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

GRAND RIVER ENTERPRISES SIX NATIONS, LTD.,
JERRY MONTOUR, KENNETH HILL AND ARTHUR
MONTOUR, JR.,

Claimants/Investors,

-and-

UNITED STATES OF AMERICA,

Respondent/Party.

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COUNTER-MEMORIAL OF RESPONDENT UNITED STATES OF AMERICA

In accordance with the Minutes of the First Session of the Tribunal, dated March 31, 2005, and the Tribunal's Letter to Counsel, dated June 24, 2008, Respondent United States of America respectfully submits this Counter-Memorial to the claims of Grand River Enterprises Six Nations, Ltd., Jerry Montour, Kenneth Hill, and Arthur Montour.

Preliminary Statement

The Claimants in this arbitration allege violations of international law obligations under NAFTA Chapter Eleven arising from certain legislative measures taken by various States of the United States (the "Settling States") relating to the 1998 Master Settlement Agreement ("MSA"), a global settlement of litigation brought by the Settling States against major tobacco companies. For the reasons discussed below, the claim is

baseless, should be rejected, and warrants, under Article 40 of the UNCITRAL Arbitration Rules, that Claimants bear all costs of this arbitration, including legal representation and assistance costs borne by the United States.

As a preliminary matter, the Claimant that is subject to deposit obligations under the challenged measures, Grand River Enterprises Six Nations Ltd. ("Grand River"), is a Canadian cigarette manufacturer that exports Seneca cigarettes to the United States. Grand River has no investment in the United States, and thus cannot meet fundamental jurisdictional requirements under NAFTA Article 1101(1).

In an attempt to create the appearance of a U.S. investment, Claimants allege that Grand River and its U.S.-based distributor for cigarette sales on-reservation in the United States, Native Wholesale Supply ("NWS") (formerly Native Tobacco Direct), are "corporate branches" of an undocumented parent enterprise aimed at the development of the Seneca brand in the United States. The allegation is unsupported, and should be rejected.

Claimants' allegations of discrimination under Article 1102 (national treatment) and Article 1103 (most-favored-nation treatment) are equally unsupported. The challenged measures do not distinguish between domestic and foreign manufacturers, and both domestic and foreign manufacturers have signed on to the MSA. Claimants do not even attempt to show discrimination on the basis of nationality, as required under Chapter Eleven. Furthermore, Claimants' allegations of discrimination ultimately concern the failure to accord Grand River special treatment, in the form of exemptions from deposit obligations which are not available to any other tobacco manufacturer in like

circumstances. Claimants provide no support for their claimed entitlement to such special treatment. The claims under Article 1102 and Article 1103 should be rejected.

Also unavailing are Claimants' wide-ranging claims under Article 1105, which obligates Parties to accord the minimum standard of treatment of aliens to the *investments* of investors of another Party. The deposit obligations at issue in this case apply to Grand River, a Canadian cigarette exporter that has no investment in the United States. Because the challenged escrow obligations do not apply to any U.S. investment of Claimants, they cannot support a claim under Article 1105.

Furthermore, the challenged measures were both reasonable and predictable. Grand River, which did not sign the MSA and is not subject to any of the MSA's payment obligations or advertising restrictions, began exporting Seneca brand cigarettes to the United States shortly after the execution of the MSA. Grand River then proceeded to exploit an unanticipated loophole in the original MSA-related measures, which enabled the company to avoid its escrow obligations under those measures. The escrow obligations were intended to ensure that an adequate source of funds would be available to the Settling States to satisfy any potential future tobacco-related judgments that the Settling States may obtain against tobacco product manufacturers that had not signed the MSA, known as "Non-Participating Manufacturers" or "NPMs."

In addition to Grand River, many other NPMs similarly exploited the loophole, thereby reducing the amount of escrowed funds available to the Settling States by hundreds of millions of dollars. The challenged measures reflect the response of Settling States to NPMs like Grand River: by closing the unintended loophole under the original MSA-related measures, Settling States would once again have access to an adequate

source of funds to satisfy any potential future tobacco-related judgments against NPMs and thereby receive compensation for health care costs resulting from the NPMs' cigarettes.

Faced with these facts, Claimants rest their Article 1105 claim on unsupported, and unsupportable, allegations of certain commitments made by the Settling States to NPMs. According to Claimants, NPMs were "entitled" to expect that they could continue to exploit the loophole under the original MSA-related measures in perpetuity. But the allegation of such an entitlement or specific commitment is unsupported by evidence and logically unsupportable, given that the continued avoidance of escrow obligations by NPMs would have undermined the very purpose of the original MSA-related measures: to ensure adequate funding sources for Settling States, in the event that those states were able to obtain future tobacco-related judgments against NPMs.

Lacking any basis to claim that a U.S. investment had not been accorded the minimum standard of treatment under Article 1105, Claimants attempt to argue violations of separate international agreements, such as the Jay Treaty. But even if Claimants could establish such a violation, the binding interpretation of the NAFTA Free Trade Commission confirms that a breach of a separate international agreement does not establish a breach of Article 1105(1). In any event, Claimants cannot support the extraordinary proposition that the 1794 Jay Treaty would shield Grand River and its U.S. distributors from all state regulation of the distribution and sale of billions of Seneca cigarettes throughout the United States.

Claimants also invoke numerous international human rights instruments in an attempt to demonstrate the existence of "evolving" norms of customary international law

which they allege have been breached here. But Claimants cannot establish any violation of such norms arising from the challenged measures in this case, and in any event they fail to demonstrate that those norms have risen to the level of customary international law applicable under Article 1105. In addition, Claimants' suggestion that the challenged measures have denied them justice is directly contradicted by the fact that they continue to seek injunctive relief from those very measures in U.S. courts.

Furthermore, Claimants' alleged "expectations" of freedom from state regulation rely to a great degree on the purportedly "on-reservation" market served by NWS. But the market ultimately served by NWS exists, in large part, off-reservation.

Clearly, much of NWS' "on-reservation" market exists, in reality, off-reservation.

Finally, Claimants' expropriation claim under Article 1110 should be rejected. Even if Claimants were able to establish the existence of their "integrated" business enterprise, they do not even attempt to place a value on that enterprise, and thus make no attempt to compare the value of their alleged enterprise before and after the adoption of the challenged measures. In fact, Grand River's financial performance improved consistently from 1999 to 2005 and has remained strong thereafter. Understandably, Claimants allege no date of expropriation. The expropriation claim is baseless and should be dismissed.

For the above reasons, and as discussed in detail below, Claimants' claim should be dismissed in its entirety, and Claimants should bear all costs of this arbitration.

FACTS

I. The Master Settlement Agreement Addresses Serious Tobacco-Related Public Health and Fiscal Concerns

In the United States, much of the cost of treating cigarette-related diseases ultimately is borne by the states, which administer Medicaid and other health and welfare programs. Beginning in the mid-1990s, many states sued the major U.S. tobacco companies (Philip Morris, Lorillard, Brown & Williamson, and R.J. Reynolds, collectively, "the majors"), seeking to recover costs they had incurred in treating smoking-related illnesses, as well as injunctive relief. The lawsuits were settled by the Master Settlement Agreement ("MSA"), which was entered into on November 23, 1998.[1]

The MSA has been characterized by the U.S. Supreme Court as a "landmark" public health agreement,[2] which addresses "one of the most troubling public health problems facing our Nation today."[3] From 1999 through 2004, tobacco use in the United States was responsible for approximately 438,000 premature deaths per year, or nearly one in five deaths in the United States.[4] In one 1998 report, the year the MSA was concluded, smoking-related medical costs in the United States were estimated to be $72.7

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[1] Four states—Florida, Minnesota, Mississippi, and Texas—previously settled independently with the majors.

[2] *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 533 (2001).

[3] *Food & Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125 (2000).

[4] CENTERS FOR DISEASE CONTROL AND PREVENTION, MORBIDITY & MORTALITY WKLY., SURVEILLANCE FOR CANCERS ASSOCIATED WITH TOBACCO USE—UNITED STATES, 1999—2004 (Sept. 5, 2008) at 2, *available at* http://www.cdc.gov/mmwr/preview/mmwrhtml/ss5708a1.htm (last visited Dec. 10, 2008).

billion.[5] As of 2004, smoking-related health care expenditures and productivity losses cost each state, on average, over $3.8 billion annually.[6]

The lawsuits settled by the MSA included several causes of action premised on the dangers and health effects inherent in the use and sale of tobacco products, such as: strict liability for selling a defective or unreasonably dangerous product; product liability; unjust enrichment; breach of implied and express warranties; nuisance; and breach of assumed (or "special" or "voluntarily undertaken") duty.[7] The lawsuits also included causes of action premised on fraud and deception, such as: deceptive trade practices (violation of consumer protection statutes); fraud; misrepresentation and omission; conspiracy; racketeering; unlawfully marketing to, targeting, and contributing to the delinquency of, minors; and antitrust law violations.[8]

The MSA was a multi-party agreement signed by 52 governmental entities (46 states, the District of Columbia, Puerto Rico, and four U.S. territories), defined under the

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[5] Leonard S. Miller et al., *State Estimates of Total Medical Expenditures Attributable to Cigarette Smoking, 1993*, 113 PUB. HEALTH REP. 447, 447 (1998).

[6] DEPARTMENT OF HEALTH AND HUMAN SERVICES - CENTERS FOR DISEASE CONTROL AND PREVENTION (CDC), SUSTAINING STATE PROGRAMS FOR TOBACCO CONTROL – DATA HIGHLIGHTS 2006 AT TABLE 4, *available at* http://www.cdc.gov/tobacco/data_statistics/state_data/data_highlights/2006/00_pdfs/DataHighlights06rev.pdf (last visited Dec. 19, 2008).

[7] *See, e.g.*, Complaint, *New York v. Philip Morris, Inc.* (N.Y. Sup. Ct. Jan. 27, 1997) (No. 400361/97) (alleging public nuisance, unjust enrichment, undertaking of and willful failure to perform a special duty, strict liability, negligence, breach of express and implied warranties, indemnity, and restitution); First Amended Complaint, *California v. Philip Morris, Inc.* (Cal. Sup. Ct. filed Aug. 29, 1997) (No. 97-AS-03031) (seeking recovery of hundreds of millions of dollars spent on treating tobacco-related illnesses of Medi-Cal (California's Medicaid program) beneficiaries).

