections, used for the storage of “hazardous substances” and which is “substantially or totally below ground”. The Regulations go on in Section 2610(f) to define “hazardous substances” as *any* liquid or solid substance that is not otherwise determined to have no adverse affect on the quality of the waters in the state of California (emphasis added). Gasoline has been determined to be a hazardous substance for the purpose of the Regulations.

15. The express purpose of the Regulations, as stated in Section 2620(a), is “to protect waters of the state from discharges of hazardous substances from underground storage tanks”. To effect this purpose, the Regulations, *inter alia*, establish separate monitoring requirements for new and existing USTs. The Regulations also establish uniform requirements for unauthorized release reporting, as well as for the repair, upgrade, and closure of USTs.

16. The state and local officials charged with administration of the Regulations include the California Environmental Protection Agency (Cal/EPA), the California State Water Resources Control Board and the nine Regional Water Boards, and the Department of Health Services.
17. The California State Auditor (the “Auditor”), in a December 17, 1998 Report to the Governor of California specifically found that the State has a “flawed regulatory process for ensuring that groundwater sources provide drinking water free of gasoline contamination”. The Auditor roundly criticized state officials for failing to take adequate steps to protect California groundwater and for not promptly addressing contamination resulting from leaking USTs. In particular, at page 15 of the Auditor’s Report, it is stated,

The State of California has missed opportunities to aggressively address the problem of gasoline contamination in our drinking water even though the State has had sufficient evidence that leaking storage tanks and gasoline additives pose a major threat to California’s groundwater.

18. The Auditor’s Report identifies a number of specific failures in respect of UST legislative enforcement. They are as follows:
- i. UST owners and operators are not promptly reporting threats to drinking water;
 - ii. Regulatory agencies have not been “sufficiently aggressive” in taking action against individuals who violate water quality laws;
 - iii. State legislation designed to identify leaking USTs and ensure that officials require the owners or operators to clean up the leak promptly “is not producing the desired outcome”;
 - iv. A 1996 California study determined that “leaks are not discovered until the tanks [USTs] are removed, rather than detected as part of an ongoing monitoring program”;

- v. Some tank owners and operators have not obtained required permits and would not be identified to state officials;
- vi. For 11 of the 43 cases reviewed by the Auditor, contamination was discovered upon removal of a UST for which no permit had been issued and for which no monitoring plan existed;
- vii. A survey of USTs with permits found a 29 month gap between the most recent UST monitoring report and discovery of a leak, indicating a failure on the part of the owner/operator to monitor their UST.

19. In 1998, the federal Environmental Protection Agency promulgated UST rules establishing a deadline of December 22, 1998 to remove, replace or upgrade USTs that do not meet state and federal standards (the "Permit Program"). Tank owners and operators were given ten years to ensure their USTs were compliant. After January 1, 1999, tank owners who had not upgraded their USTs to acceptable standards were not to receive petroleum products. According to the Auditor, as of September 30, 1998, only 18.5% of the 15,675 regulated USTs had been issued upgrade certificates. Rather than strictly adhere to the Permit Program, the Cal/EPA issued waivers for a great many USTs that were not in compliance with the Regulations so as to permit the UST owners/operators to continue receiving petroleum products.

Nature of the Claim

20. As well as providing significant emissions and air quality benefits, MTBE gives early warning of the release of gasoline into the environment due to its solubility in water. When gasoline containing MTBE is discharged into the environment some of the MTBE may dissolve in the surrounding ground water. A resultant plume of MTBE in water often travels faster than other gasoline components in the environment due to groundwater movement, and is more readily apparent as it has a characteristic taste and smell that is detectable at

extremely low threshold levels. MTBE detection in water is thus an indicator of a gasoline release in the environment.

21. The presence of MTBE in drinking water occurs primarily as a result of gasoline releases to the environment. Gasoline is released primarily due to:
 - i. the failure of the State of California to enforce its environmental legislation relating to underground storage tanks (“USTs”) and water resource protection; and
 - ii. local municipalities permitting the operation of inefficient two stroke engines on drinking water reservoirs.
22. In the mid 1990s, trace amounts of MTBE began to appear in ground and surface waters. In 1997, the City of Santa Monica elected to close a number of its public drinking water wells due to the presence of MTBE from leaking underground gasoline storage tanks.
23. The response of the government of California was to propose legislation which, rather than address the problem of environmental law enforcement and specifically leaking USTs, arbitrarily called for a ban on the use of MTBE in gasoline. On February 24, 1997, Senator Mountjoy introduced Bill 521 in the California Senate. After debate by the California Senate and Assembly, an amended bill was chaptered on October 9, 1997 (the “Bill”).

Senate Bill 521 (as chaptered)

24. The stated purpose of the Bill was 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 MTBE, ETBE, TAME and ethanol, in gasoline, and to ensure that the air, water quality, and soil impacts of the use of MTBE were fully mitigated. The Bill called for the appropriation of \$500,000 from the Motor Vehicle Fuel Account in the Transportation Tax Fund to the University of California to conduct a study and assessment of the human health and environmental risks and benefits, if any, associated with the use of MTBE, as compared

to ETBE, TAME, and ethanol (the “UC Report”). It was the intent of the Legislature that the study be undertaken by the University of California to assure that the results would be objective and academically sound, and that the report would reflect the high standards expressed in the University of California’s Policy on Integrity in Research.

