

**IN THE MATTER OF A CLAIM UNDER
THE NORTH AMERICAN FREE TRADE AGREEMENT
And
THE UNCITRAL ARBITRATION RULES**

B E T W E E N:

METHANEX CORPORATION

Claimant/Investor

and

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

Respondent/Party

**CLAIMANT'S REPLY
TO THE STATEMENT OF DEFENSE**

Unless a fact is expressly admitted herein, the Claimant will require the Respondent to prove any fact relied on in its Statement of Defense under the provisions of Article 24.1 of the UNCITRAL Arbitration Rules.

The headings set forth in this Reply follow the headings in the Respondent's Statement of Defense (the "Defense").

I THE FACTS

A. Nature of Methanex' Business

(i) Methanol Market

1. Methanol is a pure commodity. As a result pricing is determined by the supply/demand balance. It is also a global commodity so that any regional pricing differences are quickly closed (subject to any transportation cost differentials). As a result, any measure to eliminate MTBE in California or the United States impacts the global market for methanol.
2. It is misleading to state in paragraph 15 of the Defense that methanol is "primarily used to produce formaldehyde" without any reference to MTBE. While the largest single use of methanol is for the manufacture of formaldehyde, representing 36% of global methanol consumption for the past three years, MTBE manufacture represents the second largest single use for methanol globally, and

the largest use for methanol in the United States. In 1999 MTBE consumed 29% of methanol globally, and 30% in both 1998 and 1997. In North America, 42% of methanol use in 1999 was for the manufacture of MTBE, and of that methanol, approximately 95% was consumed in the United States. Following MTBE, the third largest use for methanol is the manufacture of acetic acid, which only consumed somewhere between seven and eight percent of the global supply over the past three years.

3. The methanol prices quoted in the Defense are also misleading. Methanol pricing typically cycles between US\$100 and US\$200 per tonne. Structural pricing levels are influenced by United States Gulf Coast producers (and their natural gas raw material cost) at the bottom of the cycle and methanol (or methanol derivative) substitution economics at the top of the cycle.

(ii) Methanex

4. To date, Methanex has not sold any of its methanol plants. While the Fortier plant has been temporarily idled, during this time, Methanex has actually acquired the minority 30% ownership from its partner so as to now hold, indirectly, 100% of the shares in Methanex Fortier. The shut-in of the Kitimat facility is also temporary, but of undetermined duration, due to the current economic conditions.
5. Methanex' share price has historically correlated with the price of methanol and has thus, over the previous several years, not steadily declined but rather, has been cyclical in nature.
6. The Toronto Stock Exchange ("TSE") is the principal market for Methanex shares. The Respondent refers to the NASDAQ in its Defense. NASDAQ is the secondary market for trading in Methanex shares, and in 1999 represented only 12% of the total volume of shares traded. The day following the issuance of the Governor of California's Executive Order (the "Executive Order"), the trading volume in Methanex shares on the TSE was nine times the average of the preceding four days and the closing price was C\$0.55 lower than the closing price the preceding evening. With 173 million shares outstanding, this decline alone represented almost US\$70 million or 10% of the market capitalization of the company.
7. Following a prolonged period of languishing since the Executive Order, the share price has improved in recent months due to a significant increase in the global methanol price and independent efforts of Methanex to improve its corporate position generally in the methanol industry.

B. MTBE

8. MTBE was not "born" of regulation in that federal law has never mandated its specific use. Research and development activities of refiners spurred the introduction of alternate gasoline formulations, some containing MTBE from about the late 1970s, during the phase out of lead from gasoline. MTBE was thus widely used for over a decade prior to the passing of the *Clean Air Act Amendments* of 1990, which saw the introduction of reformulated gasoline ("RFG") in 1995. The United States Environmental Protection Agency ("EPA") has repeatedly emphasized that MTBE was not required in RFG, in so far as neither the *Clean Air Act* nor EPA requires the use of specific oxygenates, but rather an oxygen content by weight. Refiners have the choice as to which oxygenate to use. Both ethanol and MTBE are used in the current RFG program, with fuel providers choosing to use MTBE in about 87% of the RFG mainly due to reasons of lower cost, superior blending characteristics and ease of transport.

