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C O N T E N T S

PAGE

OPENING STATEMENT

For Methanex Corporation: Mr. Dugan

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1 P R O C E E D I N G S

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

10 OPENING STATEMENT BY COUNSEL FOR CLAIMANT/INVESTOR

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

20 This, obviously, is a case of significant
21 importance to the international arbitration

1 community, to the utility of international law, and
2 to American jurisprudence, and we realize that it
3 represents and presents to the Tribunal some very
4 difficult and very thorny issues dealing with the
5 American political system. But all Methanex asks
6 for is a fair hearing upon the merits on both the
7 law and the facts.

8 Now, in terms of the presentation that I'm
9 going to make today, I'd like to go over first with
10 the Tribunal the structure that I'd like to proceed
11 so that there's no misunderstanding. In terms of
12 the evidentiary issues, we had discussed prior to
13 this hearing that we are--we would be willing to do
14 our best to make available to the Tribunal
15 Mr. Puglisi and also the lawyer for whom
16 Mr. Puglisi works, who had also been retained by
17 Methanex; and the Tribunal advised that it would
18 take that under consideration in determining when
19 and how to deal with the issue of the documents.
20 So, unless there is some misunderstanding, I
21 believe we will defer that to a later point in the

1 hearing.

2 Now, with respect to the other unresolved
3 evidentiary issues, I think, and it would be my
4 proposal, if the Tribunal agrees, to put them off
5 to the closing, for this reason: Much of what we
6 asserted in our evidentiary motion with respect,
7 for example, to what we believe are U.S. admissions
8 concerning, for example, the primary impact on
9 foreign methanol producers of a shift in the market
10 to ethanol, those go to the weight of the evidence,
11 really, more than to any exclusion of the evidence;
12 and I think as a weight-of-the-evidence issue,
13 they're probably more appropriately and more
14 effectively dealt with here at the closing, rather
15 than at the opening.

16 Similarly, with respect to the United
17 States's failure to produce the negotiating
18 history, I think that that will come down to two
19 issues. One issue is a question of whether the
20 Tribunal is going to be willing to draw adverse
21 inferences from that, and if so, what adverse

1 inferences will be drawn. And for that reason, I
2 think that's also more appropriately dealt with,
3 perhaps, just prior to the start of the closing.

4 Similarly, I think the same analysis
5 applies to the issue we raised in our evidentiary
6 letter with respect to the United States's blocking
7 of our attempts to obtain relevant evidence from
8 third-party witnesses. I think the two issues that
9 the Tribunal will have to resolve are, first,
10 whether or not to draw inferences from that
11 conduct; and, secondly, what inferences to draw.
12 And again, I think that's probably all done more
13 effectively in the closing, which will focus, in
14 large part, on the inferences to be drawn from the
15 totality of the evidence that's before the
16 Tribunal.

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

20 Now, what I'd like to deal with today are
21 to go over the facts and the law with respect to

1 Methanex's three claims: Article 1102, national
2 treatment; Article 1105, fair and equitable
3 treatment; and Article 1110, expropriation.

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

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

15 And I would like to deal with that after
16 the opening presentation, either during the
17 closing--I think during the closing would be the
18 preferable time to do it.

19 And the reason why I want to do it is, as
20 you'll see today, there is, I think, a significant
21 issue in the record, that has developed in the

1 record, since the time we filed our Second Amended
2 Claim--Complaint, that I think the Tribunal will
3 have to take issue of and that I think will affect
4 the contours of that argument. So, again, I think
5 that that argument should be pushed off to
6 the--after the witnesses, as well.

7 Now, I'd like to start with an analysis of
8 Article 1102, the national treatment provision of
9 NAFTA, and I'm starting with that because I think
10 an analysis of the facts and the law under that
11 case provides a good foundation for our arguments
12 with respect to 1105 and 1110. I think that each
13 of the arguments are equally sound; but as you'll
14 see from the presentation today, most of my effort
15 will be concentrated on 1102. But especially the
16 facts that we intend to develop today, we intend to
17 draw the Tribunal's attention to, will support the
18 same types of conclusions with respect to 1105 and
19 1110.

20 Now, Methanex's position with respect to
21 1102 is that, as a legal matter, it requires a

1 three-step analysis. The first step is that the
2 Tribunal must determine whether the United States's
3 industry is in like circumstances with Methanex and
4 its investments. If the Tribunal finds that
5 ethanol producers are in like circumstances with
6 methanol producers, then the second step is to
7 determine whether any of the methanol producers,
8 i.e. Methanex, have received something less than
9 the most favorable treatment that's accorded to the
10 United States's ethanol industry.

11 If, as a result of the second step, the
12 Tribunal concludes that, in fact, methanol
13 producers, including Methanex, have received less
14 than the most favorable treatment accorded to
15 ethanol, then it shifts to the third step.

16 And the third step is to determine whether
17 there is any rational, any reasonable, any
18 justifiable basis for that disparate treatment
19 between the methanol industry and the ethanol
20 industry.

21 And as we will see when I get into it a

1 little bit more, in more detail, it's Methanex's
2 position that if we get to the third step, it's
3 going to be the United States's burden to show if
4 this disparate treatment is justified on an
5 environmental basis.

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

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

16 Similarly, if you consult the French and
17 the Spanish text of NAFTA, you will see that the
18 French uses the word "analog" or analogous or the
19 equivalent of analogous. I don't speak French
20 fairly well, so I can't pronounce it correctly, but
21 that I think you see the import of what I'm trying

1 to get across, which is it doesn't use the word
2 "identical" either. The same is true for the
3 Spanish text, which uses the word "similar."

4 Again, all of these phrases, in my mind,
5 as I understand it, connote something much
6 different than "identical."

7 So, it's Methanex's position that the test
8 is not identity. The test is likeness. And that
9 means that it's irrelevant that Methanex is in
10 identical circumstances with other U.S. methanol
11 producers. That's not relevant.

12 Similarly, it's not relevant that Methanex
13 is not in identical circumstances with U.S. ethanol
14 producers. The critical question here is whether
15 methanol--and methanol U.S. in particular--is in
16 like circumstances with U.S. ethanol producers.
17 That's the test before the Tribunal as methanol
18 sees it--as Methanex sees it.

19 Now, in terms of the negotiating history,
20 one issue that I'd like to raise at this point is
21 that with respect to whether there is any

1 negotiating history, we're aware that the United
2 States has indicated in other contexts--there was a
3 case under Chapter 20 of NAFTA involving trucks
4 from Mexico, in which the United States proffered a
5 interpretation of like circumstances and referred
6 to the negotiating history of like circumstances as
7 supporting its interpretation of like circumstances
8 in that particular case. So, we believe there may
9 well be relevant negotiating history as to what the
10 appropriate definition of "like circumstances" is
11 with respect to Chapter 11 as well.

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

18 Now, the best precedent, the best NAFTA
19 precedent that we think establishes the importance
20 of competitiveness in the like circumstances test
21 is the S.D. Myers case. And we've put up on the

1 screen an excerpt, you can find that at Tab 2, an
2 excerpt from the S.D. Myers case that I think
3 explains this quite lucidly.

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

12 And then it went on to apply that
13 articulation of like circumstances to the facts
14 before that Tribunal. SDMI--that's a reference to
15 S.D. Myers--was in a position to attract customers
16 that might otherwise have gone to the Canadian
17 operators because it could offer more favorable
18 prices and because it had extensive experience and
19 credibility. It was precisely because SDMI was in
20 a position to take business away from its Canadian
21 competitors, that Chem Security and SynTech lobbied

1 the Minister of the Environment to ban exports when
2 the U.S. authorities opened the border.

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

7 Now, we believe that WTO precedent is
8 similar to this NAFTA precedent, and the second
9 excerpt that we've got is just a short quotation
10 from a WTO organization case, an asbestos case:
11 "Thus, a determination of likeness under
12 Article 3(4) is fundamentally a determination about
13 the nature and extent of a competitive relationship
14 between and among products. Now, that's a
15 determination of likeness, not like products, a
16 determination of likeness, and we think that that
17 concept is equally applicable here. Likeness is
18 fundamentally a determination about the nature and
19 extent of the competitive relationship.

20 Now, I don't think any of the state
21 signatories to NAFTA disagree with that

1 proposition. They all recognize that competition
2 is an important element of the likeness test. I
3 don't think we've gotten a clear definition of what
4 else is important from the state signatories other
5 than an assertion that all the facts and
6 circumstances are important, which Methanex doesn't
7 agree with. But I think that there is at least
8 some level of agreement, that competition is the
9 most important element of this test.

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

21 Now, the fact that the two oxygenates I'm

1 talking about, methanol and ethanol, are used in
2 slightly different ways in the gasoline
3 manufacturing process we do not believe has any
4 relevance. It doesn't affect the competitive
5 analysis, and it certainly doesn't affect the
6 competitive analysis for the integrated oil
7 companies.

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

1 of very closely related products.

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

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

17 You can see from the first chart methanol
18 is used by--it feeds into the MTBE plant where it's
19 combined with isobutylene, and then it goes from
20 the MTBE plant to the blending process, and it's
21 blended with or without a number of the other

1 various agents, and that gasoline is then delivered
2 to the consumer.

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

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

18 Now, it's important to remember that when
19 methanol is combined with isobutylene to make MTBE,
20 the isobutylene has no oxygen in it. The most
21 appropriate way for a non-chemical engineer to

1 think of it is that the isobutylene is simply a
2 convenient delivery device for the oxygen that's
3 contained in methanol; but it's methanol that is
4 supplying the oxygen to reformulated gasoline that
5 uses MTBE, just like it's ethanol that is
6 specializing the oxygen to reformulated gasoline
7 that uses ethanol. So, in that sense, the two are
8 entirely equivalent, they are oxygenates with
9 slightly different chemical character that are used
10 by integrated oil companies in the manufacture of
11 reformulated gasoline.

12 Now--and I'm focusing now on the
13 integrated oil companies as opposed to the gasoline
14 blender segment of the market. I think it's useful
15 to divide the market into two segments. Integrated
16 oil refineries are the--just what it says,
17 integrated companies that have sometimes upstream
18 operations, crude oil operations, and downstream
19 operations where they deliver the gasoline to the
20 consumer. Chevron is a good example. It has
21 integrated operations from crude all the way down

1 to gas stations at the street corner.

2 Now, before the California ban, these
3 integrated companies typically did just what I
4 showed. They combined their captive stream of
5 isobutylene with methanol, manufactured MTBE, and
6 blended that with their gasoline at their blending
7 plants before they delivered it to the consumers.

8 Now, over the last several years prior to
9 the ban, Methanex has supplied methanol to at least
10 six of the integrated oil companies in California:
11 ARCO, Chevron, Exxon, Tesoro, Tasco, and Valero.
12 That's all found in the second Macdonald affidavit,
13 paragraph 23, which I think we provided to you.

14 Now, sales to these integrated oil
15 companies accounted for a hundred percent of
16 Methanex's business in California, and there is no
17 doubt about that. It's in Mr. Macdonald's
18 affidavit. The United States chose not to
19 cross-examine him. It is, in essence, an
20 undisputed fact.

21 Now, since the ban went into effect, these

1 refiners, these oil companies, have shifted to
2 ethanol. They've stopped buying methanol, and now
3 they buy ethanol. And again, that's in
4 Mr. Macdonald's affidavit. And they've done
5 exactly what was illustrated on the two charts
6 because they're now required to use ethanol.

7 Now, the U.S. argues that Methanex has not
8 met its burden to show that these integrated oil
9 company have shifted to ethanol, but that's just
10 ridiculous. I mean, in addition to Mr. Macdonald's
11 affidavit, evidence submitted and relied upon by
12 the United States itself shows that that's
13 precisely what's happened. The integrated refiners
14 have shifted to ethanol, and what I've got up on
15 the screen now is Exhibit 5, and it's just an
16 excerpt from a California Energy Commission report
17 that was submitted by the United States as part of
18 its evidence, and I think the quote corroborates
19 precisely what Mr. Macdonald has stated in his
20 witness statement. This is the quote: "Since
21 completion of the Energy Commission's previous

1 survey of ethanol industry production capacity in
2 August 2001, ethanol has been successfully
3 introduced into CaRFG"--that stands for California
4 reformulated gasoline--"by most California
5 refiners."

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

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

15 Now, perhaps the most vivid evidence of
16 the--what we called the binary choice for these
17 integrated oil companies, binary choice between
18 methanol and ethanol, is the Valero-Methanex sales
19 contract for the sale of methanol. And this
20 contract has an opt-out provision because of the
21 California MTBE ban, and if I could turn your

1 attention to that, that's Exhibit 6. And this is
2 the provision of that sales contract between
3 Methanex and Valero. "Buyers shall not be liable
4 for any delay or failure to perform under this
5 agreement to the extent arising from or directly
6 related to any governmental law, regulation,
7 ordinance, psychiatry decree, subsidy, or action of
8 whatsoever that buyer can reasonably establish has
9 caused an adverse effect on buyer's production of
10 or demand for MTBE in California. In such a
11 circumstances, buyer shall, upon prompt notice to
12 seller, have the right in its sole discretion to
13 restrict or cease acceptance of an amount of
14 product hereunder"--product in that case being
15 methanol--"which on a percentage basis represents
16 the reduction in the demand for buyer's MTBE
17 affected by such law and buyer's minimum purchase
18 obligation shall be reduced by the quantities so
19 admitted."

20 Now, as Mr. Macdonald explains, this
21 provision was in the contract because of the MTBE

1 ban. If it went into effect, Valero reserved the
2 right to stop buying methanol, and that's precisely
3 what happened. The ban went into effect, and
4 Valero, one of Methanex's customers, stopped buying
5 methanol from Methanex and instead bought ethanol,
6 almost certainly from a U.S. producer, in order to
7 manufacture oxygenated gasoline.

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

15 Now, there's another segment of the
16 industry. It's the gasoline blenders sector.
17 These are not the integrated oil companies. These
18 are the blenders and distributors who buy gasoline
19 and then blend it and distribute it. These
20 blenders buy now; they buy ethanol in order to
21 deliver oxygenated gasoline. They also blend it

1 with various other things, depending on what the
2 market they're operating in. Prior to the ban they
3 bought MTBE.

4 Now, it's Methanex's position that
5 although the competition between ethanol and
6 methanol is different in this section, it's
7 nonetheless direct. It's direct in this sense:
8 Every purchase of ethanol by a gasoline blender
9 since the ban directly displaces a sale of methanol
10 to the MTBE producer. In other words, before the
11 ban, when they were purchasing, when the MTBE
12 producers were purchasing methanol, they purchased
13 methanol, manufactured MTBE, and sold the MTBE to
14 the gasoline blender. Now the gasoline blender
15 buys ethanol, but the direct effect, the direct
16 consequence of that purchase of ethanol by the
17 gasoline blender is a displacement of a sale of
18 methanol to the merchant MTBE producers.

19 So again, the nature of the competition is
20 slightly different, but the displacement of
21 methanol by ethanol as the oxygenate used in the

1 manufacture of RFG is still very direct, still
2 very, very immediate.

3 Now, what I'd like to show you is Exhibit
4 7, which is simply a statistical analysis of the
5 effect of the binary choice. And it shows--it
6 shows what's happened in the market. In 2002,
7 sales of methanol were 500 million gallons. Sales
8 of ethanol were 100 million gallons. And then, as
9 the ethanol, as the integrated--as the companies
10 began the process of shifting to ethanol, sales of
11 ethanol took off for 2004 that are estimated to be
12 900 million gallons and sales of methanol decreased
13 correspondingly, and they are expected to be zero
14 in 2004.

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

1 of that final product.

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

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

20 Article 1102, subsection (3), the
21 treatment accorded by a party under paragraphs one

1 and two means with respect to a state or province,
2 i.e. with respect to California, treatment no less
3 favorable than the most favorable treatment
4 accorded, in like circumstances, by that state or
5 province to investors, and to investments of
6 investors, of the party of which it forms a part.

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

20 Now, this is where I think the U.S.
21 argument about the fact that methanol--that

1 Methanex is in identical circumstances with
2 methanol producers and they are equally badly
3 damaged shows that there's no denial of national
4 treatment. That's not the test. The United States
5 is perfectly capable of treating certain of its own
6 citizens in a way that is arbitrary and
7 unreasonable and very, very inequitable and
8 damaging, and we believe that's how the United
9 States has treated U.S. methanol and MTBE
10 producers, and it's recognized that this is a
11 very--that the shift to ethanol has been very
12 damaging. The pending energy legislation in
13 Congress has allocated up to \$2 billion in relief
14 for MTBE producers. So, Congress recognizes the
15 damaging impact of this shift on the other
16 oxygenate sectors.

17 But the point here is NAFTA is an
18 international treaty, and NAFTA provides that a
19 foreign-owned investment has to be treated as well
20 as the comparable U.S. investment, and in this
21 case, the comparable U.S. investment is ethanol,

1 not methanol.

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

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

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

20 Now, if the rule were any different, if
21 the rule were that a state can treat one segment

1 very, very badly and it's immune from scrutiny
2 under international law so long as some of the
3 citizens, some of the entities that are treated
4 badly are citizens of the state, that would gut
5 international law in many respects, and it would
6 certainly undercut the whole concept of national
7 treatment. And again, the WTO has repeatedly
8 recognized that it is no excuse that a nation may
9 treat a few of its citizens equally as badly as it
10 treats foreigners.

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

17 Now, under Methanex's three-step analysis
18 that brings us to what really I think is the heart
19 of the case: Is this disparate treatment of
20 methanol justified and who has the burden of
21 justifying this disparate treatment?

1 Now, taking the second point first,
2 Methanex's position is that international law, in
3 these circumstances where there has been a showing
4 of like circumstances and disparate treatment, that
5 international law places the burden of justifying
6 the disparate treatment on the respondent country.

7 Now, much of this law, as we'll see, is
8 drawn from the WTO, because the WTO has been
9 dealing with concepts of national treatment and
10 exceptions to the national treatment obligation for
11 over 50 years.