[8] *See, e.g.*, Complaint, *New York v. Philip Morris, Inc.* (N.Y. Sup. Ct. filed Jan. 27, 1997) (No. 400361/97) (alleging fraud and misrepresentation, inducement of minors to smoke, negligent and intentional entrustment, conspiracy, violations of state not-for-profit corporation law, and federal Racketeer Influenced and Corrupt Organization Act (RICO) fraud and conspiracy); First Amended Complaint, *California v. Philip Morris, Inc.* (Cal. Sup. Ct. filed Aug. 29, 1997) (No. 97-AS-03031) (alleging violations of state antitrust act, False Claims Act, and Unfair Competition Act).

MSA as "Settling States."[9] At the time the MSA was signed, the majors, referred to as "Original Participating Manufacturers" or "OPMs,"[10] manufactured approximately 97.5% of all cigarettes sold in the United States.[11] The MSA was found to be in the public interest and approved by courts in all Settling States.[12]

Under the MSA, the majors agreed to internalize the health care costs created by their products by making three sets of payments, each in installments, to the Settling States, in return for which they would receive a release of claims.[13] The first set of payments—totaling nearly $13 billion—was to be made immediately after the execution of the MSA, and annually thereafter, on January 10, from 2000 to 2003.[14] The second set of payments was to be made annually, beginning on April 15, 2000 and recurring on April 15 of each year in perpetuity. Between 2000 and 2025, the second set of payments will total over $207 billion before adjustments for inflation and changes in the volume of cigarettes shipped.[15] The third set of payments—totaling over $8 billion before adjustments—is to be made annually on April 15, from 2008 to 2017.[16] According to a

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[9] Master Settlement Agreement § II(qq) ("MSA").

[10] MSA § II(hh).

[11] *See Grand River Enters. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 163 (2d Cir. 2005).

[12] *See, e.g.*, Consent Decree and Final Judgment at 11, *Georgia v. Philip Morris, Inc.* (Ga. Sup. Ct. Dec. 9, 1998) (No. E-61692) ("The MSA, the settlement set forth therein, and the establishment of the escrow provided for therein are hereby approved in all respects, and all claims are hereby dismissed with prejudice as provided therein."); Consent Decree and Final Judgment at 12, *Oklahoma v. R.J. Reynolds Tobacco Co.* (D. Okla. Dec. 1, 1998) (No. CJ-96-1499-L(H)) (same); Consent Decree and Final Judgment at 8, *South Carolina v. Brown & Williamson Tobacco Corp.* (S.C. Ct. Com. Pl. Dec. 31, 1998) (No. 97-CP-40-1686) (same).

[13] MSA §§ II(nn), XII.

[14] *See* MSA § IX(b).

[15] *See* MSA § IX(c)(1).

[16] *See* MSA § IX(c)(2).

2008 report, the Settling States have received $59.1 billion in settlement payments under the MSA.[17]

The MSA includes a provision which permits other cigarette manufacturers to sign on to the agreement and thereby settle any tobacco-related claims the Settling States could otherwise assert against them. Since its execution, more than forty "Subsequent Participating Manufacturers" or "SPMs" have elected to sign the agreement.[18] As an inducement for smaller manufacturers to sign the MSA, SPMs that did so within 90 days after the MSA's execution date of November 23, 1998 (known as "grandfathered SPMs") were granted partial payment exemptions: each year, those manufacturers are required to make payments with respect to cigarettes they sell only to the extent their respective market shares in that year exceed 100% of their 1998 market share or 125% of their 1997 market share, whichever is greater.[19] The market share on which payments are not made is known as the "grandfather share." SPMs that did not sign the MSA within 90 days of its execution have no grandfather share.[20]

Virtually all grandfathered SPMs exceed their grandfather share. As stated by Professor Jonathan Gruber, Professor of Economics at the Massachusetts Institute of Technology:

> In every year since 2001, at least 93.5% of cigarettes sold by SPMs have been sold by grandfathered SPMs that exceed their grandfathered share; in 2007, more than 99% of cigarettes sold by SPMs were sold by

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[17] *See* Eric Lindblom, *Campaign for Tobacco-Free Kids, Actual Tobacco Settlement Payments Received by the States* 2 (2008), *available at* http://tobaccofreekids.org/research/factsheets/pdf/0218.pdf (last visited Dec. 10, 2008) (chart showing $59.1 billion in MSA payments received by states between 1999 and 2008).

[18] *See Tritent Int'l Corp. v. Kentucky*, 467 F.3d 547, 549 (6th Cir. 2006).

[19] MSA § IX(i). Claimants refer to grandfathered SPMs as "Exempt SPMs."

[20] MSA Amendment 1 (amending § IX(i)(4)(A) of the MSA to apply to Subsequent Participating Manufacturers who "became a signatory to this Agreement more than 90 days after the MSA Execution Date").

> grandfathered firms that exceeded their grandfathered share. Indeed . . . the grandfathered SPMs sold in total more than *twice* their respective grandfather shares. The ratio of sales above the grandfather share to the grandfather share level since 2001 has been 70%, 97%, 86%, 80%, 107%, and 115%. There is no great risk here for the vast majority of the SPM market of selling below the grandfather level.[21]

Several foreign-owned tobacco product manufacturers were among the SPMs that signed the MSA within 90 days of its execution, and thus enjoy a partial payment exemption in the form of a grandfather share under the agreement, including the following: SEITA (a French company); PT Djarum (an Indonesian Company); and Lane Limited (then owned by a Dutch company).[22]

Foreign-owned tobacco manufacturers also comprise many of the SPMs that did not sign the MSA within 90 days of its execution, and thus enjoy no payment exemption. These foreign-owned SPMs include the following: Canary Islands Cigar Co. (a Spanish company); Chancellor Tobacco Company, PLC (an English company); Eastern Company SAE (an Egyptian company); House of Prince A/S (a Danish company); Mac Baren Tobacco Company (a Danish company); Compania Industrial de Tabacos Monte Paz, S.A. (a Uruguayan company); PLANTA (a German company); and Pöschl Tobak Gmbh and Company KG (a German company).[23]

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[21] Expert Report of Prof. Jonathan Gruber ¶ 26 (Dec. 19, 2008) ("Gruber Report").

[22] See Attachment 4d, Calculation of the N[PM] Adjustment – 14 Day Rule (Mar. 20, 2007) (NAAGL 2586) (showing that SEITA, PT Djarum, and Lane Limited signed the MSA within 90 days); Société Nationale d'Exploitation Industrielle des Tabacs et Allumettes v. Salomon Bros. Int'l, 928 F. Supp. 398, 399 (S.D.N.Y. 1996) (stating that "SEITA, a French corporation with its principal place of business in Paris, manufactures and markets tobacco products"); WORLD TOBACCO DIRECTORY 2004/2005 at 64, DMG World Media (U.K.) Ltd. 2004-05 (showing that PT Djarum was an Indonesian company); British American Tobacco p.l.c., Proposed Merger of British American Tobacco & Rothmans International B.V., at 45, 74 (Mar. 12, 1999), *available at* http://legacy.library.ucsf.edu/tid/ama53a99/pdf?search=%22lane%20limited%22 (last visited Dec. 18, 2008) (showing that Lane Limited was a wholly-owned subsidiary of Rothmans International B.V., a Dutch company).

[23] *See Attachment 4d, Calculation of the N[PM] Adjustment – 14 Day Rule* (Mar. 20, 2007) (NAAGL 2586); WORLD TOBACCO DIRECTORY 2004/2005 at 29, 32, 39, 106, 126, DMG World Media (U.K.) Ltd.

Many U.S.-owned manufacturers also signed the MSA after the 90-day window closed and thus receive no payment exemption. Such U.S.-owned manufacturers include the following: Anderson Tobacco Company, LLC; Farmer's Tobacco Co.; Virginia Carolina Corporation Inc.; Wind River Tobacco Company, LLC; and VIP Tobacco.[24]

SPMs are bound by the MSA's advertising and other restrictions and make settlement payments to the Settling States based upon their U.S. sales. The OPMs and SPMs are collectively referred to as "Participating Manufacturers" or "PMs," since they participate in the settlement. Payments by PMs under the MSA are based on nationwide sales.[25] The per-cigarette amount of an annual payment made by an SPM without a grandfather share is identical to the per-cigarette amount of an annual payment made by a grandfathered SPM on its sales that exceed its grandfather share, which currently is about two and a half cents per cigarette sold; OPMs likewise pay approximately two and a half cents per cigarette sold under the MSA.[26] The amount of a PM's annual payment is

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2004-05 (House of Prince, Mac Baren, Eastern Company, PLANTA, Pöschl, Canary Islands, and Monte Paz); Companies House WebCheck Service, United Kingdom Government (Chancellor Tobacco Co.), *available at* http://wck2.companieshouse.gov.uk/8356122cf6c73cb81507e8b44744555c/wcframe?name=accessCompanyInfo (last visited Dec. 10, 2008).

[24] *See Attachment 4d, Calculation of the N[PM] Adjustment – 14 Day Rule* (Mar. 20, 2007) (NAAGL 2586); South Carolina Secretary of State Business Filings Database (Anderson and Virginia Carolina), *available at* http://www.scsos.com/Search%20Business%20Filings (last visited Dec. 10, 2008); Kentucky Secretary of State Business Services, Online Business Database (Farmers), *available at* https://arp.sos.ky.gov/business/obdb/(S(fekncq55r3d44eea0pltjir3))/default.aspx (last visited Dec. 10, 2008); Wyoming Secretary of State Business Division, Business Database (Wind River), *available at* https://wyobiz.wy.gov/Ecommerce/SearchResultNew.aspx (last visited Dec. 10, 2008); Minnesota Secretary of State Business Services, Business Organizations Inquiry (VIP), *available at* http://da.sos.state.mn.us/minnesota/corp_inquiry-find.asp?:Norder_item_type_id=10&sm=7 (last visited Dec. 10, 2008).

[25] *See* n. 80, *infra*.

[26] *See* Gruber Report ¶¶ 5, 7 (stating that for 2008 the per-cigarette annual payments due from each OPM will be approximately $0.02729 per cigarette, and for each SPM, to the extent the SPM exceeds any applicable grandfather share, will be approximately $0.026092 per cigarette). Due primarily to the inflation adjustment under the MSA, per-cigarette payments have risen from their earlier level of approximately two cents per cigarette sold. *See, e.g. Grand River Enters. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 163 (2d

subject to certain adjustments, including an inflation adjustment (adjusting payments upward to account for inflation)[27] and a volume adjustment (adjusting payments upward or downward to account for changes in aggregate OPM sales).[28]

The objectives of the MSA were to resolve the states' tobacco litigation while simultaneously addressing the states' public health concerns regarding tobacco use, particularly with regard to underage smoking.[29] The MSA promotes public health by reducing tobacco use, especially among minors. Reductions in tobacco use are accomplished by imposing restrictions on the marketing, advertising, and promotional practices of Participating Manufacturers, which include the following:

- prohibiting the targeting of persons under 18 in advertising, promoting, or marketing tobacco products;
- prohibiting the distribution of free tobacco products;
- prohibiting the distribution of tobacco coupons or other tobacco credits to children;
- prohibiting payments for the use of tobacco brand names in the media;
- eliminating cartoons in advertising tobacco products;
- eliminating outdoor and transit tobacco advertising;
- banning merchandise carrying tobacco brand names;
- prohibiting agreements to suppress research into the health consequences of smoking; and

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Cir. 2005) ("SPMs, to the extent they exceed their grandfather share, if applicable, pay approximately two cents per cigarette as part of their settlement, which is identical to the per-cigarette OPM payment.").