C. CALIFORNIA MARKET FOR MTBE

9. 70% of MTBE consumed in California is produced by sources external to the United States, 20% comes from the United States Gulf Coast area and 10% is manufactured in California. Methanex supplies methanol to offshore MTBE producers, to United States Gulf Coast MTBE producers and to California MTBE producers.
10. It is not relevant that foreign MTBE producers are the principal suppliers for the California market.

D. MTBE EFFECTS ON HEALTH & ENVIRONMENT**(i) Drinking Water & Health**

11. The measure as reflected in the Executive Order was not based on any concern regarding health. In fact, the Executive Order specifically excluded health as a justification for the measure.
12. There is not a shred of clinical or epidemiological evidence to support the notion that MTBE has caused or will cause any human cancer. Moreover, there is no meaningful evidence that MTBE is causally related to any definitive human disease. There is no evidence of systemic pathology associated with MTBE and in fact MTBE may be a chemopreventative agent. In this regard, animal studies have demonstrated a reduction in specific types of benign tumors or cancers in rats.

13. There are marked inconsistencies in the animal data which vitiates any meaningful conclusions about carcinogenesis in animals. The studies have been very limited in nature and have no relevance to human carcinogenesis. There is no known causal association of MTBE with any type of human cancer and no known genotoxic effects for MTBE in humans after inhalation or oral exposure.
14. MTBE has been administered as a therapeutic agent for the treatment of gallstones. Despite single doses of up to 20ml, and significantly larger doses being administered over a period of days via catheter for direct infusion into the gall bladder, no consistent acute or chronic toxic sequelae have been reported, other than varying intensity of nausea and the detection of a breath odour.
15. The EPA, the National Institute for Environmental Health Sciences, the International Agency for Research on Cancer, the California Office of Environmental Health Hazard Assessment's Proposition 65 Committee and the U.S. National Toxicology Panel's Board of Scientific Counselors have all declined to list MTBE as a cancer causing agent, a carcinogen or an agent likely to cause cancer.
16. Paragraph 50 of the Defense is misleading. The reference to 5.0 ppb references the taste and odour thresholds for MTBE. The threshold established for health purposes in California is 13 ppb, the lowest threshold for any State. Much has been made of MTBE's extremely low taste and odour thresholds, so clearly no one could unwittingly drink water with concentrations of MTBE that would pose any health risk. One would detect the smell and taste of MTBE at concentrations far below that established by the State of California for health purposes.
17. The Respondent fails to identify the other components of gasoline - benzene, toluene, ethylbenzene and xylene (commonly and collectively referred to as "BTEX") - as having greater toxicity than MTBE. While it may be somewhat easier to clean up, BTEX is far more dangerous than MTBE.
18. It is presently not known if MTBE travels through soil rapidly. There is a limited database on the subject of the transport of MTBE through soils. It is admitted that MTBE in dissolved form does travel through aquifers.
19. It is inaccurate for the Respondent to state that MTBE is highly resistant to biodegradation. Evidence discloses MTBE is degradable under both aerobic and anaerobic conditions. MTBE will naturally degrade in aquifers once the source of MTBE has been identified and remedied. It is admitted that the current scientific research indicates MTBE generally takes longer to biodegrade than the more toxic BTEX components of gasoline.