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

16 Article 1131(1) requires this Tribunal to,
17 quote, decide the issues in dispute in accordance
18 with this agreement and applicable rules of
19 international law. We think that it's quite clear
20 that international law, as it's customarily
21 defined, includes decisions, includes decisions of

1 Tribunals such as the WTO. So, we think that
2 is--it is particularly relevant here, and it's
3 particularly relevant because these decisions deal
4 with the concept of national treatment. Again, the
5 leading body in interpreting the concept of
6 national treatment is the WTO, and we submit it
7 with, we believe, our Second Amended Claim, an
8 opinion from Sir Robert Jennings, former President
9 of the World Court, who said that it would be
10 unjustifiable for any Tribunal not to look to this
11 body of international law, of WTO law, in deciding
12 a concept of national treatment under a different
13 treaty.

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

19 Now, the WTO, as I said, routinely
20 allocates the burden of proof in national treatment
21 cases, and if we could go to a case, the--that by

1 irony is a case involving reformulated gasoline,
2 it's a WTO case that came out at the time that the
3 RFG standards were first set forth, and it deals
4 with issues of imports of RFG. This is Tab 11 of
5 your book, the particular segment of the RFG case
6 that I'd like to draw the Tribunal's attention to,
7 and it states, quote, "The Panel noted that as the
8 party invoking an exception, the United States bore
9 the burden of proof in demonstrating that the
10 inconsistent measures came within its scope." And
11 the exception they're talking about there, as we'll
12 see, is the exception to poor human health. "The
13 Panel observed that the United States, therefore,
14 has to establish the following elements: That the
15 policy in respect of the measures for which the
16 provision was invoked fell within the range of
17 policies designed to potential human, animal, or
18 plant life or health; that the inconsistent
19 measures for which the exception was being invoked
20 were necessary to fulfill the policy objective, and
21 that the measures were applied in conformity with

1 the requirements of the introductory clause of
2 Article XX."

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

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

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

15 "The Panel notes that under the Model
16 Rules, 33 and 34: 'A Party in asserting that a
17 measure of another Party is inconsistent with the
18 provisions of the Agreement shall have the burden
19 of establishing such inconsistency,' and 'A Party
20 asserting that a measure is subject to an exception
21 under the Agreement shall have the burden of

1 establishing the exception applies.' Mexico must
2 establish that the actions (and inactions) of the
3 United States are inconsistent with the schedule
4 for implementation of NAFTA. The U.S. Government
5 bears the burden of showing that its actions and
6 inactions in connection with Chapter 11 are
7 authorized by an exception to NAFTA."

8 Now, what the U.S. was arguing in that
9 case was that--and let me step back--NAFTA
10 required, in theory, that the United States and
11 Mexico open their borders to each others' trucks,
12 and that was delayed, and frankly, it was delayed
13 because of political pressure from the United
14 States's unions; and the United States adopted a
15 measure that postponed the opening of the borders
16 because of alleged safety concerns with Mexican
17 trucks. So, it was a safety issue, allegedly.

18 The Tribunal found that it was the United
19 States's burden to prove that there was a valid
20 safety reason, and it was the United States's
21 burden to prove that the measures that it adopted

1 were proportionate to whatever the problem was.
2 And the Tribunal rejected the United States's
3 position. In essence, it found that the total
4 abolition of the total ban on trucks from Mexico
5 couldn't be justified as a legitimate safety
6 regulation; that if there were legitimate safety
7 concerns, those safety concerns should be addressed
8 in a much more proportionate, reasonable manner.

9 But I think the key point for what I'm
10 trying to get to right now is that it was the
11 United States's burden to justify the safety
12 restrictions in this NAFTA Chapter 20 case. This
13 wasn't an investment dispute between a private
14 investor. It was between Mexico and the United
15 States, but I think the principle is still the
16 same. Once you establish like circumstances, once
17 you establish disparate treatment and the state
18 justifies the disparate treatment on environmental
19 grounds, it's the respondent state's burden to
20 justify it. They must show that this was
21 necessary.

1 Now, in terms of what they have to show,
2 we agree that they have to show that--and I think
3 it's laid out to a degree in some of these
4 cases--they have to show that the measure was
5 necessary to fulfill the environmental objective.
6 They have to show that the measure that was adopted
7 was designed to be the most effective measure
8 possible. They have to show that the measure is
9 the least trade restrictive--in this case, I guess,
10 the least restrictive of foreign investments--and
11 they have to show that the measure is not a
12 disguised restriction on foreign investments. And
13 those are the four elements that we believe the
14 United States must show, must meet in order to show
15 that this restriction was justified.

16 Now, the reason Methanex believes why the
17 burden in these types of cases is shifted to the
18 respondent government is because there's a
19 recognition among legal scholars, and certainly at
20 the WTO, that local interests often tried to use
21 pseudo-environmental reasons to justify what is

1 actually rank economic protectionism. This is not
2 a novel argument. There have already been three
3 such cases, the S.D. Myers case, the Metalclad
4 case, and the Tecmed case involved these types of
5 things where there's a reported environmental
6 justification that's really a disguise for other
7 reasons. Either protection of the local industry
8 or just acquiescence to local political pressures.

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

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

18 So, again, let me repeat that what I think
19 are the four things the United States must show
20 here in order to win their case, that this is not a
21 denial of national treatment. First, they have to

1 show that the environmental measure is necessary to
2 protect the environmental--is necessary to protect
3 the environment of California.

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

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

19 And finally, there is the concept of
20 proportionality. The measure must be proportionate
21 to the problem. That concept was most recently

1 articulated in the Tecmed versus Mexico case, which
2 was a Bilateral Investment Treaty case between a
3 Spanish investor and the Mexican Government, and
4 the Tribunal said there, "There must be a
5 reasonable relationship of proportionality between
6 the charge or weight imposed to the foreign
7 investor and the aim sought to be realized by any
8 expropriatory measure."

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

14 Now, one last chart I'd like to show you,
15 and it's not precisely on point, but I think it
16 illustrates the analogous principle. One of the
17 cases that we've talked about, and we'll talk about
18 more, is the Ethyl case, Ethyl versus Canada, and
19 that case resulted in a \$20 million settlement,
20 Canadian dollars I believe, by the Canadians to
21 Ethyl, which is an American corporation. The issue

1 there was the introduction of a gasoline additive,
2 MMT, into gasoline in Canada, and the Canadian
3 government issued a partial ban. It banned the
4 intra-province shipment of MMT, and it banned
5 imports of MMT. Apparently the Canadian government
6 under their federal system doesn't have the
7 authority to ban the production, so production was
8 still allowed.

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

20 First of all, it placed the burden of
21 justifying the ban on the Federal Government, so it

1 was not the burden of Alberta to show that the ban
2 was unjustified. It was the burden of the Federal
3 Government to show that this ban, which was
4 introduced for allegedly environmental reasons, was
5 justified. And we can see that from the quote, and
6 this is Tab 11.

7 The respondent, which in this case was the
8 Canadian federal government, has not demonstrated
9 that there existed a matter of such urgency or risk
10 so widespread as to warrant such comprehensive
11 restrictions as the Act provides on internal trade.
12 If the legitimate objective of the Act is as
13 stated, to prevent MMT from being used in newer
14 model vehicles in major urban areas, then total
15 elimination of MMT was unduly restrictive.

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

20 ARBITRATOR ROWLEY: What tab was that?

21 MR. DUGAN: Tab 11. No, I'm being told

1 that's wrong.

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

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

19 And the general thrust of our case is that
20 what happened in California is that California
21 singled out a proven pollution reducer for

1 elimination. Despite the presence of other
2 chemicals in California's water, including other
3 chemicals that come from leaking gasoline tanks
4 such as benzene that are much more carcinogenic,
5 much more dangerous, but it didn't ban benzene. It
6 banned MTBE instead. And that singling out of
7 MTBE, which was not the worst product that was
8 affecting California's market, raises serious
9 doubts about the true motive behind what California
10 did.

11 Now, the first thing to keep in mind is
12 that MTBE has been reckoned by almost everyone to
13 be a very effective product at reducing air
14 pollution. It's one of the best programs that has
15 ever been developed to reduce air pollution. I
16 would just like to show you a slide that summarizes
17 the reduction of air pollutions that--and this is
18 based on our expert reports--that summarizes the
19 reduction of air pollutions. It has greatly
20 reduced the emission of carcinogens such as
21 butadiene and benzene, and it's reduced the

1 emissions of noncarcinogens, total carbohydrates,
2 carbon monoxide, nitrogen oxide. And together,
3 these reductions in emissions have resulted in a
4 40 percent lower cancer risk associated with air
5 toxins. MTBE is a very effective product.

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

17 Canada has reached precisely the same
18 conclusion. If I could show you now what is Tab
19 14, it is a conclusion of Canada with respect to
20 MTBE's toxicity. The Federal Minister of the
21 Environment and the Federal Ministry of Health and

1 Welfare have concluded that the predicted
2 concentrations of MTBE in the environment in Canada
3 do not constitute a danger to the environment or to
4 the environment on which human life depends or to
5 human health--to human life or health. Therefore,
6 MTBE is not considered to be toxic as defined under
7 Section 11 of the Canadian Environmental Protection
8 Act.

9 Now, similarly, the European Union in its
10 refusal to ban MTBE, also concluded that there was
11 no toxic risk from MTBE. If we could turn to--I'd
12 like to just read you some of the quotes on what
13 the European Union concluded with respect to MTBE.
14 It concluded that, quote, The risk of severe toxic
15 effects is insignificant for oral and dermal
16 exposures; quote, that it is not foreseen that
17 toxic effects occur, end quote, even with repeated
18 exposure to MTBE, and, quote, MTBE is not
19 considered to cause adverse health or ecotoxic
20 effects at the taste and odor threshold level, end
21 quote.

1 It also concluded after conducting a
2 detailed risk assessment, quote, that the risk are
3 not expected to consumers or human health.

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

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

13 MR. DUGAN: I will. I will go back and do
14 that. These come from European Chemicals Bureau,
15 European Union Risk Assessment Report, 2002, at
16 179, and I will get you the cross-reference to the
17 joint submission of evidence. The other one came
18 from the European Commission recommendation of 7
19 November 2001, Official Journal of the European
20 Communities, and that's at 3 JS Tab 22.

21 And actually, the first one is 21 JS

1 Tab 11, at Annex 1.

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

19 Now, similarly, European Commission,
20 quote, The suspicion that MTBE can cause cancer was
21 not sufficiently founded by the available data, end

1 quote. So, that's California and the European
2 Commission finding that MTBE is not a carcinogen.

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

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

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

1 because as we will see, California banned MTBE and
2 it didn't ban benzene.

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

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

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

20 So, this is what Governor Dais was
21 mandated to do, and he determined when he made his

1 certification, he based it only on environmental
2 reasons, not on health reasons. Even though he was
3 expressly directed to consider the health and
4 environmental consequences, he chose to base his
5 conclusion strictly on environmental grounds. In
6 the Executive Order, if we could look at the
7 Executive Order.

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

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

1 certification that it was a risk to health.

2 Now, the important--

3 ARBITRATOR ROWLEY: I'm not following you.

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

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

13 MR. DUGAN: Correct.

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

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

19 The one that's submitted is one that says
20 that on balance, there is no significant risk to
21 human health or the environment of using MTBE in

1 gasoline in this state. So, the "either" before
2 refers to a certification of no risk or
3 certification of risk. We should have put that in
4 there for the sake of clarity.

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

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

13 PRESIDENT VEEDER: In the bill.

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

16 PRESIDENT VEEDER: I don't think that cuts
17 across your point because what he says in his
18 certification is that--do you want to look at
19 Executive Order because we can dig this out and see
20 if we're understanding your point quite properly.
21 What he says is: "Now, therefore, I, Gray Davis,

1 Governor of the State of California, do hereby find
2 that, quote, 'That, on balance, there is a
3 significant risk to the environment from using MTBE
4 in gasoline in this California.'" And you're
5 saying is that if you look at the numbered
6 paragraph--one you don't have on the screen but we
7 do have before us, that he's not saying anything
8 about human health.

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

20 Now, we think that the fact that it's an
21 environmental rather than a health measure is shown

1 by how it was banned. This ban finally took place
2 almost five years after it was announced, and it
3 was extended for one year in 2002, and when it was
4 extended, the reason why it was extended was simply
5 because of economic reasons, because it cost too
6 much to implement the ban. If we could go to the
7 Governor's Executive Order of 2002, in which he
8 extended the ban, he states, "I find that it's not
9 possible to eliminate use of MTBE on January 1,
10 2003, without significantly risking disruption of
11 the availability of gasoline in California"--and
12 I'm sorry, this is Tab 17. "This would
13 substantially increase prices, harm California's
14 economy, and impose an unjustified burden on our
15 motorists."

16 Now, if this were truly a health
17 emergency, it's hard to believe that the Governor
18 would have justified extending the ban for a year
19 because it was inconvenient for motorists. And we
20 submit that the reason why he extended it for a
21 year was because it was not a health concern.

1 There was no urgent public health crisis that was
2 pending, and that's why he felt compelled to extend
3 it for a year, for economic reasons.

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

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

1 identified with foreign interests.

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

5 Well, if you look at the UC, University of
6 California study, what they relied upon was a
7 figure of--they stated that, quote, We estimate
8 that 0.3 percent to 1.2 percent of public water
9 supply wells, (65 to 165 wells) in the state have
10 detectable levels of MTBE, end quote. That's the
11 U.C. report, Volume 4, which is 4 JS Tab 39-A.

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

19 Now, Methanex obviously believes that the
20 problem of Methanex getting into the water was not
21 a serious concern, did not justify a ban, but one

1 of the best pieces of evidence of that is a study
2 that was compiled by the Natural Resources Defense
3 Counsel, an environmental group, that was based on
4 data collected by the California Department of
5 Health Services for October 1999 to October 2000.
6 That's up on the screen now. It's Exhibit 18.
7 This is referred to in Pamela Williams's expert
8 report. She did a similar study.

9 And if you look at this report, where is
10 MTBE on the list of the top 23 groundwater
11 contaminants? It's not. It's just not there.
12 Now, benzene is there. It's the third from the
13 bottom, but MTBE is not there.

14 And again, look the at number of samples
15 that exceeded the--I think that's the maximum
16 contaminant level for this contaminant. It shows
17 that for that period, benzene showed up in the
18 water 27 times. MTBE showed up less than 27 times.
19 So, it's not one of the leading contaminants, and
20 even on the basis of the number of times it showed
21 up above maximum contaminant levels, it did not

1 show up very often. It couldn't have shown up very
2 often. It had to be less than 22.

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

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

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

21 MR. DUGAN: The health threshold in

1 California is 13 parts per billion. It used to be
2 20 to 30 parts per billion as set by the United
3 States EPA.

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

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

20 And what California did was set a level to
21 make sure that, set on a very conservative basis,

1 it would never affect any of the consumers in
2 California.

3 But again, I don't think there is any
4 credible evidence that anyone has ever been
5 adversely affected by drinking water at this level.

6 So it's a conservative, very
7 safety-conscious level that doesn't mean that water
8 containing more than 13 parts per billion of MTBE
9 is going to make someone sick. That is simply not
10 the case.

11 Now, if you go back to the criteria that I
12 was talking about, that the important criteria here
13 are, first of all, look at water that consumers are
14 actually going to drink. Second, look at the
15 levels of detection; and three, looking at the
16 protocols for detection. The normal protocol for
17 detecting a contaminant is a two detection
18 protocol, the idea being obvious, that one
19 detection may be unreliable, that you can't be
20 certain that there is a contaminant in the water or
21 anything in the water until you do--until you have

1 two detects.

2 Now, Methanex's expert, Pamela Williams,
3 did that type of analysis based on the California
4 data, and what she came up with was a much
5 different analysis than what the UC-Davis study had
6 come up with, and these are the slides at Tab 19,
7 and what this shows is MTBE detection frequency for
8 drinking water sources based on a subset of
9 groundwater data, and when she uses the term
10 "subset," what she's talking about are groundwater
11 sources that are likely to be consumed by people,
12 drinking water, at concentration levels at or above
13 five parts per billion. And she gives both the one
14 detection and the two detection criteria.

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

20 Even if you use the one part per billion,
21 I mean the one detection protocol, which is not the

1 accepted scientific protocol, the percentage
2 detects are still very, very low, in the
3 neighborhood of one to two-tenths of 1 percent.

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

11 If we could go to the next slide.

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

18 ARBITRATOR REISMAN: Just refers to
19 surface water?

20 MR. DUGAN: No, what I just said, I'm
21 sorry, just referred to groundwater.

1 ARBITRATOR REISMAN: To groundwater.

2 MR. DUGAN: And what I'm showing you now--

3 ARBITRATOR REISMAN: Zero detects in
4 groundwater?

5 MR. DUGAN: Zero detects using a
6 two-detection protocol above five parts per
7 billion, five parts per billion again being the
8 aesthetic level.

9 Now, the next chart deals with surface
10 water, reservoirs, and it shows the same thing,
11 using a two detection protocol, five part per
12 billion threshold for the years '99, 2000, 2001,
13 there were zero detects in water that is actually
14 and likely to be consumed.

15 And behind that chart is the more detailed
16 data that Dr. Williams based her analysis on.

17 So, it's Methanex's position that if the
18 data for California's water are properly analyzed,
19 using those criteria, again water that's most
20 likely to be used by consumers, two-detect protocol
21 above the aesthetic threshold, which is a very low

1 threshold, there wasn't a problem. It simply
2 didn't exist. It was blown all out of proportion
3 for reasons that we'll get to later, but a hard
4 analysis shows that there simply was not a problem
5 with California's drinking water.

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

9 But, he banned it despite--

10 ARBITRATOR ROWLEY: Could I stop you
11 there.

12 MR. DUGAN: Sure.

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

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

19 ARBITRATOR ROWLEY: But just staying with
20 this for a moment, let's assume that Dr. Williams
21 is right. On the other hand, California was not

1 acting on Dr. Williams's correct analysis, and the
2 analysis it had showed there were detections. Is
3 that the basic difference?