[27] *See* MSA Exh. C.

[28] *See* MSA Exh. E.

[29] *See* MSA § I at 2d, 4th, 6th, and 7th recitals.

- prohibiting material misrepresentations of fact regarding the health consequences of smoking.[30]

The MSA also places additional affirmative obligations on OPMs, including:

- abolishing two trade associations that were alleged to have been involved in misrepresentations regarding the health effects of smoking;

- making publicly available millions of documents that were produced in discovery in domestic litigation; and

- establishing a national foundation—with over $1.5 billion in funding—to conduct a sustained, nationwide advertising and education program aimed at reducing youth smoking and educating the public about smoking-related illnesses.[31]

The MSA's positive impact on public health has been dramatic and will likely increase over time. Since the MSA was executed, smoking consumption in the United States has declined by about 25 percent.[32] Smoking rates for eighth grade students have declined by more than half,[33] and for twelfth grade students (the final year of high school), are at their lowest levels on record.[34]

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[30] *See generally* MSA §§ III (a), (b), (d), (e), (f), (g), (q), (r).

[31] *See* MSA §§ III(o), IV, and VI.

[32] *See* DEPARTMENT OF HEALTH AND HUMAN SERVICES - CENTERS FOR DISEASE CONTROL AND PREVENTION (CDC), CIGARETTE PRODUCTION, EXPORTS, AND DOMESTIC CONSUMPTION—UNITED STATES, 1990-2007, *available at* http://www.cdc.gov/tobacco/data_statistics/tables/economics/expdcom.htm (last visited Dec. 20, 2008) (showing that total U.S. cigarette consumption was 480.0 billion units in 1997, the year just prior to the MSA's execution, and 360.0 billion units in 2007, indicating a decline of 25%).

[33] *See* L.D. Johnston et al., *National Institute on Drug Abuse, Monitoring the Future National Survey Results on Drug Use, 1975-2006: Volume I, Secondary School Students 2006* (NIH Publication No. 07-6205), at 218-19 (2007), *available at* http://monitoringthefuture.org/pubs/monographs/vol1_2006.pdf (last visited Dec. 20, 2008) (reporting that monthly smoking rates among eighth graders declined from 19.1% in 1998 to 8.7% in 2006, and daily smoking rates for that group declined from 8.8% in 1998 to 4.0% in 2006).

[34] See L.D. Johnston et al., National Institute on Drug Abuse, Monitoring the Future National Survey Results on Drug Use, 1975-2006: Volume I, Secondary School Students 2006 (NIH Publication No. 07-6205), at 157-58 (2007), available at http://monitoringthefuture.org/pubs/monographs/vol1_2006.pdf (last visited Dec. 20, 2008) (reporting that monthly smoking rates among twelfth grade students declined from 37% in the mid-1990s to 22% in 2006, and daily smoking rates for that group declined from 25% in the mid-1990s to 12% in 2006); *see also* DEPARTMENT OF HEALTH AND HUMAN SERVICES - CENTERS FOR DISEASE CONTROL AND PREVENTION (CDC), MORBIDITY & MORTALITY WKLY., CIGARETTE USE AMONG HIGH SCHOOL STUDENTS—UNITED STATES, 1991-2003 (June 18, 2004), available at http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5323a1.htm (last visited Dec. 10, 2008) (showing at

Because most smokers in the United States begin smoking before age 18, reductions in youth smoking will almost certainly lead to reductions in smoking in the overall population. These consumption declines will, in turn, lead to a substantial reduction in smoking-related deaths and disease.[35] Demand for cigarettes is further dampened by the PMs' payment obligations under the MSA, the costs of which are passed on, in large part, to consumers in the form of higher prices.

II. The Escrow Statutes Ensure That States Have Access To Funds To Satisfy Any Potential Future Judgments Against Non-Participating Manufacturers For Harms Caused By Their Tobacco Products

Cigarette manufacturers that are neither original MSA signatories (OPMs) nor subsequent signatories to the MSA (SPMs) are known as "Non-Participating Manufacturers" or "NPMs." Simply put, an NPM is "*any* cigarette manufacturer that is not a signatory to the MSA."[36] NPMs include both U.S. and foreign-owned cigarette manufacturers, such as Xcaliber International Limited, LLC (Oklahoma),[37] Star Scientific, Inc. (Delaware),[38] S&M Brands, Inc. (Virginia),[39] KT&G Corp. (Korea), Dos Santos, S.A. (Spain), and Concord International Tobacco Fze. (United Arab Emirates).[40]

Table 2 that current cigarette use among twelfth grade students declined from 39.6% in 1997 to 26.2% in 2003).

[35] *See, e.g.*, CENTERS FOR DISEASE CONTROL AND PREVENTION, *supra* note 4, at 2 (providing that from 1999 through 2004, tobacco use in the United States was responsible for approximately 438,000 premature deaths per year).

[36] Model NPM Statute – Frequently Asked Questions, Evidentiary Submissions in Support of Claimants' Memorial – Merits Phase, Volume IV, Exhibit 37, at 4 (July 10, 2008) (emphasis added). NPMs are those cigarette manufacturers that are not on the list of PMs. *See Attachment 4d, Calculation of the N[PM] Adjustment – 14 Day Rule* (Mar. 20, 2007) (NAAGL 2586).

[37] *See KT&G Corp. v. Att'y Gen. of Oklahoma*, 535 F.3d 1114, 1118, 1124 (10th Cir. 2008) (noting that, in addition to being an NPM, "Xcaliber is an Oklahoma limited liability company based in Pryor, Oklahoma.").

[38] *See Star Scientific, Inc. v. Beales*, 278 F.3d 339, 346 (4th Cir. 2002) (noting that Star Scientific, Inc. is incorporated in Delaware and "did not participate in the Master Settlement Agreement").

NPMs have no obligations under the MSA. None of the MSA's public health provisions apply to them, nor are they obligated to make any payments to the Settling States.[41] At the same time, the Settling States have preserved all their past and future claims against NPMs.[42]

In an effort to protect the public health from the adverse effects of NPM cigarettes and their associated medical and productivity costs borne by states, state legislatures adopted a series of NPM-related measures, including escrow statutes, complementary legislation, and allocable share amendments.[43]

The escrow statutes arose from the recognition by Settling States that unlike cigarette sales by PMs, health care costs arising from the sales of NPM tobacco products would not be internalized in the prices of NPMs' cigarettes.[44] The Settling States also recognized that the harm caused by NPMs' tobacco products might not become manifest until long after an NPM had entered, and perhaps exited, the U.S. market, which could impede the ability of states to satisfy future judgments against them.[45] Thus, the MSA

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[39] Tobacco Reporter, Global Tobacco Industry Guide 2003, at 352 (noting that S&M Brands, Inc. is located in Keysville, VA). In addition, S&M Brands, Inc. is not on the PM list and is therefore an NPM. *See Attachment 4d, Calculation of the N[PM] Adjustment – 14 Day Rule* (Mar, 20, 2007) (NAAGL 2586).

[40] *See KT&G Corp. v. Att'y Gen. of Oklahoma*, 535 F.3d 1114, 1118, 1124 (10th Cir. 2008) (noting that, in addition to being an NPM, "KT & G is a Korean corporation that sells cigarettes in the United States … ."); *see also* WORLD TOBACCO DIRECTORY 2004/2005 at pp. 73, 106, 124 (DMG World Media (UK) Ltd. 2004-05) (KT&G Corp., Dos Santos, S.A. and Concord Tobacco International Fze.). None of these companies is on the PM list and they are therefore NPMs. *See Attachment 4d, Calculation of the N[PM] Adjustment – 14 Day Rule* (Mar. 20, 2007) (NAAGL 2586).

[41] *See generally* MSA §§ II, III, IX, and XII.

[42] *See* MSA § XVIII(t).

[43] *See, e.g.*, N.Y. Pub. Health Law § 1399-nn (declaring that it is in the interest of New York to establish an escrow fund because of public health concerns); Idaho Code § 39-7801(a)-(f) ("cigarette smoking presents serious public health concerns to the State of Idaho and to Idaho citizens").

[44] *See* MSA Exhibit T, Model Statute, Findings and Purpose, ¶ (d).

[45] *See* MSA Exhibit T, Model Statute, Findings and Purpose, ¶¶ (a) and (f).

created the potential for NPMs to exploit their ability to operate outside the restrictions of the MSA while imposing unrecoverable health care costs on the states.

To address these concerns by "effectively and fully neutraliz[ing] the cost disadvantages" suffered by PMs vis-à-vis NPMs,[46] each Settling State enacted an escrow statute, substantially in the form of the model escrow statute contained in Exhibit T to the MSA.[47] Each escrow statute presented NPMs with two options: either sign the MSA as an SPM, or remain an NPM and make deposits into escrow.[48]

For those tobacco manufacturers deciding to remain NPMs, each state escrow statute requires the manufacturer to establish and fund an escrow account in an amount determined by the NPM's sales volume in that state. The escrow accounts provide security for potential future damages resulting from the sale and use of the NPM's tobacco products.

Many escrow statutes expressly set out several reasons for establishing escrow requirements to cover any future tobacco-related NPM liability, including the following:

> (i) cigarette smoking presents serious public health concerns to the state and its citizens—the Surgeon General has determined that smoking causes lung cancer, heart disease, and other serious

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[46] MSA § IX(d)(2)(E).

[47] *See* Robin Miller, *Validity, Construction, Application and Effect of Master Settlement Agreement (MSA) Between Tobacco Companies and Various States, and State Statutes Implementing Agreement; Use and Distribution of MSA Proceeds*, 25 A.L.R. 6th 435, 467 (2007) ("All of the settling jurisdictions have enacted escrow statutes.").