(ii) Groundwater Contamination

20. It is inaccurate for the Respondent to imply in paragraph 56 that MTBE presents a significant risk to all of the drinking water supplies in California. MTBE and other gasoline components pose a risk to drinking water supplies only where those drinking water supplies are adjacent to leaking underground storage tanks (“UST”) or other sources of gasoline contamination, a situation that not only creates an MTBE risk, but also creates a risk of BTEX contamination of the water. While detectable amounts of MTBE may move farther or more rapidly in an aquifer, its taste and odour are quickly identified and disclose the fact of a leaking UST or other source of gasoline contamination. It is more accurate to state that leaking UST and other sources of gasoline contamination present a significant risk to drinking water supplies in their vicinity.
21. Contrary to the position adopted by the Respondent, the Claimant does not regard gasoline leaks or other releases as inevitable in substantial quantity. To accept leaking UST or other gasoline releases as “inevitable” completely disregards the initiatives of the California, United States and other countries who have taken the position that it is not acceptable to simply presume that substantial gasoline leaks are bound to occur.
22. Two-stroke watercraft engines emit up to 30% of their gasoline fuel unburnt in their exhaust as part of their normal operation, discharging not only MTBE but also BTEX. This is a recognized source of environmental contamination. While there are documented cases of surface water contamination by gasoline components, the Claimant is unaware of any California drinking water with MTBE levels in excess of the State’s threshold as a result of watercraft being permitted on recreational use reservoirs.
23. Leaking UST have caused virtually all contamination of drinking water in California. In the examples cited by the Respondent, the City of Santa Monica problem was caused by leaking UST, as was the situation in Glennville, California. Leaking UST also caused the problems in the South Lake Tahoe Public Utility District. In each of these cases, all components of gasoline were leaked into the environment, not just MTBE. While MTBE may have led the plume and been the initial marker for the leak, BTEX was also inevitably present.
24. The references to contaminations of MTBE in the Lake Donnor and Shasta Lake regions do not evidence any problem with drinking water. The examples quoted are not necessarily representative of MTBE concentrations in these or other lakes, reservoirs or drinking water.
25. The cost estimates referred to in paragraph 70 of the Defense are for the costs to clean up the gasoline spills not an MTBE spill.

E. CALIFORNIA'S ACTIONS**(i) Senate Bill 521**

26. Paragraph 71 of the Defense suggests that the US\$500,000.00 provided by Senate Bill 521 (the "Bill") was adequate to carry out the study required by the Bill. In fact, the Bill required a comparative study of the human health and environmental risks and benefits, if any, associated with the use of MTBE as compared to ETBE, TAME and ethanol. Such a study was not done and could not have been done for the amount of money provided. Rather than advise the government that it was impossible to carry out such a study, the University of California, taking its cue from the tenor of the Bill, proceeded to work up a case detailing the purported risks of MTBE.

(ii) University of California Report

27. Paragraph 72 of the Defense states that the University of California issued a "competitive peer review request for proposals." In fact, the call for proposals was only open to University of California staff, without regard to the availability of others, regardless of experience or stature in the field. The Bill restricted the use of the funds to the University of California.
28. The failings of the University of California Report (the "UC Report") have been outlined in the Statement of Claim.

(iii) Public Testimony and Peer Review

29. Although public hearings were held and the UC Report debated, no significant changes were made in the UC Report when delivered to the Governor. In particular, the EPA had serious concerns respecting the UC Report, but their comments were ignored. It is interesting to note in paragraph 82 of the Defense that the Respondent, in listing various agencies, makes no mention of the EPA comments on the UC Report.

(iv) Executive Order

30. The Executive Order clearly requires MTBE to be removed from gasoline no later than December 31, 2002. This requirement in turn triggered the application of Section 4 of the Bill which provides:
- “(a) If the sale and use of MTBE in gasoline is discontinued pursuant to subsection (f) of section 3 of this act [the Executive Order], the State shall not thereafter adopt or implement any rule or regulation that permits or requires the use of MTBE in gasoline.