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

21 As I said, Governor Davis went ahead and

1 he banned it any way, but he banned it despite what
2 I think were fairly significant, severe defects in
3 the UC-Davis study that were known at the time.

4 And those defects, I mean, were pointed
5 out, but he banned it anyway. The first was that
6 the UC-Davis study was incomplete. The UC-Davis
7 had been or the University of California had been
8 tasked by the Legislature to do a comparative
9 analysis of a number of potential oxygenates, not
10 just MTBE. It didn't do so.

11 Secondly, I don't think anyone denies that
12 the University of California study was underfunded.
13 It was \$500,000, and they themselves admitted that
14 with that amount of money they were incapable of
15 conducting the type of thorough and comparative
16 analysis that they had been tasked to do.

17 Third, as the U.S. now concedes, the
18 University of California study completely bungled
19 the cost analysis. In analyzing the cost of
20 banning MTBE, it included the sunk costs of
21 cleaning up the tanks, even those--those costs

1 would have to be incurred whether or not MTBE was
2 banned. But it added those into the costs. The
3 U.S. now concedes that that was the wrong approach,
4 and it was criticized at the time for being the
5 wrong approach.

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

15 Fifth, the University of California study
16 didn't accept its own data with respect to future
17 rates of leakage, and we will get into in more
18 detail later, but it predicted a future catastrophe
19 on California drinking water that simply wasn't
20 justified by information contained within the four
21 corners of the UC study itself. It failed to take

1 into account the impact on leaking tanks of the
2 ongoing California tank upgrade program, and we
3 will get into that in more detail later, but that
4 information was found within the four corners of
5 the report itself, and it simply ignored it.

6 Finally, the report itself, and this is
7 important to keep in mind, the report did not
8 recommend an immediate ban. It didn't recommend to
9 Governor Davis that he decide to ban it. It
10 recommended that Governor Davis consider banning
11 it. I think the only inference to be drawn from
12 that, from that use of the word "consider," is that
13 the University of California didn't feel that the
14 information that it had found was conclusive enough
15 to justify an immediate decision to ban it.
16 Nonetheless, Governor Davis went on to ban it. He
17 went beyond what the study recommended.

18 Now, one of Methanex's chief criticisms of
19 what California did is that it banned MTBE, even
20 though there were better solutions for the water
21 problem that were available.

1 Now, I will repeat it again, Methanex does
2 not believe that anybody's drinking water should
3 ever smell like turpentine. Neither should it have
4 benzene in it. It shouldn't have any of the
5 contaminants that were listed in the NRDC list.

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

16 And, in fact, when California did, and
17 California has addressed the causes of the problem,
18 and it has had a very significant impact on the
19 MTBE issue. Let's take two-stroke engines first.

20 Two-stroke engines are those small, noisy,
21 smelly engines that are used on jet skis and

1 outboard motors, and they're two stroke in the
2 sense that they combine oil and gasoline, and
3 they're not the normal four-stroke engines.

4 The consequence for the environment is
5 that they are very inefficient users of fuel, and
6 apparently they don't burn up to 30 percent of
7 their fuel. If you have an outboard engine that is
8 only burning 70 percent of the fuel, the other
9 30 percent ends up either on the lake or in the
10 air. And if the fuel contains MTBE, the MTBE gets
11 into the reservoir.

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

19 And as a consequence, the rate of
20 detection of MTBE dropped dramatically on the
21 reservoirs in California to the point where the

1 problem has been virtually solved, which is not
2 just MTBE that's not getting into the water. It's
3 gasoline that's not getting into the water, it's
4 oil that's not getting into the water, it's benzene
5 that's not getting into the water. By addressing
6 the source of the problem, they cleaned up the
7 whole contamination problem caused by using motors
8 on the lakes. It was obviously the most
9 appropriate solution for this particular problem,
10 and it solved the MTBE problem with respect to
11 reservoirs as well.

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

20 Secondly--not secondly, getting back to
21 the tanks, the leaking underground storage tanks,

1 there is absolutely no doubt that they are the
2 proximate cause, the primary cause of the MTBE
3 issue. Governor Davis said so in his Executive
4 Order itself, and let me quote from the Executive
5 Order. "Whereas the findings and recommendations
6 of the UC report, public testimony, and regulatory
7 agencies are that while MTBE has provided
8 California with clean air benefits, because of
9 leaking underground fuel storage tanks, MTBE poses
10 an environmental threat to groundwater and drinking
11 water."

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

20 Now, the reason why leaking underground
21 gasoline tanks were a problem was because

1 California had not implemented its own laws, its
2 own regulations or federal laws and regulations
3 requiring it to clean up the tanks. And the best
4 evidence of that is a statement from California
5 itself, from California's State Auditor, and if I
6 could put that up, that's Tab 21. Health services
7 and the state and regional boards are not making
8 certain that public water system operators, storage
9 tank owners and operators, and regulatory agencies
10 responsible for detecting and cleaning up chemical
11 contamination are doing their jobs. Not only does
12 the state regulate underground storage tanks
13 ineffectively, it has failed in some instances to
14 aggressively enforce the state's Safe Drinking
15 Water Act and the laws governing underground
16 storage tanks. Specifically, health services, the
17 regional boards, and local agencies have not
18 adequately enforced laws that require prompt
19 follow-up monitoring for chemical findings and
20 contaminated sites, notified the public about
21 chemicals found in drinking water, and managed the

1 complete cleanup of chemical contamination of
2 water--groundwater.

3 The date of this report is 1998, so it's
4 contemporaneous with the University of California
5 study and contemporaneous with the deliberation by
6 California as to what to do with respect to the
7 MTBE issue. And Methanex submits that the answer
8 is quite clear. What California should have done
9 was enforce its own laws and accelerated its tank
10 compliance program.

11 Now, California did have on the books, as
12 is obvious, laws and regulations requiring that
13 these tanks be cleaned up, and it was in the
14 process of cleaning up these tanks. It was late.
15 The goal had been delayed, and there had been a
16 1998 deadline for upgrading all these tanks, and it
17 had simply not been met. There had been
18 substantial progress, but the goal has not been
19 met, which is what prompted the criticism by the
20 state auditor.

21 But I think it's important to recognize

1 that substantial progress was being made in
2 cleaning up tanks, and if we could go next to
3 the--a chart from, again, from Dr. Williams's
4 report, that shows the progress that was being made
5 and shows the effect of cleaning up, of fixing the
6 tanks. And you can see that when the efforts
7 started to first fix the tanks in the early--in the
8 late eighties and the early nineties, the reports
9 of leaking tanks skyrocketed, and the number of
10 closed tanks skyrocketed. After then that peaked
11 in 1989 or 1990 s as the program, the compliance
12 program and the upgrade program got purchase, the
13 number of reported leaking underground fuel tanks
14 dropped with a slight spike in the late nineties,
15 and the number of closed, the number of tanks that
16 had to be closed also dropped.

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

19 The next slide, which is still in Tab 22,
20 shows--I'm sorry, next tab--next slide, which is
21 Tab 22, shows the same thing. It shows what

1 happened to leaking tanks after the 1998 deadline.
2 Now, again, this is where California was deficient,
3 as the State Auditor pointed out, but it was making
4 good progress, and the number of tanks reported
5 after the deadline has continued to drop
6 significantly to the point where it's now reached
7 what the scientists call an asymptotic level. It's
8 approaching zero and never actually gets to zero,
9 but it's approaching zero, so there has been
10 tremendous progress in the program of fixing the
11 tanks and fixing the problem.

12 Now, the reason why that's important--I'll
13 just give you the cite--well, the reason why that's
14 important is because even at the time that the
15 University of California study was being done,
16 California officials recognized that fixing the
17 tanks would fix the leakage problem. They knew
18 that at the time. And I would like to give you two
19 sources that showed that they knew that. The first
20 is Tab 24. Tab 24 is a citation. It's a quote
21 from the University of California report itself. I

1 think it's very important because it shows exactly
2 the type of data that was in the report and should
3 have been acted on. To estimate the probability of
4 MTBE release to groundwater from UST systems,
5 regression analysis was performed on leak data for
6 six annual periods, '92 through 1997. This
7 analysis showed annual baseline leakage
8 possibilities ranging between 2.5 percent and 2.9
9 percent of USTs active between 1992 and 1997.

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

21 So, if you compare those two figures, 2.5

1 percent and 0.07 percent, what you're really
2 comparing of 250 and seven. So, in other words,
3 what the University of California found was that
4 once the tanks are upgraded, the leakage rate would
5 drop from a number of 2.50 to .07, from 250 to
6 seven. That's a drop of about 97 percent.

7 So, within the report itself, there was
8 data and knowledge and evidence that the solution
9 to this problem was coming. Once the tanks were
10 upgraded, the number of leaks containing MTBE would
11 diminish greatly. They knew that. And at the
12 bottom, if you look at the quote at the bottom,
13 that had been predicted before by the California
14 EPA. Upon the completion of the tank upgrades
15 program, the leaking of gasoline components,
16 including MTBE in soil and groundwater should
17 greatly diminish.

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

20 Now, California officials, after the ban
21 was announced in 1999, before it was actually

1 implemented, have admitted that this program of
2 fixing the tanks has gone a long way towards
3 solving the problem. And if you would like, I will
4 draw your attention to Tab 25, a chart that we put
5 up that includes some of these statements by
6 California officials themselves.

7 Now, the most compelling quote is from
8 Governor Davis himself. As I mentioned earlier, in
9 2002, he decided to extend the ban on MTBE--the
10 ban--extend the deadline for starting the ban of
11 MTBE for one year, and one of the reasons why he
12 did so was because, quote, Strengthened underground
13 storage tanks requirements and enforcement have
14 significantly decreased the volume and rate of MTBE
15 discharges since Executive Order D-5-99 was issued
16 in March of 1999.

17 Gordon Schremp, who works for the
18 California Energy Commission, stated at the 2002
19 World Fuels Conference that, quote, The frequency
20 of MTBE showing up in wells is a lot less than
21 anticipated in the UC study.

1 He's wrong about that because as I showed
2 you, the UC study itself anticipated that the
3 number of future impacts of MTBE would be very,
4 very low as the tanks were cleaned up.

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

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

21 And finally, a study by Malcolm Pirnie,

1 it's not a government statement but it finds the
2 same thing. Future MTBE computation of groundwater
3 and surface waters in California is likely to be
4 much less severe than predicted by UC researchers.

5 Again, I would take issue with that
6 because I say that the UC researchers themselves
7 knew that contamination was going to drop off
8 greatly. They simply ignored that particular piece
9 of data that was in their own report.

10 So, what it comes down to is that if
11 California had been truly protected and protecting
12 its water source and making sure that none of those
13 23 contaminants got into the water or at least
14 those that they would control, it would have
15 accelerated its tank compliance program. It would
16 have done what it could to get that in place as
17 fast as it could, and it would have accelerated the
18 elimination of two-stroke engines from reservoirs.
19 Had it done so, that would have taken care of the
20 problem. And not only would it have taken care of
21 the problem of MTBE, but there wouldn't be benzene

1 in the water either. There wouldn't be gasoline
2 leaking into groundwater that's used for drinking
3 water. There wouldn't be oil leaking into it.
4 There wouldn't be any of the other long list of
5 contaminants in gasoline. It would have been by
6 far the better solution.

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

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

14 MR. DUGAN: Um-hmm.

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

21 MR. DUGAN: Correct.

1 ARBITRATOR REISMAN: So MTBE if you use
2 her method, MBTE problem doesn't exist. Simply
3 doesn't exist.

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

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

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

18 ARBITRATOR REISMAN: So just--my notes are
19 incorrect, then. Then double detect doesn't show
20 that there is no MTBE in the water. MTBE is in the
21 water, according to her.

1 MR. DUGAN: Yes, but the point she tried
2 to make is MTBE, the double detect. Remember, it
3 was the two charts that I showed you that showed
4 zero detects, not only used the double detect
5 protocol, but they were looking at a restricted
6 class of those times, those incidents when MTBE was
7 detected. In other words, she looked at the subset
8 of data, as she calls it, of water that was
9 actually likely to be consumed as drinking water,
10 so she ignored detects of MTBE in wells that were
11 drilled, for example, right next to a leak, to
12 assess the leak, which were included in the
13 database. She only focused on those wells that
14 were likely to provide drinking water for the
15 consumer.

16 And if you look at only drinking water
17 wells and you use the double detect protocol, and
18 you ignore all detections below five parts per
19 billion--in other words, if there's a detect, even
20 in a drinking water well of one part per billion,
21 no one can smell that. It's not a health threat.

1 And if you ignore that detection as not being a
2 detection at a level of concern, if you apply all
3 three of those criteria and analyze the data in
4 that manner, then you come up with no detects.

5 ARBITRATOR REISMAN: Which means
6 that--which would mean that the testimony that was
7 given in the public hearings after the UC study
8 with people indicating that they had detected it,
9 that was an illusion?

10 MR. DUGAN: No, it's not an illusion. And
11 I guess I'm not making myself clear. What
12 Dr. Williams focused on, again, was a very--a
13 subset of the data, but there was no doubt that
14 there were many other cases where, for example, in
15 wells that weren't intended for drinking, there
16 were single detects at levels, for example, of two
17 parts per billion, four parts per billion, or even
18 a single detect at nine parts per billion. As long
19 as it wasn't a double detect, she didn't--she
20 concluded, using the double detect protocol, she
21 concluded that there were no detections.

1 But there were a lot of detections. It's
2 a question of how she analyzed it, and what she
3 analyzed as the serious concern, and to maybe
4 simplify it she said, yes, there had been a lot of
5 detections of MTBE in the water, but how many
6 detections have there been of water that's really
7 going to be drunk by consumers and how many
8 detections have there been at a level that can be
9 smelled by consumers, and how many true detections
10 have there been using the two-detect protocol. And
11 once you apply those three conditions to this whole
12 mass of detects, you come out with a much smaller
13 universe. You come out with a zero universe.
14 Using those three criteria you come out with a zero
15 universe. But it's not denying that the existence
16 a much larger universe of detects.

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

19 MR. DUGAN: Sure.

20 (Brief recess.)

21 MR. LEGUM: With your permission,

1 Mr. President, one--one note, we understand now
2 that the claimant is going to make part of their
3 presentation of their case-in-chief not today but
4 in their closing on Wednesday of next week, and we
5 would just like to put a placeholder that if that
6 is, indeed, the way they wish to proceed, then we
7 may need to revisit the schedule in terms of the
8 amount of time between their closing/presentation
9 of this one part of their case-in-chief and when we
10 provide our rebuttal to that.

11 Thank you.

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

16 Mr. Dugan.

17 MR. DUGAN: Thank you.

18 So, where we left off before the break
19 was, I--we think Methanex has shown that MTBE is
20 not toxic, it's not carcinogenic, it's not a health
21 risk, and there were better solutions to deal with

1 the contamination problem. And that the UC-Davis
2 study itself had some well-known serious defects.

3 Was the--was th--the legitimate question
4 was MTBE contamination so serious, some type of
5 looming public health disaster that, as the amici
6 argue, a responsible government actually had no
7 choice but to ban MTBE? Well, I think the best way
8 of examining this is to look at what Europe did.
9 Europe did not think that MTBE contamination posed
10 this type of risk whatsoever.

11 Agencies in Germany and in the European
12 community have determined that banning MTBE,
13 because of its infrequent detect in drinking water
14 would not benefit the environment, and what I would
15 like to put up now is a slide with some of the
16 quotes, some of the relevant quotes. First is the
17 German Environmental Protection Agency. German EPA
18 ultimately concluded that, quote, MTBE is an
19 important component for the production of gasoline
20 there was no risk established for the environment
21 from the use of MTBE in fuels in Germany. Nor is

1 such a risk expected to occur in the future.

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

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

14 Now, I think the best way of summing this
15 up is to cite a press release that was issued by
16 the European Community on May 11, 2001, and I think
17 this is found in the--Dr. Williams's report on
18 leaking underground storage tanks at 22. And what
19 they said sums up in many ways Methanex's position.
20 Quote, At this stage, the Commission believes the
21 best way to tackle the problem of possible

1 underground--of possible groundwater contamination
2 by MTBE is to ensure that all underground tanks
3 used to store fuel at service stations comply with
4 the best available technical standards and that
5 these standards be robustly enforced.

6 PRESIDENT VEEDER: Whenever you cite
7 something, if you could give the reference for the
8 transcript.

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

13 PRESIDENT VEEDER: Thank you.

14 MR. DUGAN: Now, Denmark presents a
15 particularly interesting case with respect to MTBE
16 because it actually proposed a phaseout of MTBE
17 because of what it thought were the environmental
18 concerns, but that phaseout was reversed due to
19 upcoming new EU standards for automotive emissions.
20 Those standards will result in an increase in the
21 percentage of MTBE used throughout Europe,

1 including in Denmark, and for that reason they
2 reversed the ban.

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

9 More importantly, there are portions of
10 Europe that use MTBE in significantly greater
11 portions than the United States. Finland, for
12 example, it uses MTBE in concentrations of up to
13 15 percent in contrast to the typical U.S.
14 concentration of 11 percent. And it's well-known
15 that Finland is a land of a lot of lakes. It has a
16 fairly high water table.

17 Nonetheless, the--Finland, which served as
18 the rapporteur for the EU Risk Assessment and the
19 scientific work on the report was prepared by the
20 Finnish Environmental Institute, the national
21 product control agency for health and welfare, and

1 the Finnish Institute of Occupational Health, and
2 they are the ones who concluded that MTBE did not
3 present a risk.

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

14 In fact, the European Community, as I
15 mentioned, it's so confident in the success of its
16 improved underground storage tank program that it
17 has proposed to increase the use of MTBE in Europe
18 in the future, in order to reduce air pollution.

19 Now, I think the best perspective on why
20 California actually enacted the ban comes from two
21 sources that we cited. If we could put that slide

1 up. This is Tab 27. And these are from two DeWitt
2 conferences. DeWitt is a trade publication for
3 MTBE and oxygenates. And at a May 2002
4 international conference on oxygenates, the foreign
5 delegates expressed, quote, disbelief that a
6 product that has little or no proven health risk
7 could be banned without regard for the commercial
8 impact or even a fair hearing based on science and
9 the facts."