[48] *See Star Scientific Inc. v. Beales*, 278 F.3d 339, 346 (4th Cir. 2002) (observing that the Virginia escrow statute requires tobacco manufacturers selling cigarettes in the state to either join the MSA as a PM or place funds into escrow as an NPM). Settling States that enacted and diligently enforce escrow statutes are not subject to the "NPM Adjustment" under the MSA, which "provides for a potential reduction in annual payments by Participating Manufacturers . . . to the states if, *inter alia*, there is an aggregate market share loss by PMs to NPMs since 1997." *See Grand River Enters. Six Nations Ltd. v. Pryor*, 425 F.3d 158, 163 (2d Cir. 2005).

> diseases, which most often do not appear until many years after the person in question begins smoking;[49]
>
> (ii) cigarette smoking also presents serious financial concerns for the state, which may have a legal obligation, under certain health care programs, to provide medical assistance to eligible persons for smoking-related health conditions;[50]
>
> (iii) under such health care programs, the state pays millions of dollars annually to provide medical assistance to eligible persons for smoking-related health conditions;[51]
>
> (iv) it is state policy that financial burdens imposed on the state by cigarette smoking be borne by tobacco product manufacturers rather than by the state to the extent such manufacturers either decide to enter into a settlement with the state or are found culpable by the courts;[52] and
>
> (v) it would be contrary to state policy if tobacco product manufacturers who decide not to enter into such a settlement could use a cost advantage—resulting from their decision not to join the MSA—to derive large, short-term profits in the years before liability may arise without ensuring that the state will have an eventual source of recovery from them if they are proven to have acted culpably.[53]

The escrow statutes were intended to address the above concerns, by providing a source of recovery for Settling States in the event that such states were to obtain future tobacco-related judgments against NPMs.[54]

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[49] *See, e.g.*, OKLA. STAT. tit. 37, § 600.21(A) (2008); GA. CODE ANN. § 10-13-1(a) (2008); N.Y. PUB. HEALTH LAW § 1399-nn(1); CAL. HEALTH & SAFETY CODE § 104555(a); IDAHO CODE ANN. § 39-7801(a) (2008).

[50] *See, e.g.*, OKLA. STAT. tit. 37, § 600.21(B); GA. CODE ANN. § 10-13-1(b); N.Y. PUB. HEALTH LAW § 1399-nn(2); CAL. HEALTH & SAFETY CODE § 104555(b); IDAHO CODE ANN. § 39-7801(b).

[51] *See, e.g.*, OKLA. STAT. tit. 37, § 600.21(B); GA. CODE ANN. § 10-13-1(c); N.Y. PUB. HEALTH LAW § 1399-nn(3); CAL. HEALTH & SAFETY CODE § 104555(c); IDAHO CODE ANN. § 39-7801(c).

[52] *See, e.g.*, OKLA. STAT. tit. 37, § 600.21(C); GA. CODE ANN. § 10-13-1(d); N.Y. PUB. HEALTH LAW § 1399-nn(4); CAL. HEALTH & SAFETY CODE § 104555(d); IDAHO CODE ANN. § 39-7801(d).

[53] *See, e.g.*, OKLA. STAT. tit. 37, § 600.21(D); GA. CODE ANN. § 10-13-1(f); N.Y. PUB. HEALTH LAW § 1399-nn(6) (2008); CAL. HEALTH & SAFETY CODE § 104555(f); IDAHO CODE ANN. § 39-7801(f).

[54] *See, e.g.*, OKLA. STAT. tit. 37, § 600.21(D) (finding that the state interest requires NPMs to "establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment-proof before liability may arise"); GA. CODE ANN. § 10-13-

An NPM's escrow deposit obligation under a particular escrow statute is based on the number of its "Units Sold" in that state. "Units Sold" is defined as the number of individual cigarettes sold as measured by excise taxes collected by the state on packs bearing a state excise tax stamp.[55] Thus, an NPM's escrow obligations are based only on those sales that are subject to state excise tax stamping requirements.

Furthermore, "Units sold" refers to cigarettes sold in the state by the applicable Tobacco Product Manufacturer, "whether directly or through a distributor, retailer or similar intermediary or intermediaries."[56] When a manufacturer intends to sell cigarettes in the United States through an importer, the manufacturer qualifies as a "Tobacco Product Manufacturer" under the escrow statutes.[57]

The per-cigarette escrow obligation for NPMs under the escrow statutes is roughly equivalent to the per-cigarette payments of OPMs, and of SPMs for sales above any applicable grandfather share, under the MSA.[58] The per-cigarette obligation for NPMs currently is approximately two and one-half cents per cigarette sold.[59]

1(f) (same); N.Y. PUB. HEALTH LAW § 1399-nn(6) (same); CAL. HEALTH & SAFETY CODE § 104555(f) (same); IDAHO CODE ANN. § 39-7801(f) (same).

[55] *See, e.g.*, OKLA. STAT. tit. 37, § 600.22(10); GA. CODE ANN. § 10-13-2(10); N.C. GEN. STAT. § 66-290(10) (2008); S.C. CODE ANN. § 11-47-20(j) (2007); ARK. CODE ANN. § 26-57-260(10)(A) (2008).

[56] *See, e.g.*, OKLA. STAT. tit. 37, § 600.22(10); GA. CODE ANN. § 10-13-2(10); N.C. GEN. STAT. § 66-290(10); S.C. CODE ANN. § 11-47-20(j); ARK. CODE ANN. § 26-57-260(10)(A).

[57] *See, e.g.*, OKLA. STAT. tit. 37, § 600.22(9)(a); GA. CODE ANN. § 10-13-2(9)(A); N.C. GEN. STAT. § 66-290(9)(a); S.C. CODE ANN. § 11-47-20(i)(1); ARK. CODE ANN. § 26-57-260(9)(A)(i).

[58] *See KT&G Corp. v. Att'y Gen. of Oklahoma*, 535 F.3d 1114, 1122 (10th Cir. 2008) ("The parties agree that [an NPM's] per-cigarette [escrow] amount is roughly equivalent to the per-cigarette amount the MSA requires from OPMs and SPMs for sales which are not exempt."); *Grand River Enters. Six Nations Ltd. v. Pryor*, 425 F.3d 158, 163 ("The per-cigarette amount [under the escrow statutes] is roughly equal to what an OPM or SPM would pay under the MSA."). For every year in which an NPM's cigarettes are sold in a state that has enacted an escrow statute, the NPM must place the required funds into escrow by April 15 of the following year. *See, e.g.*, OKLA. STAT. tit. 37, § 600.23(A)(2); GA. CODE ANN. § 10-13-3(2)(A); S.C. CODE ANN. § 11-47-30(b)(1); N.C. GEN. STAT. § 66-291(a)(2); ARK. CODE ANN. § 26-57-261(2)(A).

[59] Gruber Report ¶ 8. Under the escrow statutes, NPMs are subject to the same inflation adjustment to which PMs are subject under the MSA. *See* MSA Exhibit T, Model Statute, Definitions, ¶ (a); Gruber

Unlike a PM which makes payments under the MSA, an NPM that makes escrow deposits pursuant to an escrow statute retains ownership over escrowed funds,[60] receives interest on escrowed funds as it is earned,[61] and may choose the bank where the funds are to be deposited.[62] In effect, an NPM must maintain a savings account for 25 years in each state in which it sells its cigarettes and retain the principal in that account as security to which a state can look to recover any future judgment or settlement for damages incurred as a result of the sale of the NPM's cigarettes in that state. Barring such a future judgment or settlement, a state has no right to an NPM's escrowed funds. After 25 years, any escrowed funds are returned to the NPM, less any payments made with respect to such judgments or settlements.

III. Settling States Enacted Complementary Legislation To Ensure That NPMs Do Not Evade Deposit Obligations Under The Escrow Statutes

Despite early enforcement by some states of their escrow statutes, many NPMs continued to sell cigarettes in the United States without complying with state escrow obligations. In particular, compliance lagged for NPMs located in foreign countries.[63]

Report ¶¶ 5, 7-8 (stating that the per-cigarette payment amounts for OPMs, SPMs, and NPMs in 2008 will each increase by 3% or the change in the Consumer Price Index, whichever is greater).

[60] *See, e.g.*, OKLA. STAT. tit. 37, § 600.23(B)(3) (stating that escrowed funds will "revert back" to the manufacturer once released); S.C. CODE ANN. § 11-47-30(b)(2)(C) (same); N.C. GEN. STAT. § 66-291(b)(3) (same); GA. CODE ANN. § 10-13-3(2)(B)(iii) (same); ARK. CODE ANN. § 26-57-261(2)(B)(iii) (same).

[61] *See, e.g.*, OKLA. STAT. tit. 37, § 600.23(B) (stating that manufacturers receive interest or other appreciation on deposited funds "as earned"; S.C. CODE ANN. § 11-47-30(b)(2) (same); N.C. GEN. STAT. § 66-291(b) (same); GA. CODE ANN. § 10-13-3(2)(B) (same); ARK. CODE ANN. § 26-57-261(2)(B) (same).

[62] *See* OKLA. STAT. tit. 37, § 600.22(6) (requiring that financial institutions holding escrow funds be federally- or state-chartered, unaffiliated with any tobacco product manufacturer, and have assets of at least $1 billion); S.C. CODE ANN. § 11-47-20(f) (same); N.C. GEN. STAT. § 66-290(6) (same); GA. CODE ANN. § 10-13-2(6) (same); ARK. CODE ANN. § 26-57-260(6) (same).

[63] *See, e.g.*, *Tobacco Products: Licensing for Tax Purposes, Cal. S. Health and Human Serv. Comm. Analysis of B. AB 71*, at 16 (Aug. 20, 2003), *available at* http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_0051-0100/ab_71_cfa_20030818_142151_sen_comm.html (last visited Dec. 20, 2008) ("According to the Attorney General, enforcement of the NPM statute has been costly and cumbersome. NPMs are allowed to sell cigarettes for a period of 16 months in a state before the law obligates them to make an escrow deposit. Many NPMs are located in foreign countries making it difficult to effect service

As stated by Brett T. DeLange, Deputy Attorney General, Chief, Consumer Protection Division, Idaho Office of the Attorney General, during the course of enforcing the Idaho escrow statute in 2000 and 2001:

> It became clear to the State that the [Idaho escrow statute's] remedies were too limited and allowed Non-Participating Manufacturers to evade their escrow obligations for too long a time before they could be subject to court injunction. It also became clear that a number of NPMs—particularly foreign ones—were willing to underfund their escrow deposits, knowing that there would be a substantial time before the State would be able to impose an effective remedy. I was also advised by more than one cigarette importer that some foreign NPMs knew of the enforcement difficulties States had under their respective Qualifying Statutes and planned to take advantage of the situation, which they proceeded to do. For example, in 2001, Idaho sued Kisanlal Bastiram Sarda, a tobacco company located in India, for failure to comply with Idaho's MSA Act . . . . The State attempted service, only to be rebuffed because the tobacco company operated behind an armed compound and the process server was unable to penetrate the compound to effect service.[64]

Idaho also had difficulties enforcing its escrow statute against another NPM located outside the United States, Grand River Enterprises Six Nations, Ltd. ("Grand River"). Idaho sued Grand River in 2002 as a result of Grand River's failure to meet its escrow obligations with respect to the sale of nearly 8 million Grand River-manufactured cigarettes in the State of Idaho.[65] In September 2002, an Idaho court enjoined Grand River from selling any cigarettes in Idaho, whether directly or through an intermediary, until Grand River took steps to comply with Idaho law, including the establishment of a qualified escrow fund.[66] Grand River has never taken such steps and remains in violation of the court's order.[67] As observed by Mr. DeLange, "Grand River is located in Canada

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of process and enforce judgments. According to the Attorney General, NPMs have found other ways to avoid compliance.").