- (b) If the sale and use of MTBE is to be discontinued pursuant to subdivision (f) of section 3 of this act, the State Air Resources Board shall immediately notify the Environmental Protection Agency that the use of MTBE in gasoline in this State will be discontinued.”
31. The Governor used no data from the public hearings or the peer review in coming to his decision to remove MTBE from commerce, but relied solely on the UC Report.
 32. Once the Governor held that there was a significant risk to the environment, he had the authority under the Bill to take any “appropriate action”. He failed to do so.
 33. Appropriate action would have involved an analysis similar to that carried out under the *Toxic Substance Control Act* (“*TSCA*”). The *TSCA*, as written and interpreted by the courts, is a guide as to how California ought to have conducted its risk management actions on the MTBE in water issue. The *TSCA*’s overall approach is particularly well suited to the MTBE situation in which it is not the “manufacture, distribution in commerce, use, or disposal of MTBE”, *per se*, which poses a risk, but rather the release into the environment of gasoline that presents a risk. The basic premise of the *TSCA* is that the regulator’s actions should be limited to only the type and degree of regulation necessary to address an unreasonable risk posed by a substance.
 34. Under the *TSCA*, if such an unreasonable risk is found, the EPA is required to apply “one or morerequirements to the extent necessary to protect adequately against such risk using the least burdensome requirements...” (15 U.S.C. § 2605(a)). In addition, EPA may not promulgate a rule under the *TSCA* if the risk of injury to health or the environment can be “eliminated or reduced” by actions taken under another federal law, unless EPA finds that regulation under the *TSCA* is in the “public interest” (15 U.S.C. § 2605(c)).
 35. In selecting the least burdensome alternative, the proper course for the Governor to have followed was to consider each regulatory option, beginning with the least burdensome, and the costs and benefits of regulation under each alternative. Under this “least-to-most-burdensome hierarchy,” the Governor’s selection of the most burdensome alternative - a total ban of MTBE - cannot be justified if there was any other regulation that could have achieved an acceptable level of risk.
 36. Methanex agrees that MTBE (or BTEX), *once in the environment*, poses some degree of risk. However, the severity of any risk to human health or the environment had not been thoroughly established; nor had it been properly compared to the benefits provided by MTBE or the costs of eliminating the use of MTBE. Likewise, there was no objective evaluation of the efficacy of actions to prevent MTBE from getting into the environment, nor of any alternative means of managing the risk presented when MTBE is in the environment.

37. The Governor failed to proceed with an examination of a descending hierarchy of options in which risk reduction is measured against the action, and in which a ban or removal from commerce is the last resort, being taken only where, after examining all other measures, the risk remains unacceptable. As such, the Governor's action lacked both procedural and substantive fairness.

(v) Subsequent California Legislative Action

38. The subsequent legislative action taken by the Senate clearly demonstrates that new requirements designed to prevent unauthorized UST releases were politically possible and could be effective in reducing, if not eliminating, any unacceptable risk to contamination of ground or surface waters by gasoline components including MTBE.

(vi) Actions Taken by Regulatory Agencies

39. The numerous public meetings on proposed regulations that would eliminate the use of MTBE in gasoline in California referred to in the Defense paragraph 92 are irrelevant given that the Executive Order has a deadline date of December 31, 2002, by which MTBE must be removed.
40. The reference in paragraph 99 of the Defense stating that the proposed CaRFG3 regulations are based on a "comprehensive set of scientific studies" is misleading. An analysis of the "comprehensive studies" reveals a limited selection of studies from and by those whose findings could be anticipated.

F. OTHER STATE AND FEDERAL ACTIONS

41. Paragraph 105 of the Defense suggests that one of the recommendations of the Blue Ribbon Panel could be taken in isolation. In fact, the Blue Ribbon Panel Report (the "BRP Report") states: "The following recommendations are intended to be implemented as a single package of actions" (emphasis in original)(Executive Summary, p.3).
42. The BRP Report then proceeds to list the recommended actions to "enhance, accelerate, and expand existing programs to improve protection of drinking water supplies from contamination." The recommendations included:
- "accelerate enforcement of the replacement of existing tank systems ..., including, at a minimum, moving to have all states prohibit fuel deliveries to non-upgraded tanks..."
 - "evaluate the field performance of current system design requirements and technology..."