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

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

19 So, it's Methanex's position that the ban,
20 the MTBE ban in 1989, was totally unjustified, and
21 that the later ban on methanol was unjustified.

1 There was no health crisis, and a prudent, rational
2 consideration of the scientific evidence,
3 especially a rationale consideration of the level
4 of the leakage into true drinking water and the
5 impact of the tank upgrades would have led an
6 unbiased decision maker to reject the ban and
7 instead focus on the causes of the problem, which
8 were the two-stroke engines and the leaking tanks.

9 But the MTBE ban itself is only half the
10 story, and from Methanex's point of view it's not
11 the most important half. The most important half
12 of the story shows that in addition to banning
13 MTBE, Davis decided to use ethanol as a substitute,
14 as a substitute oxygenate, and he made this
15 decision, he rushed to this decision precipitously
16 long before there had been any reasoned evaluation
17 by California of the advantages and disadvantages
18 of ethanol as an oxygenate.

19 Now, let's look at the evidence. Before
20 Governor Davis--before Gray Davis became governor,
21 California was actually opposed to the use of

1 ethanol. Governor Davis's predecessor, Governor
2 Pete Wilson, had actually vetoed a bill to exempt
3 ethanol from the restrictions imposed on all of
4 their oxygenates. And in doing so, Governor
5 Wilson, he detected and he laid bare the bill's
6 efforts to give a market advantage to ethanol over
7 all other oxygenates. Quote, This legislation,
8 while purporting to provide access to the market,
9 seeks to enhance the advantage of this product,
10 ethanol. There are no regulatory barriers to its
11 use, and state law should not be used as a means to
12 achieve market advantage, especially when the
13 consequences will foul our air.

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

17 But beyond that, there was another case.
18 In 1993, the United States EPA proposed a
19 30 percent ethanol requirement in the national
20 oxygenate market, and that was actually the
21 proposal that generated one of the critical pieces

1 of evidence in the case that we will get to later,
2 but that proposal met with a lot of opposition, and
3 some of the opposition came from California itself.
4 Governor Wilson filed a brief, resisting and
5 arguing against that program, and one of the
6 reasons why he argued against the program was that
7 California thought that at that time in 1994, that
8 shifting to ethanol would result in, quote,
9 irreparable injury to the health and welfare of
10 California citizens and to the environment.

11 So, prior to Davis, prior to the time that
12 Davis took office, California had a very negative
13 view of using ethanol. California thought that
14 using ethanol would harm the health and the
15 environment in California. And actually, that fear
16 of using ethanol was very well-founded because
17 ethanol's problems were very well-known even in
18 1999. And, in fact, the UC report itself
19 identified a number of these very serious ethanol
20 problems.

21 Let's take a look at the actual summary

1 recommendation that California--that the University
2 of California provided to Gray Davis. And this, I
3 believe, is paragraph nine of the summary of
4 recommendations from the University of California.

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

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

18 Now, one of the most important things that
19 the University of California found is what it just
20 alluded to: Adverse health effects associated with
21 incomplete combustion. And what they're talking

1 about there is that by using ethanol, what would
2 happen is concentrations what are known as
3 acetylaldehyde and formaldehyde are known
4 carcinogens as the UC-Davis study recognized. And
5 that if--the study itself recognized that if
6 ethanol were substituted, cancer could increase in
7 California up to 2800 cases a year--not a year.
8 2800 total, I believe. That is an extraordinary,
9 extraordinarily large increase in cancer. It
10 showed that the use of ethanol would have very,
11 very serious health concerns.

12 And I would like to show the exact source
13 from the UC-Davis study that says that because I
14 think it's important, the exact quote. This is
15 from the UC report, volume one, summary
16 recommendations, quote, Under ambient conditions,
17 unburnt ethanol is converted to acetylaldehyde and
18 eventually to peroxyacetyl nitrate and
19 formaldehyde. The ambient concentrations of
20 acetylaldehyde and formaldehyde, both air toxics
21 (sic) and known carcinogens are expected to

1 increase if ethanol is substituted for MTBE as the
2 oxygenate of choice.

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

9 Now, it also became clear, although not at
10 the time but later, that using ethanol could have
11 the same types of problems in water as MTBE
12 could--as MTBE did. There was a study completed in
13 2001. It was actually the last of the studies that
14 were ordered by Governor Davis to evaluate the use
15 of ethanol, and it found that the use of ethanol
16 could cause a four-fold increase--four-fold
17 decrease in the rate of benzene degradation, and
18 increase benzene plume lengths by 250 percent. And
19 we would like to show you a slide that we hope
20 captures this graphically. And this is Tab 32.

21 Now, what this slide shows is when ethanol

1 is added to gasoline, what it does is ethanol
2 biodegrades faster than benzene, but by doing so it
3 depletes all the oxygen in the soil. Because there
4 is no oxygen in the soil, it makes it hard for the
5 other ingredients of gasoline, such as benzene, to
6 biodegrade. And because the oxygen has been
7 depleted, benzene spreads farther.

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

13 And the reason why that's important, if we
14 go back to the chart--and I'm not going to put it
15 back up there, but the chart that we saw earlier,
16 the list of the 23 prevalent contaminants in
17 drinking water, one of them is benzene. And here
18 we have the report by California itself saying that
19 if you use ethanol in place of MTBE, you're going
20 to aggravate the already very serious benzene
21 problem, and Methanex believed that's precisely

1 that's what's going to happen, that benzene
2 contamination, as a result of the substitution of
3 ethanol, is going to get much worse in California.

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

11 In fact, the best evidence of that is a
12 letter that Senator Dianne Feinstein wrote,
13 questioning the switch to ethanol. This is what
14 she said, quote, As you know, the south coast air
15 district has already experienced 31 days above the
16 Federal ozone standard in 2003. This is worrisome
17 because there are only 21 days exceeding the
18 Federal ozone standard in all of 2002. Moreover,
19 for the first time in five years, Southern
20 California experienced a stage one smog alert on
21 Friday, June 11, 2003. The switch to

1 ethanol-blended gasoline is considered one of the
2 main culprits of this increased ozone.

3 So, Senator Feinstein at least believes
4 that air pollution is getting worse because of the
5 switch to ethanol. That was slide 33.

6 Now if I could also put up two more slides
7 that are derived from our experts' reports that
8 quantify the ranges of how ethanol can cause a
9 damaging impact to the air quality in
10 California--and this is based on the Williams
11 study--it's possible that the use of ethanol could
12 increase concentrations of carbon monoxide by up to
13 370 percent, nitrogen oxide up 100 percent,
14 peroxyacetyl up to 300 percent, and formaldehyde up
15 to 21 percent.

16 And moving on to slide 35, it could
17 increase acetaldehyde by up to 13 percent, and
18 that's the increase that causes the up to 2,800
19 additional cancer deaths. It increases evaporative
20 emissions in benzene by up to 44 percent, total
21 hydrocarbons of up to 55 percent, and chemicals

1 with ozone-forming potential by an increase of up
2 to 72 percent. Ethanol is simply not good for the
3 air.

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

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

16 And one of the things he requested at that
17 time was, he requested from the United States EPA a
18 waiver of the oxygenate mandate because he didn't
19 think it was economically feasible for ethanol to
20 cover all the needs of California for oxygenated
21 fuels, so he asked for a waiver, but he also made

1 it clear when asking for the waiver, he went out of
2 his way to make it clear that a very significant
3 chunk of the market was going to be set aside for
4 ethanol. And this is what he said, and this is
5 from his waiver request. This is Tab 36.

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

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

21 Now, he's saying that a significant

1 portion of gasoline would still contain ethanol
2 before any studies had been done. He's already
3 making it clear that he's going to shift to the
4 ethanol industry a big chunk of the California
5 market.

6 Next piece of evidence. In the Executive
7 Order banning MTBE, he did two things with respect
8 to ethanol, and this is California Executive Order
9 D-5-99, and it's paragraphs 10 and 11. And this
10 was the actual order banning MTBE. The first was
11 that he--in paragraph 11, he ordered, quote, The
12 California Energy Commission, CEC, shall evaluate
13 by December 31st, 1999, and report to the Governor
14 and the Secretary for Environmental Protection the
15 potential for development of a California
16 waste-based or other biomass ethanol industry. CEC
17 shall evaluate what steps, if any, would be
18 appropriate to foster waste-based or other biomass
19 ethanol development in California should ethanol be
20 found to be an acceptable substitute for MTBE."

21 So he's directing the California Energy

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

5 More importantly, in paragraph 10 of the
6 Executive Order, he stated, quote, The California
7 Air Resources Board and the State Water Resources
8 Control Board shall conduct an environmental fate
9 and transport analysis of ethanol in air, surface
10 water, and groundwater. The Office of
11 Environmental Health Hazard Assessment shall
12 prepare an analysis of the health risks of ethanol
13 in gasoline, the products of incomplete combustion
14 of ethanol in gasoline, and any resulting secondary
15 transformation products. These reports are to be
16 peer-reviewed and presented to the Environmental
17 Policy Council by December 31, 1999.

18 As we'll see, the reports weren't finished
19 actually until October of 2001.

20 But more importantly--

21 ARBITRATOR ROWLEY: Mr. Dugan, could you

1 remind me the date of the Executive Order.

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

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

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

13 In addition, let's go to the witness
14 statement of James Caldwell that the United States
15 has put in, and let's look at another list of
16 oxygenates used under the oxygenated fuel program
17 for potential ones. This list is even longer.
18 This is Tab 39.

19 Now, this tab includes MTBE, ETBE, TAME,
20 DIPE, TBA, ethanol, TBA again, MTBE again, and then
21 a methanol-TBA blend, a methanol-GTBA blend, a

1 methanol blend with butanol or some other type of
2 alcohol, a five percent, 2.5 percent methanol
3 co-solvent alcohol blend, something called
4 Octamides, which is five percent methanol and 2.5
5 percent co-solvents, and then 15 percent MTBE.

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

16 Why didn't Davis order an analysis of all
17 these other oxygenates or at least some of these
18 other oxygenates? Why did he simply single out
19 ethanol as the only oxygenate that California was
20 going to study as a replacement for MTBE? That's a
21 very important question. And our answer, as we

1 will see, is because he'd already determined, even
2 at that point, to substitute ethanol for MTBE.
3 He'd already made the decision.

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

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

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

17 MR. DUGAN: Because he was splitting the
18 baby, as politicians do, and he was faced with two
19 competing concerns. He thought that he had tried
20 to substitute ethanol for the entire market in
21 California. It would have produced supply

1 disruptions, increased gasoline prices, and
2 consumer outrage. There simply wasn't enough
3 ethanol to supply all of California at that time.
4 So, his idea was simply to split the baby. He
5 would give ethanol a big share of the market,
6 perhaps half the market, and the other half of the
7 market would be serviced by reformulated gasoline
8 without oxygen.

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

20 MR. DUGAN: Well, giving ethanol
21 50 percent of the market is still a very, very

1 significant benefit. The question is, I mean, did
2 he think that giving them 50 percent of the market
3 was enough? And our argument is that he did, that
4 giving them 50 percent of the market, while at the
5 same time maintaining price stability for gasoline
6 in California was the way for him to resolve a lot
7 of competing concerns.

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

17 PRESIDENT VEEDER: If I could raise one
18 question for which you will need to go back to the
19 Senate Bill 521 because in Section 2 of the Senate
20 Bill, if you look at Section 2 and Section 3,
21 perhaps I could read it out, what the Legislature

1 was mandating the study to be undertaken by the
2 University of California was not simply MTBE and
3 ethanol, but also ETBE and TAME.

4 MR. DUGAN: Yes.

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

9 MR. DUGAN: Correct.

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

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

1 MTBE.

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

10 Now, the next piece of evidence is what
11 Davis told the United States Congress in October of
12 1999, and this is slide 40. And at that time there
13 was testimony from a California official, Michael
14 P. Kenny, and he said, quote, I'm pleased to be
15 here on behalf of Governor Gray Davis, the
16 California Environmental Protection Agency, and the
17 California Air Resources Board to discuss our
18 state's perspective on the report and its findings.
19 Once MTBE is eliminated, the only feasible
20 oxygenate will be ethanol.

21 Now, again, the date of this is

1 October 1999. This is before any of the studies of
2 ethanol and its use had been completed. The first
3 study was completed in December of 1999, and there
4 were subsequent addenda and then the final study
5 was completed in October of 2001.

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

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

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

21 Now, throughout 2000 and 2001, the

1 deliberate shift to ethanol continued. In March of
2 2000, the Secretary of the California EPA reported
3 to the Renewable Fuels Association, which is the
4 ethanol lobby, that he expected, "substantial use
5 of ethanol in the production of California gasoline
6 even with the waiver." And that's found at 23 JS
7 Tab 42.

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

16 Now, in contrast, California made no such
17 allowances for competing alcohol oxygenates such as
18 TBA, for example. And at the same time that
19 California was accommodating ethanol, it was
20 banning all of its competitors. In 2001, it issued
21 a regulation making clear that its intent was to

1 ban all alcohols other than ethanol. Now, that
2 regulation didn't name methanol by name. It was--I
3 believe that that quote comes from--that comes from
4 1999.

5 But the clearest intent that California
6 wanted to get rid of all the competitors except
7 ethanol comes from the latest amendments to the
8 California RFG3 regulations, which were adopted in
9 December 2002. And if we could put those up,
10 please.

11 Again, these are the California
12 regulations with respect to the MTBE ban, and this
13 is found at Tab 41. It states that (reading)
14 Starting December 31, 2003, no person shall sell,
15 offer for sale, supply, or offer to supply
16 California gasoline which has been produced at a
17 California production facility with the use of any
18 oxygenate other than ethanol or MTBE unless a
19 multimedia evaluation of use of the oxygenate in
20 California gasoline has been conducted and the
21 California Environmental Policy Council established

1 by the Public Resources Code Section 71017 has
2 determined that such use will not cause a
3 significant adverse impact on the public health or
4 the environment.

5 It goes on to state, the covered
6 oxygenates, oxygen from the following oxygenates is
7 covered by the prohibitions in 2262. I won't go
8 through the rest of the cite. But here for the
9 first time, California names methanol as one of the
10 prohibited oxygenates. It hadn't done so before
11 this. It did so in regulations that were passed at
12 the end of 2002, and that came into effect either
13 at the beginning of this year or, I think, in July
14 of this year.

15 Now, it also lists many other potential
16 oxygenates that were banned that were never studied
17 by California. Isopropanol, n-Propanol n-Butanol,
18 and all the others. I won't read the whole list.
19 It's a long and tortuous chemical list. But my
20 point is that this evidences two things. First of
21 all, it's further evidence of California's intent

1 to make sure that only ethanol got the market in
2 California, only ethanol had studies for it funded
3 by the state studying its impact. None of these
4 others were funded by the state studying its
5 impact.

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

11 Now, the second reason why this is
12 particularly important, the Tribunal has always
13 been concerned with the fact that the original 1999
14 Executive Order by Gray Davis did not name
15 methanol. It only banned MTBE by name. And the
16 United States, on the basis of that, has asserted
17 repeatedly that methanol--and Methanex--do not
18 belong in this case because they are only remote
19 suppliers. They're not named in the order. That
20 as a consequence, the California measure, the 1999
21 measure, does not relate to methanol, that there is

1 no legally significant relationship between the
2 1999 measure and methanol.

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

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

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

18 PRESIDENT VEEDER: Yes, of course.

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

21 MR. LEGUM: Of course.

1 PRESIDENT VEEDER: Let's break and come
2 back.

3 MR. DUGAN: Thanks very much.

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

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1 Committee said: "The number one barrier to
2 creating that industry is the assurance of a
3 long-term market for ethanol here in California.
4 Assurance, I can be very specific on that.

5 It requires--and this, by the way, is Tab
6 42. It requires the investment folks looking down
7 the road and seeing a market for somewhere in the
8 reasonable 10-year period, which is a tough, tough
9 barrier for creating a biomass ethanol industry in
10 California. California Energy Commission biomass
11 to ethanol report, "The driving force for an
12 in-state ethanol production is the impending
13 phaseout of MTBE by December 31, 2002."

14 Again, at a biomass-to-ethanol hearing,
15 quote, The only reason that all of us are even here
16 today is there's a phaseout going on of MTBE.

17 So, it's Methanex's position that what was
18 taking place in California was that California was
19 trying to foster a local industry through subsidies
20 and through the ban of its competitors, and that's
21 what make it is illegal. While it may be

1 appropriate to subsidize local industries in
2 certain circumstances, you can't do it by banning
3 its competitors, and that's what was taking place
4 here.

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

17 Secondly, the fact that California failed
18 to create the market, California failed in
19 delivering on its intended purpose, doesn't mean
20 that it didn't have an improper intent to start
21 with. It did have an improper intent. It did want

1 to create an in-state market, and it did want to do
2 so by banning MTBE, and that's the intent that has
3 to be focused on, not whether they were successful
4 or not.

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

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

1 before MTBE was phased out.

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

13 The second is that the ethanol industry's
14 and California--ADM's role in the promulgation of
15 the California measures wasn't limited to the
16 events concerning the contribution. They were
17 involved with the manipulation of the public
18 opinion and the whipping up of the degree of
19 concern about MTBE that simply wasn't merited by
20 the facts, and they did it because the ethanol
21 industry sensed that this was an opportunity to

1 displace MTBE, and as it turned out, they were
2 correct. But they were there right from the
3 beginning, long before the meetings in Decatur in
4 1998, and long before the ban was actually
5 implemented.

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

18 We have submitted information to the
19 Tribunal in which we quoted from the decision and
20 the briefs that were submitted to the United States
21 Supreme Court in the McConnell decision, and I

1 think it's very important that we go over exactly
2 what was said and who said it, and what the Supreme
3 Court concluded in that opinion, because Methanex
4 believes that the Supreme Court's findings in that
5 opinion and what was said by the Solicitor General,
6 conclusively validate Methanex's position here.