[64] Declaration of Brett T. DeLange, Esq., Deputy Attorney General for the State of Idaho and Chief of the Consumer Protection Division ¶¶ 9-10 (Dec. 15, 2008) ("DeLange Declaration").

[65] DeLange Declaration ¶ 13.

[66] DeLange Declaration ¶ 14.

[67] DeLange Declaration ¶¶ 14, 34.

and it has proved very difficult for the State to enforce or collect upon its judgment" under the Idaho escrow statute.[68]

To address such enforcement difficulties, many states enacted statutes, later referred to as "complementary legislation." Although there are differences between the individual statutes, the complementary legislation generally requires all cigarette manufacturers whose products are sold in a given state to file an annual certification with the state attorney general and/or the state revenue department.[69] In its certification, the cigarette manufacturer must attest that it is either (i) meeting its payment obligations as a PM under the MSA, or (ii) making required escrow deposits as an NPM.[70]

The complementary legislation also requires the state attorney general or revenue department to maintain a directory of tobacco product manufacturers that are currently in compliance with either the MSA or the state escrow statute.[71] Under the complementary legislation, no stamping agent can affix a state tax stamp—which is required for lawful cigarette sales—to any cigarette package if the manufacturer of that brand of cigarette is not listed in the directory.[72]

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[68] DeLange Declaration ¶ 15.

[69] *See, e.g.*, CAL. REV. & TAX CODE § 30165.1(b) (requiring reporting to the state attorney general only); IDAHO CODE ANN. § 39-8403(1) (same); N.M. STAT. § 6-4-17(A) (same); OKLA. STAT. tit. 68, § 360.4(A) (requiring reporting to the state attorney general and the state tax commission).

[70] *See, e.g.*, CAL. REV. & TAX CODE § 30165.1(b) (requiring "every tobacco product manufacturer whose cigarettes are sold in this state whether directly or through a wholesaler, distributor, retailer or similar intermediary or intermediaries" to certify annually that the manufacturer is either a PM or in full compliance with its escrow obligations as an NPM); IDAHO CODE ANN. § 39-8403(1) (same); N.M. STAT. § 6-4-17 (same); OKLA. STAT. tit. 68, § 360.4(A)(1) (same).

[71] *See, e.g.*, CAL. REV. & TAX CODE § 30165.1(c); IDAHO CODE ANN. § 39-8403(2); N.M. STAT. § 6-4-18(A); OKLA. STAT. tit. 68, § 360.4(B).

[72] *See, e.g.*, CAL. REV. & TAX CODE § 30165.1(e); IDAHO CODE ANN. § 39-8403(3); N.M. STAT. § 6-4-22(A); OKLA. STAT. tit. 68, § 360.4(C).

Unlike the escrow statutes, which apply only to "Tobacco Product Manufacturers" as defined under the statutes,[73] the complementary legislation applies to any person who holds, owns, possesses, transports, imports, or causes to be imported cigarettes that the person knows or should know are intended for distribution or sale in violation of the statute.[74] Thus, under the complementary legislation, if a manufacturer is not listed in the state directory, the cigarette brands produced by that manufacturer cannot, under any circumstances, be sold lawfully within the state. As stated by Mr. DeLange, the "triggering event," for purposes of applying the complementary legislation, is when a person in possession of cigarettes that are not listed on the state's tobacco directory "introduces" those cigarettes into the state.[75]

By January 2003, approximately fifteen states had enacted complementary legislation.[76] The effectiveness of the complementary legislation in promoting compliance with the escrow statutes prompted the National Association of Attorneys General ("NAAG") Tobacco Project to create "a Complementary Legislation Working Group, a multi-State staff-level group coordinated by the NAAG Tobacco Project [which] was charged with developing draft Complementary Legislation that could be recommended as a model to all of the Settling States."[77] A majority of Settling States

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[73] *See* Facts Sec. VII.

[74] *See, e.g.*, CAL. REV. & TAX CODE § 30165.1(e); IDAHO CODE ANN. § 39-8403(3); N.M. STAT. § 6-4-22(E); 68 OKLA. STAT. tit. 68, § 360.4(C) (also making it unlawful to import noncompliant brands for personal consumption).

[75] DeLange Declaration ¶ 28.

[76] *See* National Association of Attorneys General Tobacco Project Model Complementary Legislation, Introduction and Analysis at 2 (Jan. 2003).

[77] *Id*.

enacted complementary legislation along the lines of the NAAG model in 2003.[78] Under the complementary legislation that follows the NAAG model, any cigarettes sold in violation of those statutes are subject to forfeiture and seizure as contraband.[79]

IV. The Allocable Share Amendments Correct An Unintended Flaw in the Escrow Statutes That Defeated The Purposes of Those Statutes in Many Jurisdictions

Payments by PMs under the MSA are based on nationwide sales and are made to an MSA Escrow Agent.[80] Those payments are then distributed among the Settling States according to fixed percentages, known as allocable shares, which are assigned to each Settling State as set forth in Exhibit A to the MSA. The respective allocable shares were agreed to by the Settling States.[81]

Escrow deposits by NPMs under the escrow statutes are based not on nationwide sales, but rather on sales in a particular Settling State.[82] Under the escrow statutes, NPMs are required to make escrow deposits into a qualified escrow account.[83]

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[78] *See* NAAG, *Effective Dates of Model Escrow Statute, Allocable Share Reform and Complementary Legislation* (June 20, 2006).

[79] *See, e.g.*, ALA. CODE § 6-12A-6(b); GA. CODE ANN. § 10-13A-8(b); IDAHO CODE ANN. § 39-8406(3); KY. REV. STAT. ANN. § 131.622(1); OKLA. STAT. tit. 68, § 360.7(B); NAAG Tobacco Project Model Complementary Legislation, Introduction and Analysis at 2-3 (explaining that the complementary legislation enacted by states subjects violators to criminal and civil penalties, including injunctive relief and designation of the product as contraband subject to seizure, forfeiture and destruction).

[80] *See* MSA § II(z) (defining "Market Share" as a tobacco manufacturer's share of the total number of cigarettes sold in the fifty United States, the District of Columbia, and Puerto Rico, as measured by federal excise taxes); *id*. § II (mm) (defining "Relative Market Share" as an OPM's share of the total number of cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico by OPMs); *id.* § IX(c) (basing the amount of OPM payments on Relative Market Share); *id*. § IX(i) (basing the amount of SPM payments on Market Share); *id.* §§ IX(b), (c)(1), (e) (stating that Escrow Agent is to receive payments from PMs).

[81] *See* Miller, *supra* note 47; MSA § II(f) (definition of "Allocable Share").

[82] *See* MSA Exh. T at T-3 (under the model escrow statute, calculation of escrow obligations based on the number of cigarettes sold, directly or indirectly, by a manufacturer in the state, as measured by state excise taxes).

[83] See MSA Exh. T at T-2 (model escrow statute defining "Qualified escrow fund" as "an escrow arrangement with a federally or State chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least $1,000,000,000 . . .").

The original escrow statutes included an allocable share release provision, which compared the escrow due on an NPM's sales in a given Settling State to the amount the Settling State would have received as its allocable share of the manufacturer's nationwide payments, had the manufacturer been a PM under the MSA.[84] If the escrow due on the NPM's sales in the state exceeded what the state would have received as its allocable share of the manufacturer's nationwide payments, the NPM could obtain a release of the difference from the state.[85]

The purpose of the original release provision was to ensure that an NPM's deposit obligations under the escrow statutes would not exceed what the NPM's payment obligations would have been under the MSA, had the NPM been a PM.[86] The allocable share release provision was based on an assumption that NPMs sold cigarettes nationally. As stated in the American Law Report on the MSA and its related measures:

> [C]alculations under the [original escrow] statutes were based on an assumption that a nonparticipating manufacturer sold cigarettes nationally. When this was the case, the statutes functioned as intended, permitting the NPM to obtain a refund of excess amounts placed in escrow in each state. However, when an NPM followed a regional sales strategy, as several did, the original escrow statutes allowed the NPM to obtain a refund that was much larger than intended. To correct this problem, the settling states (other than Missouri) have uniformly amended their escrow statutes by adoption of the Allocable Share Amendment.[87]

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[84] *See* Gruber Report ¶ 15.

[85] *See, e.g.*, ARK. CODE ANN. § 26-57-261(2)(B)(ii) (2005); GA. CODE ANN. § 10-13-3(2)(B)(ii) (2003); N.C. GEN. STAT. § 66-291(b)(2) (2005); OKLA. STAT. tit. 37, § 600.23(B)(2) (2004); S.C. CODE ANN. § 11-47-30(b)(2)(B) (2005).

[86] *See Tritent Int'l Corp v. Kentucky*, 467 F.3d 547, 551-552 (6th Cir. 2006) (discussing the allocable share release provision under the Kentucky escrow statute).

[87] Miller, *supra* note 53. A few Settling States—Michigan, Utah, and Alaska—enacted certain "equity assessment" measures to further address the issue of burden sharing by NPMs vis-à-vis PMs. Minnesota, which is not a signatory to the MSA, enacted a similar measure. The measures require NPMs to pay an "equity assessment" per cigarette sold in the state, which functions as a tax on tobacco products. *See* Expert Report of Prof. Joseph Isenbergh, Part 1 (Dec. 18, 2008) ("Isenbergh Report").

Given the assumption under the original escrow statutes that NPMs sold cigarettes nationally, an NPM could exploit the allocable share release provision under those measures by concentrating all of its U.S. sales in only one or a few Settling States. For example, if an NPM were to concentrate all of its U.S. sales in a state that had been allocated a two percent allocable share under the MSA, the NPM could obtain a release from that state of any escrow deposits made based on the remaining ninety-eight percent of its sales, virtually eliminating its obligations under the escrow statutes. NPMs exploiting the original release provision in such a manner were contributing to cigarette sales in a particular state, but were not contributing a proportional amount of funds to be held in escrow to cover any future smoking-related health costs arising from the sale and use of their cigarettes in that state.