- “strengthen release detection requirements to enhance early detection...”
 - “require monitoring and reporting of MTBE and other ethers ...”
 - “encourage states to require that the proximity to drinking water supplies, and the potential to impact those supplies, be considered in land-use planning and permitting decisions for siting new UST facilities...”
 - “implement and/or expand programs to train and license UST system installers and maintenance personnel...”
 - “work with Congress to examine, and, if needed, expand the universe of regulated tanks...”
43. In addition, the BRP Report presents several recommended actions (still as part of the “single package”) relating to implementation of federal and state *Safe Drinking Water Act* programs, protection of private wells and surface water sources of drinking water, and funding and implementation of remediation and treatment programs.
44. The BRP Report then recommended actions relating to reducing the amount of MTBE being used, an option which was clearly open to California.
45. A specific recommendation of the Blue Ribbon Panel was that federal law be amended to clarify the authority of EPA and the States to “regulate and/or eliminate the use of gasoline additives that pose a threat to drinking water supplies.” With respect to States, the BRP Report recommends that States should be given the authority to regulate and/or eliminate a gasoline additive only if they:
- 1) “demonstrate that their water resources are at risk from MTBE use, above and beyond the risk posed by other gasoline components at levels of MTBE use present at the time of the request.”
 - 2) “...have taken necessary measures to restrict/eliminate the presence of gasoline in the water resources.”

California did not and could not meet this test.

46. The several Blue Ribbon Panel members who concluded that the use of MTBE in gasoline should be completely eliminated had an apparent bias for that result.
47. The statement in paragraph 107 of the Defense that in late 1998 the State of Maine withdrew from the federal oxygenated fuels program “after discovering” that approximately 16% of wells in the State were contaminated with MTBE is inaccurate and misleading. In fact, Maine did not withdraw from the federal

oxygenated fuels program as it was never in it. It did withdraw from the RFG program, which it had entered as part of its State Implementation Plan to meet the *Clean Air Act*. The State had already indicated it intended to opt out prior to any surveys being conducted.

48. The Respondent states in paragraph 107 of the Defense that approximately 16% of wells in the State of Maine were contaminated with MTBE. In fact, the 16% reference is to a study of "public drinking water systems" and not "wells in the state". Sources for these systems include reservoirs, surface water and wells. The same study detected toluene in 13% of the samples. The study covered virtually all of the State's some 800-900 systems. It did not include private wells. A separate telephone survey of private wells determined that many with unacceptable levels of gasoline components were due to deliberate or accidental dumping of gasoline in the subject's yard.
49. MTBE was not banned or removed from commerce in Maine. It continues to be used as a source of octane in the gasoline pool.
50. In paragraph 108 of the Defense, there is reference to joint statements by the EPA Administrator and the U.S. Secretary of Agriculture. Such statements demonstrate that the political considerations in this debate are driven by the agricultural lobby to secure a ban of MTBE in favour of ethanol.

II POINTS AT ISSUE

A. Jurisdiction and Admissibility

51. The Arbitral Tribunal has the power to rule on objections that it has no jurisdiction by reason of Article 21 of the UNCITRAL Arbitration Rules, however, the Respondent appears to have confused the issue of liability with the issue of jurisdiction.
52. Under Article 1116 of NAFTA, an investor may submit to arbitration "a claim that another Party has breached an obligation under ... Section A ... and that the investor has incurred loss or damage by reason of, or arising out of, that breach". The Arbitral Tribunal has jurisdiction to determine if the investor's claim alleges a breach of an obligation under Section A and, in so doing, determine whether that claim has been made out. Issues such as whether the Bill and Executive Order are measures, whether Methanex fits within the wording of Article 1116, whether Methanex has incurred loss or damage, whether the claims are or are not too remote and whether the measures pleaded in the claim fail to accord a minimum standard of treatment required under Article 1105 are all issues of liability, not jurisdiction.