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

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

20 And one of the questions was, was this
21 necessary, and the Solicitor General defended the

1 campaign finance law before the Supreme Court, and
2 in defending the law and in arguing to the United
3 States Supreme Court that prophylactic measures of
4 the type that were included in the bill were
5 necessary, he said, and this is the quote, he
6 referred to a treasure trove of testimony from
7 members of Congress, individual and corporate
8 donors and lobbyists, as well as documentary
9 evidence, establishing that contributions,
10 especially large non-Federal donations, are given
11 with the expectation that they will provide the
12 donor with access to influence Federal officials
13 and that this expectation is fostered by the
14 national parties, and that this expectation is
15 often realized.

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

1 well.

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

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

18 And the Supreme Court upheld the law, and
19 in doing so, they accepted these types of
20 arguments. The idea that large contributions to a
21 national party can corrupt or, at the very least,

1 create the appearance of corruption of federal
2 candidates and office holders is neither novel nor
3 implausible. There is substantial evidence in
4 these cases to support Congress's determination
5 that such contributions of soft money give rise to
6 corruption and the appearance of corruption. For
7 instance, the record is replete with examples of
8 national party committees' peddling access to
9 Federal candidates and office holders in exchange
10 for large soft money donations.

11 Just as troubling to a functioning
12 democracy as classic quid pro quo corruption is the
13 danger that office holders will decide issues not
14 on the merits or the desires of their
15 constituencies, but according to the wishes of
16 those who have made large financial contributions
17 valued by the office holder. Even if it occurs
18 only occasionally, the potential for such undue
19 influence is manifest. And unlike straight cash
20 for votes' transactions, such corruption is neither
21 easily detected, nor practical to criminalize.

1 Now, if I could just break out for a
2 second from the quotes, the United States has made
3 much of the fact that we have not accused anyone of
4 any criminal conduct, and that's correct. We have
5 no proof that any criminal transactions took place.
6 That's not the issue here. The issue here is not
7 whether there was a criminal quid pro quo. The
8 issue is whether this type of political corruption
9 that the Solicitor General and the United States
10 Supreme Court is referring to, took place here.
11 That's the issue.

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

21 Implicit and as the record shows,

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

9 Next is another Supreme Court case, an
10 earlier case dealing with another campaign finance
11 reform issue. This is the case of FEC, Federal
12 Election Commission, versus the Colorado Republican
13 Federal Campaign Committee. "Corruption being
14 understood not only as not quid pro quo agreements,
15 but also as undue influence on an office holders'
16 judgment and the appearance of such influence. The
17 money parties spend comes from contributors with
18 their own personal interest. Parties are
19 necessarily the instruments of some contributors
20 whose object is not to support the party's message
21 or to elect party candidates across the board, but

1 rather, to support a specific candidate for the
2 sake of a position on one narrow issue or even to
3 support any candidate who will be obliged to the
4 contributors.

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

18 Now, Methanex's position is, and I think
19 it's undeniable based on those quotations that this
20 is, unfortunately, a pervasive aspect of the
21 American political system. And what we'd like to

1 focus on next is a very precise example involving
2 Mr. Vind, the ethanol industry, and Congressman and
3 then Senator Toricelli of how this system works.
4 And it's an exemplar of how the system works and
5 how it operates.

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

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

17 MR. DUGAN: No, that's not our position at
18 all. Our position at all, at least as a minimum,
19 is that what these quotes and what these statements
20 by the Solicitor General established is that if a
21 certain fact pattern is present, it is very much a

1 permissible inference for anyone judging that fact
2 pattern to infer, to use Senator Rudman's words,
3 that money affected the outcome. That's a
4 permissible inference.

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

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

17 Now, this is a newspaper story that was
18 reported in New Jersey in 1998, and it was an
19 analysis and a description of a series of political
20 contributions and the responses between Mr. Vind
21 and Robert Toricelli, who at the time was a

1 Congressman in New Jersey, who later ran for the
2 Senate, was elected, and then later resigned
3 because of allegations of corruption.

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

17 What he was referring to was Mr. Vind's
18 particular problem in El Salvador. He had
19 purchased some type of plant there that was
20 associated with the production of ethanol, and he
21 was having trouble obtaining the requisite business

1 approvals to operate it. So, he gave a
2 contribution to Representative Toricelli, hoping to
3 get Representative Toricelli's help in solving the
4 problem.

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

20 The next slide, on March 28, two weeks
21 after the letter, Vind made a second \$500

1 contribution to Toricelli's campaign. There would
2 be more contributions and more letters to come. On
3 September 5th, Vind and his wife Joan contributed
4 \$3,000 to Toricelli's 1996 Senate campaign, the
5 maximum allowable records show. That same day,
6 Vind's son and daughter-in-law each made \$1,000
7 contributions to the campaign. In addition, Vind
8 donated \$5,000 on September 25th to the Senate
9 Democratic Committee, which was running ads on
10 behalf of Toricelli and other Senate candidates.

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

18 Meanwhile, Toricelli's first letter to the
19 Clinton Administration helped Vind. Cantor brought
20 up Vind's problems during a trade mission with
21 El Salvador's Minister of Economy, Vind said.

1 Now, in addition to the letters, Toricelli
2 voted twice in the Senate to extend a fuel excise
3 tax exemption to ethanol producers, an issue worth
4 millions to Archer Daniels Midland, also important
5 to Vind. ADM is known to have bank rolled a
6 multi-million dollar lobbying campaign to extend
7 the credit.

8 Toricelli's Senate votes, his first that
9 dealt solely with the tax credit issue, were
10 unusual for a New Jersey Senator.

11 Senator Frank Lautenberg, democrat of New
12 Jersey, voted against the credit, and for years
13 Toricelli's predecessor in the Senate, Bill
14 Bradley, was known as a leading opponent of the
15 credit, accusing supporters of reaching deeper and
16 deeper into the pockets of American taxpayers to
17 benefit a handful of special interests. In 1994,
18 he introduced a bill to repeal it.

19 Now, next is a quote from Mr. Vind. He
20 said to the reporter, is there a quid pro quo?
21 Absolutely not.

1 And finally, there is a comment from
2 Mr. Gary Ruskind, director of the Congressional
3 Accountability Project, a Ralph Nader-affiliated
4 group. The only thing missing here is a handshake.
5 It's one more government official for hire by the
6 largest contributor and one more reason we need
7 campaign finance reform.

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

12 Now, again, Methanex is not alone in
13 asserting that Archer--ADM and the U.S. ethanol
14 industry have used this type of political influence
15 and political lobbying to gain their ends.
16 California has itself said the same thing. After
17 Governor Davis banned MTBE and applied to the
18 United States EPA for a waiver of the oxygenate
19 mandate, the EPA denied it, and at that point the
20 Government of California sued the EPA, and one of
21 the things they alleged in the course of that

1 proceeding was that the reason why EPA turned down
2 the waiver request was because, quote, Following a
3 national election, a change in administration and
4 after intense lobbying by the ethanol industry, the
5 U.S. EPA reversed course and denied California's
6 waiver request, end quote, purportedly on
7 scientific grounds.

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

15 Now, United States doesn't deny that the
16 U.S. ethanol industry would not exist without the
17 protectionist measures and the subsidies provided
18 to ethanol by U.S. Federal and state governments
19 and that had been provided for a number of years.
20 Once again, the best evidence of that are the words
21 of the United States itself. And I would like to

1 draw the Tribunal's attention to a statement by the
2 United States General Accounting Office, which is
3 the investigative arm of the United States Senate.
4 And what it reported was, quote, According to the
5 analysts we contacted or whose work we read, the
6 tax incentives allow ethanol to be priced to
7 compete with substitute fuels, such as gasoline and
8 MTBE; thus, without the incentives, ethanol fuel
9 production would largely discontinue.

10 So, that's the GAO--again, the United
11 States Congress investigating arm--saying that
12 without the subsidies, without the tax incentives,
13 there would be no U.S. ethanol industry.

14 Now, how did the ethanol industry get
15 these tax incentives? Let's turn to the words of
16 Senator John McCain. Now, if you will recall, the
17 campaign finance bill, the campaign finance
18 legislation that went up to the Supreme Court was
19 called the McCain-Feingold bill, and it was named
20 after McCain because he sponsored it and he
21 reported it. Here is what Senator McCain has to

1 say about the ethanol industry and the tax
2 subsidies that are received by the ethanol
3 industry. And this is from a speech on his
4 letterhead that we have included in the judge's
5 books for you. "Americans care deeply about tax
6 reform. The Tax Code is a bewildering 44-page
7 catalog of favors for a privileged few and a
8 chamber of horrors for the rest of America. We
9 must have systemic reform. But reform is not
10 possible when Archer Daniels Midland, the nation's
11 largest ethanol producer, like so many other
12 special interests, trade huge political
13 contributions to both parties in exchange for
14 special tax subsidies. And you lose, speaking to
15 the American people.

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

21 Now, beyond those tax subsidies, the

1 United States doesn't deny that the U.S. ethanol
2 industry is also heavily protected from foreign
3 competition by tariffs and other political
4 pressures aimed at neutralizing competition.
5 Ethanol imports are subject to a duty that amounts
6 to a total of approximately 54 cents per gallon.
7 The current price is about \$1.80 a gallon. It's at
8 a historic high, so you can see this import duty of
9 54 cents is a forbidding barrier to the entry of
10 foreign ethanol.

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

20 But for that, no other imports from any
21 other country coming into the United States, even

1 though it's generally agreed that, for example,
2 Brazil is a more efficient producer.

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

14 For example, this is a statement from
15 representative Jim Nussell, member of the House
16 Ways and Means Committee, Co-chairman of the
17 Congressional Alcohol Fuels Committee. He said
18 methanol is derived from oil and other
19 petroleum-based products, increased use of MTBE
20 transmits into even more dependence on foreign
21 energy supplies.

1 In 1992, at the start of the debate about
2 oxygenates in general, Senator Daschle, a
3 well-known supporter of ethanol, emphasized the
4 punitive approach. He introduced a tax package
5 that would put a 50 cent per gallon duty on
6 imported methanol, which would have translated into
7 a 17-cent per gallon hike in the MTBE price.

8 Now, where does this nationalistic
9 rhetoric come from, this jingoistic rhetoric? From
10 the ethanol industry.

11 Next I would like to draw the attention's
12 to a quote from Wayne Andreas, who was at the time
13 Chairman and CEO of ADM. He stated in an interview
14 with Money Line--now, methanol with an M is a
15 foreign product. If it's mandated in the
16 reformulated gas, 70 percent of it in future years
17 will come from Saudi Arabia, O.P.E.C. states, same
18 places we get our oil from and will cost billions
19 of dollars in foreign exchange. Well, ethanol
20 means a billion dollars to American farmers, so
21 it's Middle East versus Middle West.

1 In terms of the market, by the way, it's
2 also worth pointing out and following up on your
3 question earlier this morning, the size of the
4 market in California is very, very big. The
5 California Energy Commission estimated that the
6 ethanol market for this year will be approximately
7 900 million gallons, and the current price is \$1.83
8 a gallon, so that comes out to be about, I think,
9 about \$1.8 billion.

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

18 Now, going back to this campaign to brand
19 methanol and MTBE as a foreign product, public
20 interest group have also picked up the theme. One
21 of them, Citizen Action, has stated that because of

1 the CAAA, which is the Clean Air Amendments Act, I
2 believe, the demand for MTBE and methanol have
3 increased substantially leading to the reopening of
4 mothballed and the construction of new methanol
5 plants both in the United States and abroad.
6 Because methanol can be produced cheaply in many
7 foreign countries, primarily because of access to
8 very low cost natural gas resources, the United
9 States is importing an increasing amount of
10 methanol.

11 As the United States seeks to reduce
12 pollution from gasoline by shifting to
13 cleaner-burning fuels and components, there are
14 concerns that oil import dependence may be
15 exchanged for foreign methanol import dependence.

16 In fact, Citizen Action went out of its
17 way to excoriate and identify, quote, foreign-owned
18 Methanex.

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

21 MR. DUGAN: Citizen Action is a public

1 interest group. It's a public interest group
2 that's an NGO. It's a lot like some of the people
3 who are sitting in the audience today. It's
4 concerned with public interest issues, and they're
5 the ones who launched this accusation against
6 Methanex.

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

13 Now, again, another example of the ethanol
14 industry constantly depicting methanol as a foreign
15 product is a letter from Doug Vind, who, I believe,
16 is related to Richard Vind, the witness who will be
17 coming here. It's on Regent International
18 letterhead. And it states that we must insist--and
19 it's a letter to Mr. Ted Hope of the Los Angeles
20 County Metropolitan Transit Authority I think is
21 what it stands for, and the letter was with respect

1 to the purchases by the Transit Authority of
2 methanol. And Mr. Vind says to Mr. Hope, "After
3 reviewing this information, we must insist that the
4 MTA's procurement office immediately stop the
5 current practice of purchasing foreign-produced
6 methanol to supply the MTA's alcohol bus fleet."

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

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

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

21 Similarly, the whole ethanol production

1 scheme is built upon the massive subsidies that
2 corn farmers receive from the United States
3 Government.

4 And finally, we believe that the effort to
5 restrict oxygenates to ethanol is a violation of
6 the WTO technical barriers to trade agreement.

7 Now, that's not necessarily relevant here
8 because those subsidies are not the subsidies at
9 issue here, but I think it's important for the
10 Tribunal to note that these are the types of
11 agricultural subsidies that now threaten to
12 undermine the entire world trading system. It's
13 because of these types of subsidies similar to the
14 common agricultural program in Europe, similar to
15 the subsidies that Canada provides to its farmers,
16 similar to the subsidies and protection that Japan
17 provides in Japan that the Third World is so upset
18 about.

19 The Third World complains that the
20 protection and the subsidies deprive them of the
21 opportunity and the ability to compete fairly in

1 these types of products. Brazil is a good example.
2 Brazil has abundant amounts of excess sugarcane
3 that can be used to produce ethanol. Brazil is
4 probably a much lower cost ethanol producer, but
5 it's completely shut out of the market and the
6 Third World countries are protesting that the
7 system is unfair and it's tilted against them
8 precisely because of the types of subsidies and
9 protection that ethanol receives.

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

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

19 Now, we've made a lot of allegations about
20 ADM, and I think it's fair to say the U.S. doesn't
21 deny many of them. It doesn't deny that ADM is the

1 largest beneficiary of the tax incentives for
2 ethanol or that it's among the most prominent
3 corporate--recipients of corporate welfare anywhere
4 in the United States. It doesn't deny that
5 43 percent of ADM's profits come from this heavily
6 subsidized, heavily protected ethanol program.

7 How did ADM become the beneficiary of such
8 government largess? Well, you saw the quote from
9 Senator McCain, but others said the same thing.
10 He's not the only one to say that it's these
11 political contributions that ADM makes, that ADM
12 trades for favorable policies. If I could draw
13 your attention to--this was a statement, there is
14 the statement from Senator McCain again. I won't
15 reread that, but underneath that is just a--and
16 there are numerous articles like this that can be
17 found--By giving huge contributions to Democrats
18 and Republicans, ADM makes clear that these
19 contributions are not about ideology, beliefs, or
20 who wins the election. ADM contributions are given
21 to guarantee that no matter who wins, ADM will have

1 a place at the table, and access and influence in
2 Washington.

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

11 Now, in addition to their political
12 contributions, ADM engages in what Methanex
13 considers to be numerous forms of unfair
14 competition. They have many times tried to create
15 health scares about methanol and MTBE, and one
16 particular example is what happened in 1994, and
17 this is a report from a newspaper, from a trade
18 publication, the New Fuels Report, and the title of
19 the news article is "False MTBE Moratorium Report
20 Wreaks Havoc for Methanol Industry." The stock of
21 a major producer, which as it turns out was

1 Methanex, took a nose-dive last Monday, July 8,
2 after unfounded reports surfaced that the American
3 Medical Association, AMA, had called for a
4 nationwide MTBE more moratorium."

5 "By the end of last week, however, the
6 stock of Methanex, Inc., of Houston had recovered.
7 The spot market for the petroleum-based fuel
8 additive remained unaffected by publicity generated
9 by false reports of the moratorium. Reports of the
10 so-called moratorium were generated by a press
11 release sent to major news organizations by a
12 Washington, D.C.-based ethanol information group
13 called Fuels For The Future. The press release,
14 which trumpeted the moratorium in its lead
15 paragraph, was the basis for stories on two major
16 Wall Street news services. Fuels For The Future,
17 however, painted a misleading picture for the AMA's
18 action."

19 Next, who is Fuels For The Future? Well,
20 this is a quote from a Bloomberg story. Fuels For
21 The Future is financed by farmers' groups and

1 companies like Archer Daniels Midland, a company of
2 Decatur, Illinois, which would benefit from greater
3 use of ethanol, a corn derivative.

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

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

1 the misleading picture.

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

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

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

15 Next going back to the lysine price-fixing
16 case, the United States Court of Appeals for the
17 Second Circuit not only affirmed the convictions,
18 but in a relatively unusual judicial act it
19 increased the defendants' prison sentences and
20 condemned ADM's corporate culture, and this is what
21 it said. It said: "The facts involved in this

1 case represent an inexplicable lack of business
2 ethics and an atmosphere of general lawlessness
3 that affected the very heart of one of America's
4 leading corporate citizens. Top executives at ADM
5 and its Asian co-conspirators throughout the 1990s
6 spied on each other, fabricated aliases and front
7 organizations to hide their activities, hired
8 prostitutes to gather information from competitors,
9 lied, cheated, embezzled, extorted, and obstructed
10 justice.

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

13 So how did ADM operate in California?
14 What did it do in California with respect to this
15 MTBE ban? Well, the first thing it did was in
16 1997, it started the whole process. The ethanol
17 industry started the whole process of trying to
18 develop the appropriate political framework and
19 background for this type of ban trying to generate
20 support. Mr. Wright's witness statement, and the
21 materials he relied upon make that clear. For

1 example, in January 1997, at about the same time
2 that Senate Bill 521 was being drafted, and that
3 was the bill that ultimately called for the study
4 and then called for the Governor to take
5 appropriate action, Lynn Suter, ethanol's lobbyist
6 in California, reported, and this was with respect
7 to a hearing on MTBE, "This hearing was something
8 of a lovefest and received very good play in the
9 legislature, the press, and in the larger
10 community. Every single speaker invited by the
11 committee to describe options to MTBE or to tout
12 benefits of ethanol as a market alternative was
13 generated by efforts of our team last year. In
14 addition, a long list of environmental groups,
15 business and agricultural interests attended the
16 hearing and made comments during the public address
17 portion of the hearing. Nearly all of these
18 speakers were also generated through our coalition
19 building last year.