Many Settling States were adversely affected by the original allocable share release provision. In Kentucky, for example, NPMs deposited over $18 million in escrow based on 2002 sales in that state, but ultimately obtained the release of over $14 million of that amount pursuant to the allocable share release provision.[88] In New Hampshire, by concentrating its sales in the state, one NPM was able to reduce its escrow liability from over $3 million to less than $30,000.[89] Overall, for NPM sales in 2002, NPMs obtained releases of well over half of the escrowed funds they had deposited: out of $236 million

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[88] *See State Fiscal Note Statement for H.B. 58, An Act relating to the Tobacco Master Settlement Agreement*, Ky. Legis. Research Comm. at 2 (Jan. 19. 2004), *available at* http://www.lrc.ky.gov/RECORD/04RS/HB58/FN.doc (last visited Dec. 20, 2008) ("NPM sales currently represent over 10% of the cigarettes sold in Kentucky, with forty-five NPMs operating in the state. In April 2003, twenty-six NPMs escrowed approximately $18 million for calendar year 2002 sales, with subsequent actions taken against those NPMs who failed to place funds into escrow. Of the $18 million initially escrowed, $14 million was released due to the allocable share cap provision.").

[89] *See* 2004-2005 N.H. Att'y Gen. Biennial Rep. at 11, *available at* http://doj.nh.gov/publications/biennial20042005/2005_report_web.pdf (last visited Dec. 20, 2008).

in escrowed funds, $137 million was released back to NPMs through the operation of the allocable share release.[90]

By concentrating their sales in only one or a few states, the NPMs exploiting the allocable share release provision were able to maintain relatively lower prices for their cigarettes, and thereby gain market share. From 1999 to 2003, overall U.S. market share for NPMs increased from approximately 1.6% to 8.1%.[91] Such gains in market share by NPMs caused additional losses for Settling States by reducing the cigarette sales of, and thus MSA payments by, Participating Manufacturers. One NAAG estimate predicted that Settling States would lose over $571 million due to growth in NPM market share.[92]

NPM exploitation of the unintended loophole in the allocable share release provision defeated the purposes of the escrow statutes in many jurisdictions: (i) funds were not created in sufficient amounts to ensure payment of judgments against NPMs to compensate states for the health costs arising from the use of NPM tobacco products in their states, (ii) NPMs were able to maintain relatively lower prices and thereby enjoy a significant competitive advantage vis-à-vis PMs, and (iii) lower prices for NPM cigarettes increased demand among price-sensitive consumers, including smokers under age 18, to the detriment of public health.

To close the unintended allocable share release loophole, state legislatures began adopting allocable share amendments to their respective escrow statutes, beginning in

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[90] Declaration of Michael Hering, Deputy Chief Counsel, National Association of Attorneys General ¶ 3 (Dec. 19, 2008) ("Hering Declaration").

[91] *See Int'l Tobacco Partners, Ltd. v. Kline*, 475 F. Supp. 2d 1078, 1084 n.10 (D. Kan. 2007).

[92] *See* Memorandum Transmitting Resolution In Support Of Allocable Share Amendment at 2 (NAAGL 00001 – NAAGL 00002).

2003. All but one of the Settling States have passed allocable share amendments to their escrow statutes.[93]

The allocable share amendments created a more equitable framework for all tobacco manufacturers participating in the U.S. market. Under the allocable share amendments, an NPM can receive an immediate release of funds from escrow only to the extent its escrow payments for cigarettes sold in a given state exceed what the NPM, if it had been an SPM under the MSA, would have had to pay for those sales—not just the state's allocable share of that payment.[94] Thus, under the amended release provision, an NPM cannot obtain an immediate release of funds by concentrating its U.S. sales in only a few states.

The Settling States enacted the complementary legislation and allocable share amendments through open, democratic processes. As stated by Michael G. Hering, Deputy Chief Counsel for the NAAG Tobacco Project:

> I testified in support of state allocable share amendments and/or complementary legislation before at least 13 state legislatures [and in] nearly every instance, I testified alongside both supporters and opponents of the pending bills, including representatives of Participating Manufacturers, Non-Participating Manufacturers ("NPMs"), public health advocacy groups, tobacco wholesalers and tobacco retailers. In many instances a representative from Council of Independent Tobacco Manufacturers of America, an organization whose members are all NPMs, testified in opposition to the bills.[95]

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[93] *See* NAAG, *Effective Dates of Model Escrow Statute, Allocable Share Reform and Complementary Legislation* (June 20, 2006) (showing allocable share amendments passed by forty-three states and the District of Columbia coming into effect between April 17, 2003 and January 1, 2006).

[94] *See, e.g.*, ARK. CODE ANN. § 26-57-261(2)(B)(ii) (2008); GA. CODE ANN. § 10-13-3(2)(B)(ii) (2008); N.C. GEN. STAT. § 66-291(b)(2) (2008); OKLA. STAT. tit. 37, § 600.23(B)(2) (2008); S.C. CODE ANN. § 11-47-30(b)(2)(B) (2007).

[95] Hering Declaration ¶ 2.

As observed by Mr. Hering, the members of the Council of Independent Tobacco Manufacturers of America ("CITMA") are NPMs. Specifically, the CITMA organization had been formed by NPMs that opposed the allocable share amendment.[96] As one example of CITMA's active role in opposing the allocable share amendment, the organization participated in a public hearing on the State of Oregon's proposed complementary legislation and allocable share amendment. Other participants at that hearing included representatives from the Attorney General's Office, SingleStick Tobacco Company, and USA Tobacco Distributing.[97] A related work session on the Oregon bill included comments from Philip Morris, R.J. Reynolds Tobacco, and the American Heart Association.[98]

The CITMA organization also expressed its views on the proposed complementary legislation and allocable share amendment to the Wisconsin state legislature, offering several arguments in opposition to the amendment.[99] CITMA likewise expressed its opposition to Michigan's allocable share amendment, while the amendment was supported by the Michigan Department of Treasury, the Michigan Department of the Attorney General, the Michigan Grocers Association, the Michigan

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[96] *See* Memorandum Transmitting Resolution in Support of Allocable Share Amendment at 2 (NAAGL 00001-NAAGL 00002) ("Some NPMs that have been taking advantage of the loophole are vigorously opposing the Allocable Share Amendment. They organized themselves as 'CITMA,' the Council of Independent Tobacco Manufacturers of America, and they have lobbied hard against the legislation in order to preserve the preferred position.").

[97] *2003 Senate Judiciary Committee Minutes*, Or. S. Comm. on Judiciary, HB 2094A Public Hearing (June 11, 2003), *available at* http://arcweb.sos.state.or.us/legislative/legislativeminutes/2003/senate/judiciary/SJUD06112003.htm (last visited Dec. 20, 2008).

[98] *See 2003 Senate Judiciary Committee Minutes*, Or. S. Comm. on Judiciary, HB 2094A Work Session (June 16, 2003), *available at* http://arcweb.sos.state.or.us/legislative/legislativeminutes/2003/senate/judiciary/SJUD06162003.htm (last visited Dec. 20, 2008).

[99] Memorandum from Pat Osborne, on behalf of CITMA, to Members of the Wisconsin State Legislature at 5-6 (Oct. 8, 2003) (NAAG 362).

Distributors and Vendors Association, R.J. Reynolds, Commonwealth Brands, Inc., Altria (Philip Morris), Lorillard Tobacco, Liggett Group Inc., Top Tobacco L.P., and Japan Tobacco.[100] CITMA also opposed the allocable share amendment in Arizona, while the amendment was supported by the Arizona Attorney General's Office, NAAG, Lignum-2, Inc., and Top Tobacco.[101]

In Nevada, a public hearing addressing, among other measures, the state's bill for the complementary legislation and allocable share amendment, included testimony from NAAG, the Nevada Attorney General's Office, the Department of Taxation, R.J. Reynolds, Philip Morris, and SingleStick.[102] Similar levels of participation occurred in California, where the state legislature considered the state's proposed complementary legislation together with a series of tobacco-related measures.[103]

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[100] *See Nonparticipating Cigarette Manufacturers Escrow*, Mich., H. Legis. Analysis Section, S. B. 781, at 4 (Dec. 17, 2003) *available at* http://www.legislature.mi.gov/documents/2003-2004/billanalysis/House/pdf/2003-HLA-0781-a.pdf (last visited Dec. 20, 2008).

[101] See *Minutes of Comm. on Finance*, Ariz. State S. 46th Leg., Second Regular Sess., at 1-3 (April 8, 2004) *available at* http://www.azleg.gov/FormatDocument.asp?inDoc=/legtext/46leg/2R/comm_min/Senate/040804FIN.DOC.htm (last visited Dec. 20, 2008) (summarizing testimony on HB 2247).

[102] *See Minutes of Comm. on Commerce and Labor*, Nev. Assem. 73d Sess. at 11-18 (Apr. 4, 2005), *available at* http://www.leg.state.nv.us/73rd/Minutes/Assembly/CMC/Final/4020.pdf (last visited Dec. 20, 2008) (notes on public hearing addressing, among other measures, Assembly Bill 436).

[103] *See Tobacco Products: Licensing for Tax Purposes*, Cal. S. Rules Comm. Analysis of B. No. AB 71, at G (Sept. 8, 2003), *available at* http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_0051-0100/ab_71_cfa_20030909_131910_sen_floor.html (last visited Dec. 20, 2008) (indicating participation by the American Federation of State, County, and Municipal Employees; the Association of California Beverage Merchants; the California Distributors Association; the City of Los Angeles; the League of California Cities; the State Office of the Attorney General; the American Cancer Society; the American Lung Association; the American Heart Association; the Berkeley Tobacco Prevention Coalition; Brown and Williamson Tobacco Corporation; the California Association of Retail Tobacconists, Inc.; the California Grocers Association; Cal-Tax; the Coalition for a Tobacco-Free Monterey County; the County of Yolo; R.J. Reynolds Tobacco Company; the San Francisco Tobacco Free Coalition; and 7-Eleven).