(i) The Bill and Executive Order are Measures “Relating to” Methanex’ Investments

53. The words of Article 1101 of NAFTA with respect to measures “relating to” investments of investors should, in conformity with international law, be given their ordinary meaning, which is broad. Had the drafters of NAFTA wished to restrict the article to a direct or “legally significant” connection, the language of the treaty would have specifically so stated. A measure “relates to” the investment if it *de facto* affects that investment in a material way. To afford the words the interpretation requested by the Respondent would remove all measures which had the *effect* of expropriation, but which did not on their face have any legal connection with the investment. Bilateral investment treaties commonly include not just *de jure* expropriations but also measures generally recognized as indirect, creeping, or *de facto* expropriation. The definition pressed by the Respondent is inconsistent with the interpretation used by other international arbitral tribunals and would render meaningless the references in Article 1110 to “indirect expropriation” or measures “tantamount to expropriation”.
54. Under United States domestic law, the ordinary meaning of the words “relating to” is a broad one – to stand in some relation; to have bearing or concern; to pertain; refer; to bring into association with or connection with.
55. Previous NAFTA arbitration tribunals appear to have equated “relating to” with “affecting”.¹
56. The Bill and the Executive Order collectively had a “material effect” on the property rights of Methanex U.S., had “some relation to” those rights, had “significant bearing on” those rights and was an indirect expropriation of a material portion of Methanex U.S.’ business.

(ii) Article 1116 Jurisdiction

57. Article 1116 provides relief to investors where a Party has breached an obligation under Section A of Chapter 11. Article 1116 permits an investor of a Party to make a claim on its own behalf where the investor has incurred loss or damage *by reason of a breach of Section A* (emphasis added).
58. Chapter 11, Section A of NAFTA contains two articles which the Claimant claims were breached by the Respondent, namely Articles 1105 and 1110.
59. Article 1105 requires that each Party shall accord to investments of investors of another Party, treatment in accordance with international law, including fair and equitable treatment and full protection and security. With the failure to accord Methanex U.S. fair and equitable treatment as detailed below, California

¹ *Pope & Talbot Inc. v. The Government of Canada*, Interim Award dated June 26, 2000

committed a breach of Section A. Methanex has a claim for this breach, provided it is able to show damages have been suffered as a result.

60. Article 1110 provides that no Party may indirectly expropriate an investment of an investor of another Party or take a measure tantamount to expropriation of such investment except on payment, without delay, of compensation equivalent to the fair market value of the expropriated investment. The measures detailed above are tantamount to an expropriation of Methanex U.S.' business, and the failure to compensate Methanex U.S. is a breach of Section A. As a result, Methanex has a claim for this breach, provided it is able to show damages have been suffered as a result.
61. Methanex claims significant losses distinct from any loss to Methanex U.S. Under Article 1116 of the NAFTA, once a breach of Section A is established, an investor may recover for loss or damages incurred by reason of, or arising out of, that breach. As detailed below, Methanex has suffered significant damages as a result of the breaches of Articles 1105 and 1110.

(iii) Waiver by Methanex US and Methanex Fortier

62. Methanex, Methanex U.S. and Methanex Fortier have provided a proper waiver to their rights to initiate or continue any proceedings set out in Article 1121(1)(b).
63. Under well-recognized legal principles, the Respondent is entitled to rely on both factual and apparent authority of the corporate counsel and assistant corporate secretary of Methanex, Mr. Randall Milner.
64. Mr. Milner had authority to bind Methanex U.S., Methanex Fortier and Methanex. Should the Panel require evidence of his authority, it will be adduced.
65. The waiver is effective to preclude Methanex U.S., Methanex Fortier or Methanex from bringing action before any other administrative tribunal or court under the laws of the United States. It would be inconceivable for a court to rule in any attempted action brought by Methanex, Methanex U.S. or Methanex Fortier that the waiver is insufficient.

(iv) The Expropriated Investment

66. Methanex' claim under Article 1110 alleges an indirect expropriation of the enterprise, Methanex U.S.
67. In order for there to be an expropriation, it is not necessary to nationalize the company or seize all of its assets. The deprivation of a part of its property is sufficient.