20 Yesterday's Supreme Court decision
21 throwing out most of the campaign contributions in

1 Proposition 208 means that we will probably have to
2 become players in the campaign donation game. My
3 intention would be to keep this participation to a
4 minimum, but I can see a \$20,000 effort looming if
5 we are to take advantage of the influence that
6 might bring.

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

10 Now, the press has also called attention
11 to how these things take place and to what ethanol
12 was doing in California. This is the story from
13 the Los Angeles Times in 1997, and it's talking
14 about someone who is alleged to be an operative for
15 the ethanol industry. "While most promoters try to
16 maintain as high a profile as possible, Bob
17 O'Rourke admits that only when pressed that he is a
18 public affairs consultant for the ethanol industry.
19 He also acknowledges that he sometimes gives advice
20 to a controversial citizens group called
21 Oxybusters, which is campaigning to ban a

1 petroleum-based additive that competes with ethanol
2 to make gasoline burn clearer, but O'Rourke refuses
3 to disclose the name of his employer. He blames
4 covert consultants in the opposing camp for trying
5 to create the impression that he's quietly working
6 on behalf of the nation's most controversial
7 ethanol producer, Archer Daniels Midland Company.
8 It also serves as a cautionary tale for California
9 consumers who are being bombarded through radio
10 talk shows and news outlets with information
11 challenging the safety of the petroleum additive,
12 which is called MTBE. Insiders say some of the
13 controversy is being generated by industry-paid
14 operatives such as O'Rourke, whose allegiances are
15 not always clear."

16 Next is an article from the trade journal
17 World Refining. "The assault on the use of MTBE in
18 California has been the product of a well financed,
19 organized, negative media and public profile
20 campaign orchestrated by Archer Daniels Midland,
21 top executives, and the resulting hysteria created

1 by ADM and conservative radio talk show hosts.
2 Over time, 1996 to March of 1999, this created
3 hysteria and the inability to promptly solve the
4 Santa Monica tank and pipeline leak problem wore
5 out all of California's rational thinking."

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

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

20 And this was in 1998, and so next I would
21 like to go to the facts surrounding the secret

1 meeting in Decatur, Illinois. What we have done is
2 put together a time line, and we will hand out as
3 well the binders of the evidence that backs up this
4 time line, but the time line is meant to--to put
5 into compressed format all the evidence.

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

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

19 Next, on May 28th, 1998, Davis receives a
20 contribution of \$5,000 from ADM. June 2nd, 1998,
21 Davis receives the Democratic nomination for

1 Governor. The same day, Davis receives another
2 contribution of 5,000 from ADM.

3 Sometime before July 16, 1998, Davis asks
4 Vind to request a meeting with ADM, so it's Davis
5 seeking ADM out. July 15, 1998, Vind arranges a
6 secret meeting for Lieutenant Davis and John Burton
7 with ADM for August 4th, 1998. July 20, 1998,
8 Davis receives a contribution, another contribution
9 of \$5,000 from ADM. August 4th, 1998, secret
10 meeting between Davis, Burton, and ADM at ADM
11 headquarters in Decatur Illinois.

12 Then the floodgates open. August 17,
13 1998, Davis receives a contribution of a hundred
14 thousand dollars from ADM. Burton receives a
15 contribution of \$25,000 from ADM.

16 December, Davis receives another--November
17 3rd, Davis gets elected. Davis receives another
18 contribution of \$25,000 from ADM.

19 January 4th, he's sworn in as Governor;
20 March 25th, 1999, he issues the Executive Order
21 banning MTBE, which includes the statement in his

1 request for a waiver that a significant portion of
2 the market would still go to ethanol.

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

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

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

15 Now, Methanex believes there shouldn't be
16 any serious doubt as to why Governor Davis
17 contacted Vind to set up a meeting with ADM. He
18 was soliciting campaign contributions. That's why
19 he contacted him. That's why he affirmatively went
20 out of the way. We believe that's the only
21 inference that can be drawn.

1 Now, it's apparent from the schedule and
2 the itinerary for the meeting why the participants
3 were coming together in California, and if we could
4 look at that schedule, that itinerary, which is Tab
5 61 in your books.

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

19 Marty Andreas, Alan Andreas, Dwayne
20 Andreas, were all senior executives.

21 So, the people with line responsibility,

1 had line responsibility only for ethanol. There is
2 no one here from ADM's lycene business or its corn
3 business. It's only ethanol.

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

15 Now, we say that this meeting is secret.
16 It didn't become public knowledge until early 2001,
17 and the participants went out of their way to
18 conceal the existence of this meeting. The
19 official campaign documents filed by the various
20 participants, and this is one of them, this is the
21 expense--this is Tab 62. This is a recording of

1 the expense for Gray Davis for his flight to
2 Illinois, to Chicago, and it puts down there as the
3 purpose for the meeting, meeting with Ron and Steve
4 Powell, AFL-CIO. Well, his other purpose for going
5 to Illinois was to meet with ADM, but he's
6 studiously avoiding putting this purpose down on
7 the campaign disclosure document.

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

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

18 Five days after that, that statement, ADM
19 was forced to acknowledge that it had in fact met
20 with Davis, but even then, it issued a more
21 preposterous denial, claiming that the meeting was

1 only a get-acquainted session related to ADM's
2 extensive food business in California.

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

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

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

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

1 hold secret meetings.

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

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

10 The second statement, the second quote
11 from the Reuters report, "The U.S. agricultural
12 giant does extensive food business in California,
13 so it was only natural to have met with Governor
14 Gray Davis during the 1998 campaign and contribute
15 200,000 to its coffers," ADM spokesman Larry
16 Cunningham said. "Our contributions are public
17 knowledge," Cunningham told Reuters adding that the
18 meeting with Davis at ADM's headquarters was a
19 get-acquainted session.

20 Well, just recalling who the participants
21 were in the session, it doesn't appear that it was

1 a get-acquainted session. It appears that it was a
2 session about ethanol. Only people with line
3 responsibility for ethanol were at the meeting.
4 Bob Daneen was at the meeting. He was an ethanol
5 guy. Dick Vind was at the meeting. He was also an
6 ethanol guy.

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

11 Furthermore, the witness statement of
12 Roger Listenberger, who we'll be cross-examining on
13 Thursday, indicates a much different purpose for
14 the meeting. He said--and he said, quote,
15 Mr. Davis--this is paragraph two of his witness
16 statement. "Mr. Davis was campaigning to become
17 the Governor of California. It was my
18 understanding that the dinner was arranged in order
19 for me and others to meet Mr. Davis, discuss his
20 candidacy, and assess whether to support his
21 campaign."

1 So, ADM was going to talk with Mr. Davis
2 and see if it was worthwhile making a contribution
3 of over \$200,000 to Mr. Davis.

4 So, it's quite apparent that this was not
5 a get-acquainted session. This was a session
6 between a heavy duty political contributor that
7 wanted to see whether Governor Davis was the type
8 of candidate who was suitable for ADM to make
9 contributions to. And we know that thereafter,
10 within weeks of the meeting, ADM made a huge
11 contribution to Governor Davis, a hundred thousand
12 dollar contribution, and the question becomes what
13 happened at the meeting that led ADM to come to the
14 decision to heavily support Gray Davis, and heavily
15 support him they did. Again, hundreds of thousands
16 of dollars flowed into his coffers as a result of
17 this.

18 Now, on the basis of the evidence that's
19 in the record, and we believe it will be augmented
20 by the examinations of Mr. Vind and
21 Mr. Listenberger, I think a number of conclusions

1 can be drawn. First of all, the meeting had two
2 purposes, ethanol and whether ADM was going to
3 support Governor Davis. The fact that ethanol was
4 the purpose of the meeting can be inferred from all
5 the ethanol participants who were there, and the
6 fact that the question of whether ADM was going to
7 support Gray Davis comes from Mr. Listenberger's
8 witness statement.

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

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

19 The third point to keep in mind is that
20 after the meeting took place and after the
21 contributions were made, Gray Davis did, in fact,

1 implement a policy decision that heavily favored
2 ADM. We put into the record evidence about ADM's
3 press releases, announcing higher profits. They're
4 at 23 JS Tab 39 at 1. ADM has benefited enormously
5 from this. One of the oldest legal maximums for
6 finding the truth is *cui bono*, who benefited, who
7 received the benefit here? It's quite clearly ADM.

8 Now, is this set of facts, this pattern of
9 facts, unusual for Davis? No. This set of facts
10 was quite clearly part of Governor Davis's dealing
11 with other industries as well; and what I would
12 like to put up now is Tab 65. It's a newspaper
13 Article from The Sacramento Bee. Sacramento is the
14 capital of California, and again this is The
15 Sacramento Bee's words, making the same points that
16 I think we have been making.

17 First of all, the title, "Is it all simply
18 a coincidence? During the first year of his
19 governorship, Davis pulled in a record \$14 million
20 from a wide variety of special interests groups
21 averaging \$38,000 a day, or \$1600 an hour. A

1 certain pattern developed. Farmers, timber company
2 executives, leaders of the managed health-care
3 industry or other interest groups would stage
4 fundraising events for Davis in conjunction with
5 their discussions of pending issues. And by some
6 coincidence, he would soon adopt policies that
7 found favor with the interest groups involved. The
8 most obvious example involved healthcare company
9 regulation, with Davis insisting on the final
10 version that companies could tolerate but that
11 health consumer advocates found wanting. Lobbyists
12 believed that the surest way to get Davis's
13 attention was to stage a fundraising event, and
14 Davis political aides, lobbyists say privately,
15 make it clear that the minimum required for
16 personal appearance by the Governor is a \$100,000,
17 four times his threshold in 1998." So, that means
18 in 1998, \$25,000 would have gotten a personal
19 appearance. ADM and Regent International ended up
20 contributing \$200,000 to Governor Davis's
21 campaigns.

1 Now, in the context of what Governor Davis
2 was raising, that was a large amount of money.
3 They were--\$25,000 was the threshold for personal
4 appearance. \$200,000 must have been considered by
5 the campaign to be a very, very significant
6 contribution.

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

18 To use Senator McCain's words--I mean, to
19 use Senator McCain's words, ADM traded its
20 political contributions for a share of the market
21 in California. And to use the Solicitor General's

1 words, Davis succumbed to the temptation to favor
2 the interests of large contributors. Methanex
3 submits that is the only credible inference that
4 can be drawn from this pattern of facts that
5 happened in California, and that led Governor Davis
6 to both ban MTBE and then rush to embrace ethanol
7 before any thorough evaluation of its advantages
8 and disadvantages had been undertaken, and that's
9 why Davis focused California's attention on ethanol
10 and not on any of the other 5 or 10 or 15 other
11 potential oxygenates that could have been used to
12 replace MTBE.

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

20 The only evidence before the Tribunal is
21 what I have gone through and what we will see from

1 Mr. Vind and Mr. Listenberger, and Methanex submits
2 that the only inference to draw from that evidence,
3 the totality of the record, what happened and who
4 benefited is, again in the words of Senator Rudman,
5 "the money affected the outcome."

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

18 Now, that's not a new or novel argument.
19 That doesn't place this case outside the mainstream
20 of international jurisprudence or even domestic
21 jurisprudence. This type of pattern has been

1 repeatedly recognized in the past.

2 And what I would like to quote are three
3 international legal scholars and their take on the
4 problem. Exhibit 66. The first is a quote from an
5 Article by D. Farber and R. Hudec, Professor Hudec,
6 who unfortunately is deceased, was a leading
7 International Trade Law expert. The quote here is,
8 quote, International legal scholars have frequently
9 acknowledged the danger that environmental
10 regulations may be captured by protectionists who
11 will use them as a guise for erecting barriers to
12 imports.

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

17 Next, As tariffs have diminished, a,
18 quote, suspicion arises in some cases that
19 announced concerns about health and safety are mere
20 pretense for regulation that is motivated by
21 protectionist ends.

1 And again, Methanex submits that that's
2 what precisely happened in California between 1999
3 between 2000. The ethanol industry, the United
4 States ethanol industry, captured the quid pro quo
5 process and used it for its own ends.

6 Now, in addition to those quotes, the case
7 law is replete with these types of things,
8 instances in which the domestic industry used an
9 environmental regulation for purely protectionist
10 ends, and the best example of that is the S.D.
11 Myers case. As I'm sure the Tribunal recalls, S.D.
12 Myers was an American company that specialized in
13 the remediation of PCB wastes, and it wanted to
14 start doing business in Canada, and it wanted to
15 export PCB wastes from Canada to the United States
16 for final disposal. And its competition was in
17 Canada, western Canada, and it appeared it was not
18 as competitive. It wasn't as well run a company.
19 It didn't have as much experience as S.D. Myers.

20 So, what developed then was a fact pattern
21 that is not greatly dissimilar from what has

1 developed here. The Canadian competitor went to
2 its government and started lobbying its government
3 for some type of protection, and lo and behold it
4 got it. Now, there was no suggestion there of
5 campaign contributions. It was clearly an attempt
6 by the local Canadian competitor to lobby the
7 government, and it got it in the form of a ban on
8 PCB exports that was purportedly done for
9 environmental reasons.

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

20 Fourth, the Tribunal in Canada in the
21 Myers case noted that there were less protectionist

1 alternatives that could have addressed Canada's
2 claimed environmental concerns. The same is true
3 here. There were far less protectionist measures
4 that could have addressed California's
5 environmental concerns, namely an effective ban on
6 two-stroke engines and upgrading--accelerating the
7 tank upgrade program to take care of the leak and
8 tanks.

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

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

1 shows that the ban could not have been necessary,
2 that the ban was not necessary.

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

5 ARBITRATOR ROWLEY: One further question.
6 Assuming that you're right and the burden shifts to
7 the United States, do they have to show that the
8 ban was necessary or is it sufficient that they
9 show simply that the ban was reasonable?

10 MR. DUGAN: I think they have to show that
11 the ban was necessary. I think that that is the
12 rule of international law that comes out of the WTO
13 decisions--and as we know, this Tribunal is
14 governed by international law, and this dispute has
15 to be resolved in accordance with international
16 law--and the WTO quite clearly places the burden on
17 the respondent state to prove that the ban was
18 necessary, to prove that the environmental measure
19 was necessary. That's one of the critical showings
20 that a respondent state must make in order to
21 justify a measure that involves disparate treatment

1 for foreign-owned interests.

2 Now, what I was saying was that the S.D.
3 Myers Tribunal looked at who benefited from this
4 ban, and they found there that the benefit flowed
5 entirely to a Canadian company. The same is
6 98 percent true in this case, as well. It's the
7 United States ethanol industry that will benefit
8 from the ban of MTBE and methanol in California.

9 The Tribunal in S.D. Myers also analyzed
10 the burdens, and in Myers it was much clearer
11 because it fell on the U.S. competitor. Here, the
12 situation is such that the burden falls on both
13 foreign-owned ethanol producers such as Methanex,
14 and it also falls on U.S. methanol producers. So,
15 the burden is not entirely shared by foreign
16 companies, but Methanex submits that that doesn't
17 make any difference. Again, going back to the
18 treatment that Methanex is entitled to receive
19 under Article 1102, it's the best possible
20 treatment.

21 So, to sum it all up, the S.D. Myers

1 Tribunal came to the conclusion that this purported
2 environmental measure was improper under NAFTA
3 because, in essence, it was a measure that was
4 intended to protect a Canadian industry, and that
5 precedent, we think, is particularly relevant to
6 this case, as well, because that's precisely what
7 we are alleging.

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

1 subordinate to the political intent to shut down
2 the hazardous waste facility.

3 As a consequence, the Tribunal ruled that
4 it was an expropriatory measure, and it was that
5 basis on which the Tribunal actually awarded the
6 funds--the \$16 million to Metalclad, and it was
7 that finding that survived the subsequent appeal in
8 Canada.

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

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

18 PRESIDENT VEEDER: Yes, let's come back at
19 half past three.

20 (Brief recess.)

21 PRESIDENT VEEDER: Let's resume.

1 MR. DUGAN: Thank you.

2 The third case I'd like to turn to that
3 deals with the issue of a regulation that is
4 dressed up as an environmental regulation that has
5 no substance is the case of Ethyl versus Canada.
6 It was one of the first NAFTA cases brought. It
7 was brought by Ethyl Corporation of America, which
8 manufactures a gasoline additive called MMT, and it
9 had a production plant in Canada, and the
10 Government of Canada issued a law which prohibited
11 the importation of MMT into Canada, and equally
12 prohibited the interprovincial trade in MMT. It
13 didn't actually ban the production of MMT because
14 as I understand it, I'm not a Canadian law expert,
15 the Federal government didn't have the power to do
16 that. I may be wrong, but that was my
17 understanding.

18 In any case, Ethyl brought a NAFTA
19 complaint alleging that this was a violation of
20 NAFTA. And even more interestingly, the Government
21 of Alberta brought a case against the central

1 Government of Canada under what is known as the
2 Agreement on International Trade. That's an
3 internal Canadian agreement that in many ways
4 mirrors and parallels an international trade
5 agreement. And under that agreement, a panel was
6 convened in order to determine whether this
7 restriction was justified.

8 Now, earlier this morning, I think we made
9 reference to the fact that that panel placed the
10 burden of establishing the environmental bona fides
11 of that order on the Canadian government, and it
12 concluded that the Canadian government had not
13 established that it was environmentally necessary
14 to implement that ban.

15 The other thing that was particularly
16 interesting about it was that the panel concluded
17 that the ban was the product of--it was pushed for
18 by the Canadian automobile industry, and it was
19 opposed by the Canadian oil industry.