25. The findings of the UC Report, in draft form, were to be submitted to the Governor of the State of California (the “Governor”) by January 1, 1999. The draft UC Report was to be forwarded without alteration to the United States Geological Survey and to the Agency for Toxic Substances and Disease Registry at the Centers for Disease Control for their comments. Within thirty days of receiving commentary, the Governor was required to convene two public hearings, one in northern and one in southern California, to permit public testimony.
26. Within ten days of completing the public hearings, the Governor was required to issue a written certification as to the human health and environmental risks of using MTBE in gasoline in the state of California. The certification was to be based *solely* upon the UC Report and the testimony received at public hearings.
27. The Governor was required to state in his certification only one of two conclusions, either on balance there was no significant risk or alternatively, on balance there was significant risk, to human health or the environment in using MTBE in gasoline. If the Governor’s certification found that, on balance there was a significant risk, the Governor was compelled to take *appropriate action* to protect public health and the environment.
28. On November 12, 1998, the UC Report was completed and submitted to the Governor. Six weeks later, on December 24, 1998 peer reviews were completed. The public hearings were conducted on February 19th, 23rd and 24th. The public was also permitted until March 17, 1999 to submit written comments on the use of MTBE. By the strict terms of the Bill, the Governor then had ten days to issue his certification.

The Executive Order

29. On March 25, 1999 the Governor issued an Executive Order (the “Executive Order”) wherein he stated that “the findings and recommendations of the UC report, the public testimony and the 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” (emphasis added). On this basis, the Governor certified that “on balance, there is significant risk to the environment from using MTBE in gasoline in California”. The Executive Order, (among other things), called for the California Energy Commission in consultation with the California Air Resources Board, to develop a timetable for the removal of MTBE from gasoline at the earliest possible date, but not later than December 31, 2002.
30. The California State Legislature and various state agencies have, since March 25, 1999, taken measures to implement the Governor’s Executive Order “for the removal of MTBE from gasoline at the earliest possible date.”
31. The Bill and the resulting Executive Order collectively, is a “measure” under the provisions of Article 201 of the NAFTA.
32. The measure taken by the Governor was based solely on the UC Report which:
- i. failed to do a proper risk characterization and failed to complete the mandated comparison of the risks of MTBE use with the risks posed by other ethers which have similar chemical and environmental behaviour;
 - ii. was substantially underfunded, used an extraordinarily scant database, and relied on broad assumptions to determine the scope of the MTBE issue;
 - iii. contained a badly flawed exposure assessment and cost/benefit analysis;
 - iv. failed to adequately discuss alternative solutions and remediation; and
 - v. ignored the public testimony and peer review.

As a result, the UC Report reached unfounded conclusions and offered unjustifiable recommendations.

33. The measure taken by the Governor:

- i. was arbitrary and based on a process which lacked substantive fairness;
- ii. penalizes and bans only one component of gasoline;
- iii. failed to consider alternative measures to mitigate the effects of gasoline releases into the environment;
- iv. resulted from the failure or delay in enacting or enforcing legislation to reduce or eliminate gasoline releases into the environment;
- v. failed to take proper consideration of the legitimate interests of Methanex and Methanex US; and,
- vi. goes far beyond what is necessary to protect any legitimate public interest.

34. In the result, the State of California did not accord to Methanex US treatment in accordance with international law, including fair and equitable treatment.

35. The measure has negatively impacted and will end Methanex US' business of selling methanol for use in MTBE in California. The measure will contribute to the extended closure of the Fortier plant. The measure constitutes a substantial taking of Methanex US' and Fortier's business, and Methanex's investment in Methanex US and Fortier. The measure is both directly and indirectly tantamount to an expropriation, and has resulted in an impairment and deprivation of Methanex US' and Fortier's economic value. Further, the measure has established a flawed precedent which is being adopted and implemented by legislative actions calling for a reduction or ban of MTBE in other states of the United States.

36. As methanol is a commodity, and MTBE represents approximately 30% of the world demand for methanol, the measure will cause a general depression of the global methanol price. Methanex will suffer losses as a result thereof. California MTBE usage currently represents approximately 6% of the world demand for methanol.

37. Methanex gave notice of its intention to bring this claim and notwithstanding consultation, as of the date hereof, neither the State of California nor the United States has offered compensation for the expropriation.
38. The ban on MTBE has caused and will cause losses including, *inter alia*:
- i. loss to Methanex, Methanex US and Fortier of a substantial portion of their customer base, goodwill and market for methanol in California and elsewhere;
 - ii. losses to Methanex, Methanex US and Fortier as a result of the decline in the global price of methanol;
 - iii. loss of return to Methanex, Methanex US and Fortier on capital investments they have made in developing and serving the MTBE market;
 - iv. loss to Methanex due to the increased cost of capital; and
 - v. loss to Methanex of a substantial amount of its investment in Methanex US and Fortier.

POINTS AT ISSUE

39. Have the actions of the State of California failed to accord a minimum standard of treatment required under the provisions of Article 1105 of the NAFTA?
40. Do the actions of the State of California and its Governor directly or indirectly constitute a measure which is tantamount to expropriation under Article 1110 of the NAFTA?
41. If the Respondent has breached an obligation under either Article 1105 or 1110, or both, what is the measure of the loss or damage which may be claimed under Article 1116 of the NAFTA?

RELIEF SOUGHT

1. Methanex claims:
 - a) damages under the provisions of Article 1116 for breach of Articles 1105 and 1110 of the NAFTA in the amount of US \$970,000,000.00;
 - b) its costs of this arbitration including without limitation, expert and attorney fees and disbursements plus any Canadian Goods and Services tax payable thereon; and
 - c) interest on the sums claimed in subparagraphs (a) and (b) until paid.

Dated this 3rd day of December, 1999.

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