68. Property includes both tangible and intangible property. Customers cultivated by Methanex U.S. constitutes one of its most valuable assets and is known in law under the general heading of goodwill. It is an intangible asset but it is a valuable component of the property of a business, every bit as much as the premises, machinery and equipment.
69. It is clear that NAFTA contemplates both tangible and intangible property being subject to expropriation. Article 1139 includes in the definition of investment both tangible and intangible property acquired in the expectation, or used for the purpose of economic benefit or other business purposes. Article 1139 also contemplates the expropriation of “interests” and interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory.
70. Methanex U.S.’ access to the U.S. market is a property interest subject to protection under Article 1110. Where an investment’s business activities have been interfered with in a material or substantial way, that is an expropriation under international law.
71. The use of the words “tantamount to expropriation” are broad enough to include a measure which removes an entire market otherwise available to Methanex U.S. Regulation can indeed be exercised in a way that constitutes a measure tantamount to expropriation. An action that prevents, unreasonably interferes with, or unduly delays effective enjoyment of Methanex U.S.’ property is an expropriation.²

(v) Loss or Damage Suffered by Reason of the Bill and Executive Order

72. It is alleged by the Respondent that “given the nature of the Bill and the Executive Order” Methanex has no compensable injury or damage. The Bill and the Executive Order together constitute a measure under the NAFTA. “Measure” is defined as *including* “any law, regulation, procedure, requirement or practice”. The requirement of the Executive Order to establish a timetable for the removal of MTBE no later than December 31, 2002 is clearly a measure.
73. The effect of the measure is to cause the removal of MTBE from commerce in California. The result is the indirect expropriation of Methanex U.S.’ business of selling methanol to MTBE producers.

(vi) Remoteness

74. NAFTA Chapter 11 sets out the circumstances under which a claimant may make a claim for loss or damages. If Methanex’ claim falls within the words of NAFTA, it is entitled to compensation. If it does not fall within the words, it is

² Third Restatement of the Foreign Relations Law of the U.S., Chapter 712, Comment (g).

not so entitled. Principles of “customary international law”, to the extent they modify or otherwise limit the clear words of NAFTA, are not applicable.

75. Current bilateral investment treaties and NAFTA protect investors beyond that which is contemplated in the 1970 decision of *Barcelona Traction*, referred to by the Respondent.

(vii) Article 1105 Claim

76. The Respondent has argued in paragraph 139 of the Defense that Methanex’ claim under Article 1105(1) “is inadmissible because it fails to identify – because there is none – any *customary* international law standard of treatment incorporated into that Article that is applicable to the challenged actions.” (emphasis added) Article 1105(1) of NAFTA requires each Party to accord “investments of investors of another Party, treatment in accordance with *international law, including fair and equitable treatment* and full protection and security.” (emphasis added) Article 1105(1) does not refer to customary international law, but to “international law” regardless of its source. Moreover, regardless of whether there is a principle of “fair and equitable treatment” under international law, the Parties to NAFTA, by making express reference to “fair and equitable treatment,” clearly intended that this standard apply to investments in one NAFTA country by an investor of another NAFTA country. There is nothing in NAFTA to suggest that the “fair and equitable treatment” standard as incorporated into NAFTA is limited to substantive fairness as the Respondent suggests.
77. The Respondent asserts that “[c]ustomary international law imposes no constraints on the *processes* by which states adopt executive or legislative measures...” Methanex’ claims however, relate to how the Bill was applied and implemented. Regardless of whether there is an international law principle requiring procedural fairness in the adoption of executive or legislative measures, there is an international law principle requiring procedural, as well as substantive fairness, in the application and implementation of executive or legislative measures to the investments of foreign investors.

B. Liability

(i) Expropriation of Investment

78. The Respondent repeats the error of attempting to classify the measure as one to protect public health, which it is not.
79. The Respondent repeats the error of claiming that for expropriation to exist, it is necessary to have nationalized or confiscated Methanex’ investments in the United States.