20 And I think the importance for this
21 Tribunal is that it's another example. It's

1 another example of a ban that purports to be an
2 environmental ban that cannot be justified as an
3 environmental ban, and that it was the respondent
4 country's burden to justify it. And because the
5 Government of Canada lost at the AIT, it then
6 settled the case with ethanol--Ethyl and paid Ethyl
7 I think \$20 million Canadian.

8 The final example I'd like to draw the
9 Tribunal's attention to, is the recent Bilateral
10 Investment Treaty case involving Tecmed in Mexico.
11 I think I touched on this as well. Tecmed was a
12 Spanish company that was operating a hazardous
13 waste facility in Mexico, and as an aside, it seems
14 that so many of these cases involved either
15 additives to gasoline or hazardous waste facilities
16 in Mexico. They seem to be dominating the NAFTA
17 and the Bilateral Investment Treaty legal scene.

18 In any case, Tecmed had opened up a
19 facility in Mexico and wanted to renew the
20 operating permit for the facility. And it was
21 denied by the Mexican Government extensively on

1 environmental grounds. And what the Tribunal
2 ultimately did was decide that there were no valid
3 environment grounds, and that the real reason why
4 the Tribunal had denied the renewal by the Mexican
5 Government, had denied the renewal of the operating
6 permit was because of political pressure, because
7 Mexican residents near the dump did not want to
8 have one in their backyard. And it concluded that
9 that type of political pressure, the type of
10 parochial political pressure was not a sufficient
11 reason for closing the dump, and it awarded Tecmed
12 a fairly significant sum of money.

13 So, that's a fourth example of a decree,
14 of a government measure that purports to be one
15 thing, but is actually another thing. And again,
16 without beating a dead horse, that's precisely the
17 case that Methanex makes here. That what happened
18 in California between the MTBE ban and the bans on
19 methanol and the rush to embrace ethanol, although
20 dressed up as a series of environmental measures,
21 is actually a series of measures intended to

1 protect the ethanol industry that cannot be
2 justified on environmental grounds.

3 Now, members of the Tribunal, that more or
4 less sums up Methanex's case-in-chief concerning
5 Article 1102. In a nutshell, what Methanex argues
6 is, first, that methanol and ethanol and the
7 respective investments are in like circumstances.

8 Secondly, methanol, because of ADM's
9 contributions to Davis, was denied the best
10 treatment accorded to ethanol.

11 Third, it's the U.S.'s burden to justify
12 the ban on methanol and MTBE and the shift to
13 ethanol, and it cannot justify that because it
14 cannot prove any of the four following points, and
15 it has to prove all of them. It has to show that
16 the ban and the shift to ethanol were necessary as
17 an environmental measure; it has to show that they
18 were the most appropriate solution for the problem;
19 it has to show they were the least investment, the
20 least foreign investment-restrictive solution; and
21 it has to show that they are not an arbitrary and

1 disguised restriction on foreign investments.
2 Methanex submits that it can't make any of those
3 four showings, and for that reason, it's in
4 violation of the Article 1102.

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

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

21 A general standard for Article 1105 is

1 emerging. Taken together, the S.D. Myers, Mondev,
2 ADF, and Loewen cases suggest that a minimum
3 standard of treatment of fair and equitable
4 treatment is infringed by conduct attributable to
5 the State and harmful to the claimant if the
6 conduct is arbitrary, grossly unfair, unjust or
7 idiosyncratic, is discriminatory, and exposes the
8 claimant to sectional or racial prejudice, leading
9 to an outcome which offends judicial propriety, as
10 might be the case with a manifest failure of
11 natural justice in judicial proceedings or a
12 complete lack of transparency and candor in an
13 administrative process.

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

20 Now, Methanex believes that this is an
21 excellent articulation of the standard of fair and

1 equitable treatment as it has developed over the
2 years and as is required by the express text of
3 1105, which requires fair and equitable treatment.
4 Methanex further submits that what happened in
5 California violates this standard. What California
6 did in banning MTBE and methanol and adopting,
7 precipitously adopting ethanol was arbitrary, it
8 was grossly unfair, it was unjust, and it was
9 idiosyncratic in the sense that methanol (sic) was
10 pandering to a domestic U.S. industry, the ethanol
11 industry. It was discriminatory because it
12 discriminated against foreign-owned investments
13 such as Methanex, and that the whole process by
14 which this took place in which the critical meeting
15 was not the public hearings held in California, but
16 the meeting between Davis and ADM in Decatur,
17 Illinois, indicates a complete lack of transparency
18 and candor in the administrative process. What was
19 driving the adoption of ethanol in California was
20 the political debt that we believe Davis felt he
21 owed to ADM in return for its political

1 contributions, and that was not apparent in the
2 administrative process whatsoever.

3 So for all those reasons, we believe that
4 the evidence that we have described today supports
5 a violation of 1105, just as it supports a
6 violation of 1102.

7 Now, with respect to 1110, we have very
8 little to add what we've put into the record
9 already. The one point I want to make with respect
10 to 1110, is that at the heart of what we are
11 alleging here is discrimination, discrimination by
12 Davis in favor of campaign supporters and
13 discrimination against foreign-owned investments
14 such as Methanex. And I don't think any public
15 action that is discriminatory can ever be squared
16 with the requirements of 1110, even by its own
17 express language. It requires a nondiscriminatory
18 act. This was a discriminatory act. And for those
19 reasons, the same evidence that supports a
20 violation of 1102 and 1105 equally supports a
21 violation of 1110.

1 Now, next I'd like to turn to the question
2 of Methanex's investments in the United States and
3 whether they have been damaged. Methanex does,
4 indeed, have valuable investments and assets in the
5 United States as set forth in Mr. Macdonald's
6 witness statements. Methanex owns several
7 companies in the United States, and there are two
8 principal operating entities. Methanex Company,
9 which we call Methanex Methanol Company, which we
10 call Methanex-US, that is responsible for the
11 sales, inventory, and distribution of methanol
12 throughout the United States. It has a sales
13 staff. It has extensive leases where it stores the
14 methanol. It has a fleet of rail cars. It
15 generates considerable profits. In its best year
16 it generated over \$44 million in profits. It owns
17 a lot of goodwill, as we will see. It has paid a
18 lot for the goodwill that it has acquired, and it
19 is indisputably a significant operating investment
20 in the United States.

21 The second important company in the United

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

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

19 And just to illustrate them, I will put it
20 up on the board, the Methanex organization chart
21 which sets forth the relationship of the companies

1 in the United States to Methanex in Canada, and
2 this was provided as part of Mr. Macdonald's
3 affidavit.

4 Now, going into some detail about what the
5 assets in the United States, the investments in the
6 United States consists of, Methanex-US, which is
7 the sales and distribution company, its assets
8 include a very substantial amount of goodwill and
9 marketing rights. For example, in 2002, Methanex
10 paid 25 million for a customer list, a U.S.
11 methanol customer list, from a company known as
12 Terra Corporation and for certain production rights
13 regarding that company's Beaumont, Texas, methanol
14 plant. By the same token, in 2002, Methanex also
15 acquired similar assets from a chemical company
16 known as Lyondell, a customer list for \$10 million.
17 In fact, in 19--I believe it was 1995, Methanex in
18 Canada, the parent company, bought the one-third of
19 Methanex-US that it did not own for approximately
20 \$30 million, suggesting a valuation in 1995 of \$100
21 million for Methanex-US.

1 Now, the U.S. response to these undisputed
2 points of evidence in the Macdonald affidavits by
3 saying that goodwill, market share, and customer
4 base are not by themselves investments that are
5 capable of being expropriated. We believe that
6 they are quite clearly precisely the types of
7 investments that are protected by NAFTA, and the
8 starting point for any analysis as to whether these
9 types of assets are investments that are protected
10 by NAFTA is, of course, NAFTA itself, the text of
11 NAFTA. Article 1139 of NAFTA provides a definition
12 of what an investment encompasses, and Article
13 1139(g) is the subsection that is most relevant
14 here. It's Tab 69.

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

20 Now, when a company spends \$35 million for
21 customer lists, it seems to me that it's impossible

1 to deny that that is intangible property acquired
2 in the expectation and used for the purpose of
3 economic benefit. And that is part of
4 Methanex-US's goodwill. It's part of its marketing
5 rights. It's part of its access to customers in
6 the United States. It's part of its going value
7 concern. And all that is set forth in
8 Mr. Macdonald's affidavit.

9 And this definition quite clearly
10 encompasses those types of assets.

11 Now, the U.S. argues that 1139 is an
12 exhaustive list and because the word "goodwill"
13 does not appear in the text of NAFTA, it's not
14 covered. But we believe that misses the point.
15 The point here is that Article 1139 describes a
16 class of investments that are protected by NAFTA
17 and encompassed within that class are goodwill,
18 goodwill and marketing rights, and the rights to
19 have access to valuable customers. Those are the
20 types of intangible property that have a real
21 value, and that are acquired and used in the

1 expectation of making profits, of obtaining
2 economic benefit.

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

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

17 Similarly, two NAFTA Tribunals have dealt
18 with this issue, and both of them have concluded
19 that the types of rights that we're talking about
20 here that Methanex-US has on its balance sheet are
21 the types of investments that NAFTA was meant to

1 protect. The first of those, Pope and Talbot,
2 Canada, Pope and Talbot v. Canada, the Tribunal
3 concluded that, "The investor's access to the U.S.
4 market is a property interest subject to protection
5 under Article 1110," and that's Pope and Talbot
6 paragraph 96.

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

12 In S.D. Myers, the Tribunal recognized
13 that, "There were a number of other bases on which
14 SDMI could contend that it had standing to maintain
15 its Chapter 11 claims, including its market share
16 in Canada, including that its market share in
17 Canada constituted a market investment." The
18 Tribunal went on to state that, quote, Rights other
19 than property rights may be expropriated, and
20 international law makes it appropriate for
21 Tribunals to examine the purpose and effects of

1 governmental measures, end quote.

2 Again, Methanex's market share in
3 California, of which it had a significant chunk
4 until the MTV ban went into effect, is precisely
5 the type of property interest, precisely the type
6 of intangible property that is subject to
7 protection under NAFTA.

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

17 To the extent that that Tribunal found
18 that--to the extent that those assets exist and
19 they have value, if they're expropriated, they must
20 be compensated, and Methanex believes that's
21 precisely the situation here. Methanex-US is very

1 much an operating company. It has significant
2 goodwill. It carries it on its books as goodwill,
3 and that goodwill, that value was severely damaged
4 by its loss of its market in California and in
5 other states as well, because of the MTBE ban that
6 California enacted, and the methanol ban that
7 California enacted.

8 Now, Methanex-Fortier. Methanex-Fortier
9 is the entity that owns the methanol production
10 plant in Louisiana that even, I believe, the United
11 States concedes is a protected investment under
12 NAFTA. Methanex-Fortier was closed in 1999, before
13 the MTBE ban, but it wasn't finally written off
14 until 2004. And it was finally closed--it was
15 finally closed in 2004, and one of the reasons why
16 it was closed is set forth in Methanex's annual
17 report, which is filed with the United States
18 Securities and Exchange Commission. And what that
19 says is, and this is Tab 71, the language in the
20 annual report states, (reading), Limiting or
21 eliminating the use of MTBE in gasoline in

1 California, or more broadly the United States, will
2 reduce demand for MTBE and methanol in the United
3 States and negatively impact the viability of MTBE
4 and the methanol plants, such as our Fortier
5 facility in the United States.

6 So, the corporation recognized, and this
7 was the annual report for 2002 that was filed in
8 2003, a year before it was actually written off.
9 The company recognized that the MTBE ban in
10 California had so depressed demand for MTBE that
11 they had to keep the Fortier facility closed and
12 this was one of the--also one of the reasons, and
13 again this is referenced in Mr. Macdonald's
14 affidavit, the MTBE ban was a significant factor in
15 the decision to finally close the Fortier facility
16 in Louisiana.

17 So, those are the two investments that
18 Methanex has in the United States. Methanex-US,
19 its sales, distribution, and operating entity, and
20 Methanex-Fortier, and we think the evidence that's
21 in the record, and principally the evidence of

1 Mr. Macdonald, which again is unchallenged by the
2 United States, conclusively supports the idea that
3 there were valuable assets in the United States
4 that were subject--that were entitled to protection
5 under NAFTA.

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

17 And one of the first, I think some of the
18 most important evidence of causation is what I just
19 went over. The SEC Commission filing, which as the
20 United States points out, is subject to all the
21 rigorous requirements that it be truthful, was

1 filed with the SEC. It points out the link, the
2 causal link, between the MTBE ban and the permanent
3 closure of the Fortier facility in Louisiana, as
4 does Mr. Macdonald's affidavit. That's evidence of
5 the damage that was suffered. And that was caused
6 by the ban itself, directly caused by the ban
7 itself.

8 Next, Mr. Macdonald's affidavits show, we
9 believe conclusively, that the ban severely damaged
10 Methanex by triggering simultaneous downgrades in
11 Methanex's debt ratings. Moody's Investor Service,
12 Fitch, IBCA, and Standard & Poor's all downgraded
13 Methanex's debt, and the evidence from these rating
14 agencies themselves clearly demonstrates a direct
15 link and a damaging one between the MTBE ban and
16 Methanex's finances, and what I'd like to show the
17 Tribunal are some of those quotes from some of
18 those press releases that were issued by these
19 three debt-rating agencies. The first two come
20 from Fitch IBCA, quote, In addition, the downgrades
21 also considered the growing uncertainty in the U.S.

1 surrounding methyl tertiary butyl ether's (MTBE)
2 use in gasoline, which could potentially decrease
3 MTBE demand over the medium term. Presently, MTBE
4 demand represents about 4.3 million tons for the
5 U.S., including 1.5 million tons for California.

6 Also adding to the already weakened
7 industry fundamentals, in March 1999, the
8 California Governor issued an Executive Order
9 requiring a phaseout of MTBE in California by 2003.

10 So, this is express--an express statement
11 from Fitch's, that the downgrades considered the
12 impact of the MTBE ban.

13 Similarly Standard & Poor's. Methanex is
14 the world's leading producer and marketer of
15 methanol. The downgrade reflects the impact of
16 continued weak industry fundamentals on the
17 company's financial performance. The cyclical
18 decline has been longer and deeper than
19 anticipated, and the prospects for recovery are
20 still uncertain, given expected new capacity and
21 the possible phaseout of methyl tertiary butyl

1 ether (MTBE) in California and the rest of the U.S.

2 Again, this is Standard & Poor's,
3 referencing the ban in California as one of the
4 reasons why it downgraded Methanex's debt rating.

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

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

20 Now, the United States has challenged this
21 on the grounds that this happened before the ban,

1 and that's true. It did happen before the ban, but
2 that doesn't mean it didn't happen because of the
3 ban, and the evidence submitted by Mr. Macdonald
4 made that clear, and the evidence we're talking
5 about are reports from equity analysts who followed
6 the market very closely, who followed Methanex very
7 closely as a company, and who made it clear that
8 they were concerned about the possibility of the
9 MTBE ban further damaging, which I think there have
10 already been a couple of references to the already
11 weakened industry fundamentals.

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

21 Next is from Goepel McDermid Securities.

1 Methanex shares continue to be under pressure as a
2 result of MTBE concerns in the U.S. That's March
3 17th, 1999, a week before the ban was announced.

4 A complete ban would be chaos for the
5 industry and would have a significant negative
6 impact on the economy as MTBE plants are closed.
7 Even so, Methanex is only trading at about
8 30 percent of replacement cost and 75 percent of
9 book value after plant closures which suggests the
10 MTBE risk is fully factored into its stock price.
11 Therefore, Methanex's share price should be close
12 to the bottom.

13 So, that recognizes there that the risk
14 posed by the potential California MTBE ban had been
15 factored into Methanex's share price and already
16 caused a depression in that price.

17 It goes on to state, However, if a
18 decision to ban or phase out MTBE is given, it
19 still might temporarily knock the stock down
20 further. And that was correct. That's precisely
21 what happened, except that it wasn't temporary. It

1 was a permanent downward shift on the stock price.

2 And I think Mr. Macdonald makes that clear
3 in his evidence as well, and that subsequent
4 decline in the 10 days after March knocked another
5 \$150 million off the price of Methanex.

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

1 ban, it would be growing at 4 percent a year.

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

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

17 MR. DUGAN: Yes, I believe he's stepped
18 down now and has been replaced by Mr. Bruce Aitken.

19 I'm being corrected by my colleagues.

20 He was Chairman and CEO; now he is solely
21 Chairman.

1 ARBITRATOR REISMAN: May I ask a question.
2 You may be getting to this. How do you account for
3 the contribution of the California ban to the
4 declines you're describing and the contributions of
5 the bans in the rest of the United States, some of
6 which are in effect?

7 MR. DUGAN: Right. To a degree that might
8 be better dealt with when we get to the damages
9 phase, but let me address it here quickly.

10 California, in and of itself, is a very
11 big market. It's one of the biggest markets for
12 methanol in the world because it's such a huge
13 economy. And the market for MTBE and methanol in
14 California is itself a very big market. So, the
15 loss of that market, in and of itself, is very,
16 very significant for a company like Methanex.

17 But more importantly, California has also
18 been viewed as an environmental front runner, in
19 that if California does it, then it's likely that
20 other states will follow California and themselves
21 implement a ban. And to a degree, that has

1 happened. It's Methanex's position that the bans
2 in places like New York were triggered by
3 California's action.

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

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

10 MR. DUGAN: Well, yes, we would say when
11 we get to that stage, we will say that it was the
12 California's action--California represents
13 6 percent of global methanol demand. So, it's a
14 big market, 6 percent in a commodity market is a
15 very significant aggregate factor, but more
16 important to that, to the extent that the
17 California ban triggered similar bans in other
18 states, and it has in a few other states, we intend
19 to show those bans were caused by the California
20 ban, and thus the damage to methanol that's caused
21 by all of the bans put together can be laid at

1 California's doorstep.

2 Next, I'd like to discuss the issues of
3 causation. The United States argues that if
4 Methanex suffered any injury at all, which it
5 denies, those injuries were not proximately caused
6 by California's NAFTA breaches, and therefore,
7 Methanex's claim must fail.