V. Shortly After The Signing of the MSA, Grand River Began To Manufacture Seneca Brand Cigarettes for the U.S. Market

Grand River, a Canadian enterprise based in Ohsweken, Ontario, was formed by Claimants Jerry Montour and Kenneth Hill, together with eight other partners, in 1994.[104] In 1996, the partners incorporated as Grand River Enterprises Six Nations, Ltd.,[105] a corporation established under the laws of Canada.[106]

Jerry Montour has served as Chief Executive Officer of Grand River since "approximately 1998."[107] Jerry Montour is a member of the Wahta Mohawk tribe,[108] which is "a small Mohawk community located in the Muskoka region of central Ontario, Canada."[109] Kenneth Hill is a member of the Lower Mohawk,[110] which is one of 13 Indian Registry Groups that belong to the Six Nations of the Grand River tribe[111] located on the Six Nations Reserve No. 40 in southern Ontario, Canada.[112]

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[104] Claimants' Memorial ¶ 14 (July 10, 2008) ("Mem."); PSOC, sec. D, ¶ 15 (June 30, 2005) ("PSOC").

[105] Witness Statement of Jerry Montour ¶ 18 (July 9, 2008) ("Jerry Montour Statement").

[106] Mem. ¶ 9.

[107] Jerry Montour Statement ¶ 2.

[108] *See* PSOC exh. 2.

[109] Wahta Mohawks Website, *available at* http://www.wahta.ca/ (last visited Dec. 10, 2008); *see also* INDIAN AND NORTHERN AFFAIRS CANADA, BAND CLASSIFICATION MANUAL 11 (May 2005) (listing all First Nations in Canada, their remoteness and environmental indices, city centre, service centre, and the most populated reserve/settlement used to determine the indices as of April 2005).

[110] *See* PSOC, exh. 3.

[111] *See* INDIAN AND NORTHERN AFFAIRS CANADA, BAND CLASSIFICATION MANUAL 11 (May 2005).

[112] *See* Six Nations of the Grand River Website, Governance, *available at* http://www.sixnations.ca/Governance.htm (last visited Dec. 10, 2008); Six Nations of the Grand River Website, Community Profile, *available at* http://www.sixnations.ca/CommunityProfile.htm (last visited Dec. 10, 2008).

In early 1999—a few months after the MSA was concluded—Grand River decided to begin selling Seneca brand cigarettes in the United States.[113] The Seneca cigarettes were to be manufactured exclusively at Grand River's Ohsweken facility.[114]

VI. In 1999 And 2000, Grand River Entered Into "Cigarette Manufacturing Agreements" With Its On-Reservation Distributors, Native Tobacco Direct And Native Wholesale Supply

In March 1999, Grand River entered into a "Cigarette Manufacturing Agreement" with NTD.[115] Native Tobacco Direct ("NTD") was established in 1999 under a charter granted by the Sac and Fox Nation of Oklahoma, and co-owned by Claimant Arthur Montour, Jr. and Ross John.[116] Claimants describe NTD as the "original owner" of the Seneca trademarks.[117]

Although Arthur Montour, Jr. and Jerry Montour share the same surname, they have no familial relationship.[118] Arthur Montour, Jr. has provided a certified statement from the Mohawk Council of Kahnawake that he is "a member of the Kahnawake Band of Indians situated on the Mohawk Territory in the Province of Quebec, Canada."[119] At the same time, Arthur Montour, Jr. alleges that he is "a member of the Seneca Nation."[120]

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[113] Jerry Montour Statement ¶ 21.

[114] PSOC sec. D, ¶ 22.

[115] The Cigarette Manufacturing Agreement is between Grand River, which is defined as the "Manufacturer," and "Native Tobacco Company," which is defined as the "Distributor." Cigarette Manufacturing Agreement at 1. Claimants, however, have referred to this agreement as the "Grand River Enterprises and Native Tobacco Direct March 1999 Agreement." *See* Index to Document Production, Volume Four, Document No. 8.

[116] PSOC sec. D, ¶ 5; Witness Statement of Arthur Akwiraienton Montour ¶ 2 (July 10, 2008) ("Arthur Montour Statement").

[117] Arthur Montour Statement ¶ 4.

[118] *See* Mem. at 3 n.1.

[119] *See* PSOC exh.4.

[120] Arthur Montour Statement at ¶ 1.

The Cigarette Manufacturing Agreement between Grand River and NTD obligates Grand River to manufacture certain brands of cigarettes owned by NTD "in such quantities and at such times" as NTD may request, using "the tobacco blends and packaging as designated by" NTD, and to deliver those tobacco products to a Foreign Trade Zone in New York, again as designated by NTD.[121] The recitals to the agreement identify NTD as the "owner" of various "Proprietary Properties" (such as trademarks, copyrights, and tobacco blending formulas) for certain brands of cigarettes, including the Seneca brand.[122] The agreement provides Grand River with a "limited license" to use the Seneca brand "for the sole purpose" of manufacturing and delivering the tobacco products to NTD pursuant to the agreement.[123] As characterized by the President of Grand River, Steve Williams, the Cigarette Manufacturing Agreement between Grand River and NTD is "a limited use license and manufacturing agreement."[124]

In 2000, Arthur Montour, Jr. bought out Ross John's interest in NTD, and founded Native Wholesale Supply ("NWS"), which "immediately succeeded" NTD as the owner of the Seneca trademarks.[125] Like NTD, NWS was established under a charter by the Sac and Fox Nation of Oklahoma.[126] In 2000, Grand River and NWS entered into a Cigarette Manufacturing Agreement that, according to Claimants, was "almost

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[121] Cigarette Manufacturing Agreement at 1-2.

[122] Cigarette Manufacturing Agreement at 1.

[123] Cigarette Manufacturing Agreement at 3.

[124] Affidavit of Steve Williams in Support of Motion for Relief from Judgment ¶ 6 (Feb. 6, 2007) (Defendant's Motion to Vacate Judgment, *South Dakota v. Grand River Enters, Inc*., (6th Jud. Cir. S.D. 2007) (Civ. No. 01-465).

[125] Arthur Montour Statement ¶ 7.

[126] PSOC sec. D, ¶ 5; Arthur Montour Statement ¶ 2.

identical" to the 1999 agreement entered into between Grand River and NTD.[127] Claimants have produced the 1999, but not the 2000, Cigarette Manufacturing Agreement in this arbitration. NTD and NWS (collectively, "NTD/NWS") have sold Seneca cigarettes to distributors and/or retailers located on reservations in at least seventeen states.[128]

As characterized by Grand River, NTD/NWS serve as "third party distributors" for the company.[129] As further characterized by Grand River, once the company has sold cigarettes "F.O.B. Ontario" to NTD/NWS, Grand River loses "all control over the cigarettes,"[130] and NTD/NWS "have the power to do with [the cigarettes] as they wish and send them anywhere in the world."[131] As stated by the President of Grand River, Steve Williams, in a July 2008 affidavit in a case in the courts of Kansas:

> Grand River is a Canadian company with its principal place of business on the Grand River Reservation in Canada. Grand River produces and packages Seneca® cigarettes for Native Wholesale Supply ("NWS") and Tobaccoville, USA, Inc. ("Tobaccoville") pursuant to a limited use license and manufacturing agreement. The Seneca® cigarettes produced by Grand River for NWS and Tobaccoville are, and have been, sold at all times on an F.O.B. basis, with title and risk of loss transferring to these third parties at Grand River's facility in Ohsweken, Canada. These cigarettes have been at all times produced, packaged, and shipped under the strict instruction and requirements of NWS and Tobaccoville.[132]

Claimants allege that they "decided together" to adopt the "corporate structure" of "Grand River for manufacturing and NTD/NWS for distribution" in part "to minimize

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[127] Arthur Montour Statement ¶ 14.

[128] *See* List of NWS, NTD Purchasers, 1997 to Present (Claimants' Document Production, Vol. 4, Tab 4).

[129] Memorandum in Support of Motion for Relief from Judgment at 26 (Feb. 6, 2007) (Defendant's Motion to Vacate Judgment, *South Dakota v. Grand River Enters., Inc*. (6th Jud. Cir S.D. 2007) (Civ. No. 01-465).

[130] *Id*. at 24.

[131] *Id*. at 26.

[132] Affidavit of Steve Williams in Support of Defendant's Motion to Dismiss or for a Stay ¶ 15, *Kansas v. Grand River Enters. Six Nations, Ltd.* (D.C. Kan. 2008) (Case No. 08C207).

their tax liability."[133] As stated by Joseph Isenbergh, Harold J. and Marion F. Green Professor of Law at the University of Chicago Law School, "[t]he only way Grand River Enterprises can remain beyond the reach of U.S. taxation within the framework of the Internal Revenue Code and the Canada-U.S. [tax] treaty is if Grand River's relationship to NTD/NWS and Tobaccoville falls outside the bounds of any form of partnership or joint venture."[134]

VII. In 2002, Grand River Entered Into A "Cigarette Production Agreement" With Its Off-Reservation Distributor, Tobaccoville USA, Inc.

In 2002, Grand River entered into a "Cigarette Production Agreement" with Tobaccoville USA, Inc. ("Tobaccoville"). Under that agreement, Grand River is obligated to produce Seneca brand cigarettes "in such versions and packaging and in such quantities and at such times as per the written request" of Tobaccoville.[135] The Seneca brand cigarettes "shall be produced using the tobacco blends and packaging as designed by" Tobaccoville.[136] As stated by the President of Tobaccoville, Larry Phillips, Grand River "manufactures Tobaccoville's off-reservation Seneca brand cigarettes according to blend specifications and ingredients provided by Tobaccoville . . . Tobaccoville has at all times provided the blend specifications for the off-reservation Seneca cigarettes to GRE."[137] Under the Cigarette Production Agreement, Grand River is

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[133] Mem. ¶ 111.

[134] Isenbergh Report ¶ 37.

[135] Cigarette Production Agreement ¶ 1.

[136] Cigarette Production Agreement ¶ 1.

[137] Affidavit of Larry Phillips ¶ 3, *Tobaccoville USA, Inc. v. Henry D. McMaster*, (S.C. Admin. L. Ct. Oct. 11, 2007) (2007-ALJ-30-0198-CC) ("Phillips South Carolina Aff.").

obligated to deliver the Seneca brand cigarettes to a Foreign Trade Zone in the United States, as designated by Tobaccoville prior to each delivery.[138]

The Cigarette Production Agreement grants Tobaccoville a "limited license" to use the Seneca brand name "for the sole purpose of importation and distribution" of Seneca brand cigarettes under the Agreement.[139] The agreement also grants Tobaccoville an exclusive right to import and sell Seneca brand cigarettes in the United States "off of Native Territories," so long as Tobaccoville maintains certain minimum order levels.[140] As stated by Mr. Phillips in a case in the courts of South Carolina, "Since 2002, Tobaccoville has been the exclusive first importer and distributor of off-reservation Seneca cigarettes sold in the United States."[141] As further stated by Mr. Phillips in that case:

> All of GRE's sales to Tobaccoville take place in Canada, and Tobaccoville takes delivery of the cigarettes in Canada . . . . [Tobaccoville then imports the cigarettes] into the United States, where they are resold. GRE does not sell any cigarettes in the United States, and has no input into where sales are made, to whom, in what volumes, or the pricing.[142]

According to Claimants, Grand River shared a "further understanding" with Tobaccoville, specifically that Tobaccoville would limit the number of states in which the Seneca cigarettes would be sold.[143] As part of this plan, Grand River began, early in 2003, "to come into compliance with a select group of Settling States' Escrow Statutes on a without prejudice basis," namely North Carolina, South Carolina, Oklahoma, Arkansas,

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[138] Cigarette Production Agreement ¶ 3.