80. The Respondent fails to appreciate that under Article 1116, if an investor has incurred loss or damage by reason of or arising out of the breach by a Party of an obligation under Section A, the damages which may be claimed are at large. Accordingly, it is immaterial whether the Fortier plant ever sold methanol into California. The removal of the market for methanol as a feedstock for MTBE has resulted in a further delay in bringing the Fortier plant back into production. This has caused damage.
81. Paragraph 153 refers to some of the provisions of the preamble to NAFTA. Not referred to by the Respondent is the provision in the preamble, which states:
- “ENSURE a predictable commercial framework for business planning and investment”.
82. The claim by Methanex is not an attack on the sovereignty of the Government of California or of the United States to develop or enforce environmental laws and regulations. It is an attack on a measure, which though wrapped in the rhetoric of health and the environment is, on close analysis, an unjustifiable measure.
83. Article 1114 specifically deals with environmental measures. It provides that nothing in Chapter 11 shall be construed to prevent a Party from adopting, maintaining or enforcing any measure *otherwise consistent with this Chapter* that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns. (emphasis added)

(ii) Lack of Fair & Equitable Treatment

84. As discussed above, Methanex is claiming that the manner in which a legislative measure was applied and implemented violates Article 1105(1), not the process by which that measure was adopted. The Bill required a comparative study of the human health and environmental risks and benefits, if any, associated with the use of MTBE as compared with ETBE, TAME, and ethanol. No such study was ever carried out.
85. The Bill also required the Governor to certify, after considering not only the UC Report, but also the peer review comments and public testimony, whether using MTBE in gasoline in California posed a significant risk to human health or environment and if so, to take “appropriate action”. The Governor did not take into consideration the peer review comments or the public hearings in reaching his conclusion and therefore did not follow the requirements laid down in the Bill. Further, the Governor failed to take “appropriate action” as mandated by the Bill, by ordering the removal of MTBE from commerce, rather than the measured approach required by the TSCA or that recommended by the Blue Ribbon Panel.

C. Damages

86. Methanex' damage claim is not based on a loss of share value.
87. Methanex asserts damages have been suffered and calculates its loss under three separate heads – lost profits associated with the lost methanol sales to the MTBE market; margin losses on the balance of methanol sales due to the negative demand shock; and direct expenses incurred as a result of the measure taken by California.
88. The particulars of the direct expenses incurred by Methanex are ongoing and will be provided prior to the commencement of the arbitration.
89. The damage assessment extends beyond a simple examination of the loss of the California MTBE market for methanol. The California measure will have extenuating effects as other states move to follow the California example and remove MTBE from commerce. The damages claimed by Methanex also include the present value of anticipated losses to be suffered by Methanex from a loss of the national MTBE market for methanol.
90. Methanex has global investments and maximizes or optimizes the supply of methanol by effectively utilizing its global supply chain. There are costs to Methanex in having to re-optimize its global supply chain due to the negative demand shock impact on sales volume with the elimination of a substantial portion of the methanol market.
91. The historical decline of the share price is the marketplace recognition of the damage sustained by Methanex. The potential damage to Methanex was acknowledged by the securities marketplace when the concerns of MTBE were first raised by California and Methanex was then de-valued via its share price. The recent improvement in the share price is the marketplace's response to Methanex' efforts to improve its situation and better its corporate position in the methanol market generally. The damages claimed are not characterized as a loss to the market capitalization of the company. The loss of the market capitalization was due to the securities market recognizing that the measure imposed by California would result in an over capacity in the global market for methanol.
92. The margin losses are calculated by examining how the negative demand shock impacts the price of methanol, as a global commodity. With the skewing of the supply/demand balance, the price of methanol will be depressed with the negative demand shock. It is projected to take six years for the methanol demand to recover to the pre-negative demand shock levels. The demand loss is permanent.

Respectfully submitted this 28th day of August, 2000.

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