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

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

18 And third, even if proximate cause is the
19 applicable legal standard, and this is the most
20 important point, Methanex still quite clearly meets
21 it. We think that the evidence in the record,

1 especially the unchallenged evidence from
2 Mr. Macdonald, shows a direct causal link between
3 the MTBE ban and the damages that were suffered by
4 Methanex.

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

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

17 Secondly, and we went over this, I think,
18 in considerable detail at the jurisdictional
19 hearing, the text of NAFTA, Methanex submits, does
20 not require proximate cause, and the starting point
21 for this is the text of 1116 itself. It states

1 that a claim by an investor that deals with the
2 claim--the title is A Claim by an Investor of a
3 Party On Its Own Behalf. And one of the
4 requirements is in the last phrase of Article 1116
5 that the investor has incurred loss or damage by
6 reason of, or arising out of, that breach.

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

11 As we pointed out at the last hearing, at
12 the jurisdictional hearing, we went through one of
13 the United States's briefs, and we noted every time
14 that it used the word "or" and every time that it
15 used the word "or," it used it in the disjunctive
16 sense and not the conjunctive sense. And we think
17 that that piece of evidence still stands. "Or" is
18 normally interpreted in the disjunctive, not in the
19 conjunctive, and by using the word "or" here, the
20 drafters of NAFTA intended two separate standards,
21 two separate causation standards. The first

1 causation standard was for damage by reason of,
2 which is the shorthand for proximate cause. But
3 the second standard was for damage arising out of
4 that breach. And in our prior submissions we
5 detailed all the cases, the municipal law cases
6 particularly in the United States and Canada in
7 which the phrase "arising out of," "damage arising
8 out of," has been interpreted to create a more
9 liberal causation standard, to allow for the
10 recovery of damages that are caused less directly
11 than damages caused proximately. And we think that
12 municipal law is quite clear on that point.

13 And we further think that the way NAFTA is
14 phrased, it recognizes two separate standards, and
15 if the Tribunal is to give meaning to all the words
16 in the treaty, it has to recognize Methanex's
17 position these two separate standards.

18 But the third point that I want to make
19 which I think is really the most important point,
20 is that whatever the standard is, whether it's
21 proximate cause or whether it's some lesser

1 standard, Methanex has quite clearly satisfied it,
2 and the evidence in the record establishes that, we
3 believe, without any doubt.

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

19 Similarly, we take the position that the
20 MTBE ban was a significant factor in the permanent
21 closure of the Fortier facility, and that it

1 proximately caused the permanent closure of the
2 Fortier facility.

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

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

16 Now, I think one of the key things about
17 proximate cause--and this is important for the
18 Tribunal to focus on and for other reasons as well,
19 especially with respect to the intent test--is the
20 question of foreseeability. Was the damage that
21 was caused to Methanex foreseeable and was it so

1 foreseeable that it cannot be fairly characterized
2 as remote? And Methanex believes that's completely
3 the case. And it cites to two pieces of evidence
4 that established that. Again, we think, beyond
5 doubt.

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

14 This is Tab 76, 22 JS Tab 28.

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

21 "The primary impacts of this proposal

1 include crude oil savings, the added cost of
2 producing and using the renewable oxygenate, the
3 reductions in revenues to the U.S. Highway Trust
4 Fund and the impacts on the various oxygenate and
5 fuel industries affected."

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

9 (Reading) Finally--and again, this is the
10 primary impact as described by the United States
11 EPA itself--Finally, there could be economic
12 impacts on a number of industries and economic
13 sectors due to this program. The revenues and net
14 incomes of both corn farmers and ethanol producers
15 should rise significantly, as they surely have for
16 ADM, due to higher corn and ethanol demand and
17 prices, respectively. Expenditures for government
18 farm price supports could decrease. Revenues and
19 net incomes of domestic methanol producers and
20 overseas producers of both methanol and MTBE would
21 likely decrease due to de reduced demand in prices.

1 Oil refiners could experience transitional costs
2 due to an additional requirement and would likely
3 face higher oxygenate costs.

4 So, on the basis of that, Methanex argues
5 that it is simply impossible for the United States
6 to contend that the damage that the shift to
7 ethanol in California inflicted on Methanex was not
8 foreseeable. It was not only foreseeable, it was
9 foreseen by the United States EPA itself.

10 And we further submit that--we further
11 argue that this statement by the United States EPA,
12 in precisely analogous circumstances, should be
13 treated as a conclusive admission. There is no
14 doubt whatsoever that the damage to Methanex was
15 foreseeable.

16 Now, the second piece of evidence that
17 shows that the damage was foreseeable is the
18 statement by Senator John Burton to representatives
19 of the MTBE and methanol industries in January of
20 1999, before the ban was actually implemented.
21 There are affidavits from both Mr. Wright--or two

1 affidavits from Mr. Wright describing this meeting,
2 and there have been documents, contemporaneous
3 documents submitted as part of Mr. Macdonald's
4 affidavit which also document this meeting.

5 And this was a meeting between the
6 lobbyist, the California lobbyist for MTBE and
7 methanol, and California officials. And here is
8 the statement from one of the documents that we
9 have included. Quote, We held about 20 meetings
10 with legislators and Ned Griffith this week. There
11 were a few meetings in which we received some
12 encouraging words. However, for the most part, the
13 members told us they believe a phaseout is
14 inevitable. Susan McCabe scheduled a meeting with
15 Senate President Pro Tem John Burton which we
16 attended along with Rick Lehman and Barry Brokaw.
17 Burton was perhaps the most candid legislator to
18 date, suggesting in only two words that a phaseout
19 is inevitable. He also suggested that OFA,
20 AMI--and that stands for Oxygenated Fuels
21 Association, which is the methanol and MTBE trade

1 association, and AMI stands for American Methanol
2 Institute--that those two trade organizations
3 should focus on the terms of the phaseout.

4 Now, in Methanex's mind, and some of the
5 other affidavits go into more detail about what was
6 said, but they make it clear that Senator Burton
7 knew two things, that a ban was coming, and he knew
8 also that the ban would severely damage Methanex,
9 and he said--and this is in other evidence that has
10 been presented by Mr. Wright, that Methanex--anyone
11 who wants to make money on the ban should sell
12 Methanex's stock short. So he was aware of the
13 fact that methanol industry supporters were in the
14 room because of the AMI connection, the American
15 Methanol Institute connection. He was aware of the
16 fact that Methanex was one of the players in the
17 methanol industry, and he was aware of the fact
18 that Methanex was going to be severely damaged by
19 the ban when it was implemented. And we believe
20 that all of those inferences can and should be
21 drawn from the evidence before the Tribunal.

1 Now, that means that Senator Burton also
2 foresaw the certainty that Methanex was going to be
3 severely damaged by the California ban, so we have
4 two pieces of evidence, two compelling pieces of
5 evidence to show that what happened to Methanex to
6 show that the damage that it suffered was both
7 foreseeable and foreseen.

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

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

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

17 MR. DUGAN: Agreed, and that says that a
18 phaseout is inevitable. What it says there
19 suggesting in only two words that a phaseout is
20 inevitable, but what he said, the phrase that he
21 used, which I won't use here, suggested more than a

1 phaseout is inevitable. It suggested also that
2 Methanex was going to be put in a bad way because
3 of it. And there are others. This is just one
4 piece of evidence that reflects this statement.
5 There is other evidence in the record to that
6 effect, and we think that the connotations of using
7 this phrase, this barnyard phrase, quite clearly
8 indicate damage as well as inevitability.

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

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

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

20 MR. DUGAN: I agree, you could infer that
21 from the language. We infer, again, the idea that

1 not just that you're going to lose, but that you're
2 going to be damaged as well.

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

13 PRESIDENT VEEDER: I think I misunderstood
14 your point. I thought your point was really not so
15 much on the barnyard part of the phrase, which
16 could cover all sorts of possibilities, but it's
17 the use of your word "your," Methanex, MTBE
18 phaseout which recognized, I think, according to
19 your argument and your written submissions by
20 Senator Burton as being damaging not simply to an
21 MTBE producer, but to Methanex?

1 MR. DUGAN: Precisely, to Methanex in
2 particular, and it's reinforced by the fact that he
3 used the word, he named the company as a company
4 whose stock's to be sold short, and all of those
5 prove that Senator Burton at least was fully
6 cognizant of the fact that Methanex, as a company,
7 was going to be damaged by the ban.

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

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

18 ARBITRATOR REISMAN: Were they the
19 lobbyists for Methanex?

20 MR. DUGAN: I don't know the answer to
21 that question. They were certainly the lobbyists

1 for the AMI, which is the American Methanol
2 Institute, of which Methanex is the largest member.
3 Whether they were actually the lobbyists for
4 Methanex, I will have to go back to the record and
5 check and see. I don't know the answer to that.

6 But the "we" there, I think, refers to
7 Rosen Kendall and the lobbying firm that had been
8 hired by MTBE and methanol producers in order to
9 present their side of the story to the California
10 Legislature.

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

13 MR. DUGAN: Certainly.

14 ARBITRATOR ROWLEY: And putting the Burton
15 conversation date in that, we see it's shortly
16 after Davis is sworn in as Governor. And a month
17 or two before Davis issues the Executive Order, and
18 it's permissible, I presume, to read into this that
19 legislators, including Burton, at that time
20 considered a ban to be inevitable, but that would
21 be regardless of whether there had been

1 contributions to Davis because those contributions,
2 I take it, were not known at that time. The secret
3 meeting was not known at that time. Would I be
4 right in that?

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

19 Nonetheless, I think that what can be
20 inferred from that piece of evidence is that
21 Governor Davis had made the decision to ban MTBE,

1 and he had communicated that decision to Senator
2 Burton. And that word of the impending ban was
3 spreading in the legislature in California, and
4 Burton who was, after all, the Senate--the
5 President pro tem of the Senate, was a very
6 powerful legislator. He would be in a position to
7 know precisely what had happened.

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

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

20 Now, also bear in mind Burton was himself
21 a recipient of ADM's contributions. He is someone

1 who would have an interest in knowing what the
2 Governor was going to do about the ban. He is
3 someone who would be in a position, and again this
4 is an inference, to find out from the Governor's
5 Office what was going to happen with the ban. He
6 had flown to Decatur. He had himself received
7 contributions from ADM and Vind, and he had a dog
8 in that fight. He wasn't immune from it.

9 In fact, many of the players here had dogs
10 in that fight, to use the vernacular. Senator
11 Mountjoy, the Senator who introduced the
12 legislation to start with, was a member of
13 Oxybusters. If you recall the newspaper article
14 that I read that identified Oxybusters as one of
15 the groups that was lobbying for the replacement of
16 MTBE with ethanol, Governor Mountjoy had ties to
17 Oxy Busters as well. He had ties to the ethanol
18 industry as well. The reference for that is 12 JS
19 Tab A, which we've submitted in the record already.
20 And so I think it's important to note that a lot of
21 the lead players in this drama had benefitted from

1 ADM. Senator Mountjoy had, the Senator who
2 introduced the legislation had benefited from
3 Oxy Busters and was tied to Oxy Busters. Senator
4 Burton, who announced the ban to the methanol
5 supporters, methanol lobbyists and the Methanex
6 lobbyists, had received money from ADM, and
7 Governor Davis, of course, was the principal
8 beneficiary of the largess from ADM.

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

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

1 that the damage was proximately caused by the ban.

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

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

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

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

21 MR. DUGAN: No, this is the final version

1 of the--what's included in Exhibit 41, and it
2 contains the same language, the same operative
3 language as is in what is in Exhibit 41. It's just
4 that this is the final version that doesn't have
5 the material that was red lined out in that
6 proposed order.

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

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

15 MR. DUGAN: And the methanol lobby.

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

19 MR. DUGAN: Correct, but I think from
20 the--from that letter it referenced AMI, which is
21 the American Methanol Institute.

1 ARBITRATOR REISMAN: At that time, you
2 already had SB521. The UC report had already been
3 published. The public hearings of the UC report
4 that involved many of the legislators had already
5 taken place.

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

8 ARBITRATOR REISMAN: Perhaps, I'm sorry.

9 Would it have been difficult for anyone
10 who was following this to have concluded that in
11 light of SB521 and the options clearly spelled out
12 there, in the light of the conclusions of the UC
13 report, defective or not, as you say, that one
14 would conclude that the days of MTBE were numbered
15 and that a ban was going to go into place? Isn't
16 it quite possible to infer from all of these public
17 records, quite innocent public records, that it was
18 common knowledge, so Senator Burton or anyone else
19 who was consulted would say, we're sorry, we
20 understand people from the methanol and MTBE
21 lobbied your interests, but the matter has already

1 been decided or it's virtually decided?

2 MR. DUGAN: Well, I don't think that is
3 the permissible inference because I think what was
4 going on was, and--

5 ARBITRATOR REISMAN: Why not?

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

16 ARBITRATOR REISMAN: But SB521 didn't give
17 the Governor discretion to do something like that,
18 did it?

19 MR. DUGAN: Yes, it did. Expressly it
20 did, and in fact, that's what it was focusing on
21 because that's very important. If we can--I don't

1 know if we could readily go to SB521.

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

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

16 MR. DUGAN: What was the decision? If you
17 go down to subdivision F, it says, "If the
18 government makes the--if the Governor makes the
19 certification described under paragraph two of the
20 subdivision E, then notwithstanding any other
21 provision of law, the Governor shall take

1 appropriate action to protect public health and the
2 environment." And in our view, he was empowered by
3 that statement to take any action that he deemed
4 appropriate, and he could, for example, have issued
5 an immediate ban on two-stroke engines and required
6 that all California tanks that had missed the 1998
7 deadline meet it by the end of 1999, that that
8 would have been an appropriate reaction to protect
9 the environment.

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

16 ARBITRATOR REISMAN: Thank you for that
17 clarification.

18 MR. DUGAN: Now, what we've tried to show
19 in our presentation of our case-in-chief, despite
20 the publicity that this case has garnered, there is
21 really nothing new in this case from a legal

1 perspective, at least. At the heart of this case
2 is an industry, the U.S. ethanol industry, that
3 exists solely because of politics and
4 protectionism. Again, to use Senator McCain's
5 words, ADM trades its political contributions for
6 the tax subsidies and the other protections that
7 allow its ethanol industry to exist.

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

15 Equally, the methodology that it used in
16 California, using a purported environmental
17 regulation to disguise a form of protection for it,
18 is not a new legal situation. We tried to take the
19 Tribunal through the commentators who have
20 recognized the prevalence of this. Certainly,
21 NAFTA cases have recognized the prevalence of this

1 type of sham environmental protection in order to
2 cater to local political interests or in order to
3 protect a domestic industry.

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

8 Now, what's new here for an international
9 tribunal in particular are the factual allegations
10 concerning the political corruption that we believe
11 was at the heart of this case. That allegation of
12 political corruption, I don't believe, has ever
13 been presented to an international tribunal for
14 adjudication. But the allegations that we are
15 making, which we also tried to show as clearly as
16 we could, are not new. The recognition that this
17 type of--that the use of this type of massive
18 political contributions to obtain preferred policy
19 outcomes is not something that Methanex has made
20 up. It's been accepted, acknowledged by the United
21 States Department of Justice. It's been accepted

1 and acknowledged by the United States Supreme
2 Court. And using again the words of Senator McCain
3 and Senator Rudman, they have frankly admitted that
4 this is, unfortunately, how business is done in the
5 United States from time to time--not always, but
6 from time to time.

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

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

16 We acknowledge that asking an
17 international tribunal to pass judgment on the
18 internal political processes of a country is a very
19 difficult task. This is only a quasi-judicial
20 body--it is not a judicial body like the Supreme
21 Court--and it places the Tribunal in perhaps an

1 unprecedented position, and asks it to undertake a
2 very difficult task. Nonetheless, Methanex firmly
3 believes that that is the Tribunal's duty here,
4 that this is a Tribunal constituted in accordance
5 with an international treaty and in accordance with
6 the implementing legislation of each of the
7 countries, including the United States. The NAFTA
8 powers agreed to a treaty that empowers a tribunal
9 like this to judge the actions of both the
10 constituent states of the United States and the
11 Federal Government itself. Whether or not this
12 precise type of proceeding with respect to the
13 political corruption was envisioned by the
14 signatories on this type of case of a Tribunal
15 sitting in judgment of the official acts of a
16 government quite clearly was envisioned; that's the
17 whole purpose of these tribunals.

18 And there is nothing about this case, the
19 purported environmental justification, in
20 particular that is outside the scope of what
21 traditional tribunals have done. This Tribunal has

1 the duty to determine whether that purported
2 environmental justification was a pretense or
3 whether it was valid, and it has the duty to
4 determine whether or not what happened in
5 California and its impact on Methanex was fair and
6 equitable, pursuant to the terms of the 1105.

7 And Methanex asks simply and respectfully
8 that the Tribunal take on the duty that we think
9 the Treaty imposes upon it, and adjudicate the
10 difficult facts of this case fairly and in
11 accordance with law. That's all Methanex is
12 entitled to expect, and that's what it expects.
13 Thank you very much.

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

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

19 PRESIDENT VEEDER: And I think, subject to
20 one matter we would like to raise you with at this
21 stage, we shall break, and then we will resume

1 under our schedule with the United States tomorrow
2 morning at 9:30 for the oral submissions.

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

17 MR. DUGAN: Okay. I know we have already
18 contacted Mr. Puglisi and asked for copies of the
19 originals. I don't know where we stand on that,
20 but we are trying as we speak. We have been trying
21 all day to get the originals, not copies of the

1 originals, but originals. When I say "originals,"
2 what he obtained initially which in some cases may
3 be copies, but we will go through that tomorrow.

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

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

11 MR. LEGUM: No, Mr. President.

12 MR. DUGAN: Nothing from Methanex.

13 PRESIDENT VEEDER: Thank you very much,
14 indeed.

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

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CERTIFICATE OF REPORTER

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

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

DAVID A. KASDAN, RDR-CRR