[139] Cigarette Production Agreement ¶ 8.

[140] Cigarette Production Agreement ¶ 11.

[141] Phillips South Carolina Aff. ¶ 2.

[142] Phillips South Carolina Aff. ¶ 14.

[143] Mem. ¶ 69.

and Georgia.[144] Grand River sought to limit the number of states in which Seneca brand cigarettes would be sold in order to obtain refunds under the original allocable share release provision and thereby reduce its net escrow payments.[145]

In at least one of the five states targeted by Grand River for its off-reservation sales, South Carolina, Tobaccoville sought to be designated as the "Tobacco Product Manufacturer" for Seneca brand cigarettes sold in the state. An importer cannot qualify as a "Tobacco Product Manufacturer" under the escrow statutes *unless*: (i) the manufacturer does not intend to sell the cigarettes in the United States, whether through an importer or otherwise, and (ii) the importer is the "first purchaser" of the cigarettes "for resale in the United States."[146]

In November 2003, the South Carolina Office of the Attorney General initially stated that South Carolina was willing, under its escrow statute, to accept Tobaccoville as the "Tobacco Product Manufacturer," based on certain information that had been provided by Mr. Phillips to the Attorney General's Office. The information included the following: (i) Tobaccoville obtains the Seneca tobacco blend from a North Carolina company "which cannot sell that blend to another company"; (ii) Tobaccoville supplies the blend and packaging materials to Grand River for assembly; (iii) Tobaccoville's name appears on the packaging; and (iv) Tobaccoville notifies Grand River of the supply of cigarettes needed, and Grand River does not supply the same Seneca brand to another

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[144] Mem. ¶ 70.

[145] Mem. ¶ 69.

[146] *See, e.g.*, OKLA. STAT. tit. 37, § 600.22(9)(b); GA. CODE ANN. § 10-13-2(9)(B); N.C. GEN. STAT. § 66-290(9)(b); S.C. CODE ANN. § 11-47-20(i)(2); ARK. CODE ANN. § 26-57-260(9)(A)(ii).

company.[147] In addition, based on information provided by Mr. Phillips, South Carolina understood that "although Grand River produces Seneca blend cigarettes for a tribal owned tobacco company, the cigarettes do not contain the same tobacco blend or packaging as those marketed by Tobaccoville and they are not sold off reservation[.]"[148] Tobaccoville later confirmed the accuracy of South Carolina's understanding concerning Tobaccoville's operations related to the Seneca brand.[149]

South Carolina subsequently determined, however, that for Seneca brand cigarettes, Tobaccoville does not qualify as the "Tobacco Product Manufacturer" under the escrow statute because, first, Grand River intends for its cigarettes to be sold in the United States, and second, Tobaccoville, which is not the sole U.S. importer of Senecas, cannot be characterized as the "first purchaser anywhere for resale" for the Seneca brand in the United States.[150]

VIII. Grand River's Sales To NTD/NWS And Tobaccoville Increased From 2003 To 2006

Based on sales figures provided by Claimants, Grand River's sales to NTD/NWS increased annually from 2003 to 2006,

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[147] Letter from J. Emory Smith, Jr., Assistant Deputy Attorney General, State of South Carolina Office of the Attorney General, to Larry C. Phillips, Tobaccoville, USA, Inc. at 1 (Nov. 26, 2003).

[148] *Id*.

[149] *See* Letter from Leonard Violi to J. Emory Smith, Jr., Assistant Deputy Attorney General, State of South Carolina Office of the Attorney General at 1 (Apr. 12, 2004).

[150] *See* Answer to Petition at 2-3, *Tobaccoville USA, Inc. v. Henry D. McMaster* (S.C. Admin. L. Ct., July 6, 2007) (07-ALJ-30-0198-CC).

GRAND RIVER: TOTAL U.S. SALES TO NTD/NWS AND TOBACCOVILLE 2003-2006 (by volume)[151]

YEAR	GRE TO NTD/NWS	GRE TO TOBACCOVILLE	TOTAL GRE SALES TO NTD/NWS AND TOBACCOVILLE
2003			
2004			
2005			
2006			

Grand River has not produced sales volume information for 2007, but as the Expert Report of Navigant Consulting, Inc. ("Navigant Report") explains, Grand River's 2007 sales revenue data reveal similar trends. While revenue from sales to Tobaccoville decreased in 2007, it remained higher than in 2003. Moreover, revenue from sales to NWS increased significantly in 2007, causing Grand River's overall US sales revenue to increase from the previous year.[152]

IX. Grand River's Financial Performance Has Improved Consistently From 1999-2005 And Has Remained Strong Thereafter

Since it decided to begin exporting Seneca brand cigarettes to the United States in 1999, Grand River's financial performance, including gross sales, net sales, and gross margin, improved annually through 2005. Net income also has increased each year, with the exception of the year 2000.

[151] Claimants' Document Production, Vol. 1, Tabs E-H (Sales to Native Tobacco Direct, Native Wholesale Supply, and Arthur Montour: 2003-2006); Claimants' Document Production, Volume 2, Tabs B-E (Sales to Tobaccoville, Inc.: 2003-2006).

[152] Expert Report of Navigant Consulting, Inc. ¶¶ 47-48 (Dec. 22, 2008) ("Navigant Report").

[153] Grand River's financial performance from 1999 to 2005 is as follows:

FINANCIAL PERFORMANCE: GRAND RIVER ENTERPRISES (CAD$)[154]

YEAR	GROSS SALES	NET SALES	GROSS MARGIN	NET INCOME	MANAGEMENT BONUS
1999					
2000					
2001					
2002					
2003					
2004					
2005					
2006	*Data not produced by Claimants*				
2007	*Data not produced by Claimants*				

Claimants have not produced Grand River's financial statements for 2006 or 2007. As Navigant Consulting, Inc. ("Navigant") explains, however, based upon a review of the data Claimants have provided thus far, Grand River's overall business remained strong. Declining sales in Canada and to Tobaccoville in 2007 were offset by a significant increase in sales to NWS that same year.[155]

[153] Claimants' Document Production, Vol. 5, Tabs 12(E) at 4 and 12(H) at 4; *see also* Navigant Report ¶¶ 49-50. Navigant has concluded that certain adjustments to Grand River's financial data are necessary in order to reflect the fact that a portion of the "management bonuses" should be treated as retained earnings.

[154] Claimants' Document Production, Vol. 5, Tabs 12(C)-12(H).

[155] Navigant Report ¶¶ 47-48.

X. Native Wholesale Supply Distributes Millions Of Seneca Brand Cigarettes In States In Which Grand River Is Not Listed On The State Tobacco Directory, In Violation Of State Complementary Legislation

As illustrated by recent state actions against NWS by California, Idaho, New Mexico, and Oklahoma, millions of Seneca brand cigarettes have been sold in multiple states where Grand River does not appear in the state tobacco directory, thereby violating state complementary legislation.

As alleged in the California complaint, NWS has been selling "tens of millions" of Grand River-manufactured cigarettes each year to businesses in California, which is unlawful under California's complementary legislation because Grand River has never been listed on California's tobacco directory.[156] California also alleges that NWS has been violating federal law "by shipping cigarettes in interstate commerce to persons or entities in California that are not licensed as cigarette distributors" in California and failing to report such shipments to the State.[157] California further alleges that NWS' actions violate multiple injunctions issued by California courts, which enjoin Grand River from selling any cigarettes in California either directly or through an intermediary.[158] California seeks to enjoin NWS from selling "any cigarettes whose brand family and manufacturer are not listed on the California tobacco directory[.]"[159]

Concerning NWS' shipments of cigarettes in interstate commerce, California alleges that NWS has shipped or caused to be shipped Grand River-manufactured cigarettes from a Foreign Trade Zone ("FTZ") in Las Vegas, Nevada to

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[156] Complaint for Injunction, Civil Penalties, Contempt and Other Relief at 1-2, *California v. Native Wholesale Supply Co*. (Cal. Super. Ct. Jun. 30, 2008) (07-ALJ-30-0198-CC).

[157] *Id*. at 2.

[158] *Id*.

[159] *Id*. at 11.

California further alleges that sell to non-Indians Grand River-manufactured cigarettes purchased from NWS, and that NWS knows or should know that such sales are being made.[162]

According to California, NWS has shipped or caused to be shipped into California at least the following amounts of Grand River-manufactured cigarettes:

NWS SHIPMENTS OF GRAND RIVER-MANUFACTURED CIGARETTES INTO CALIFORNIA (2004-2008)

Year	Number of Cigarettes Shipped
2004	
2005	
2006	
2007	
2008	

As illustrated by the above figures,[163] shipments of Grand River-manufactured cigarettes by NWS into California have increased annually from 2004 to 2007, and are on pace to continue to increase in 2008.

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[160] *Id*. at 4.

[161]

[162] Complaint for Injunction, Civil Penalties, Contempt and Other Relief at 5-6, *California v. Native Wholesale Supply Co*. (Cal. Super. Ct. Jun. 30, 2008) (07-ALJ-30-0198-CC).

[163] The figure for NWS sales into California through July 30, 2008 is taken from paragraph 16 of the Declaration of Dennis Eckhart, Head of California Attorney General's Tobacco Litigation and Enforcement Section (Dec. 18, 2008) ("Eckhart Declaration"). The California complaint lists NWS sales into California through May 14, 2008. *See* Complaint for Injunction, Civil Penalties, Contempt and Other Relief, *supra* note 156, at 4.

As confirmed by Dennis Eckhart, the head of the California Attorney General's Tobacco Litigation and Enforcement Section, virtually all of NWS' shipments from the Las Vegas FTZ into California have been to , and virtually all of NWS' sales to "ultimately were re-sold to non-members of the governing tribe, resulting in substantial off-reservation effects."[164]

In addition, as stated by Mr. Eckhart, "the Seneca cigarettes shipped at NWS' direction from the FTZ to . . . travel hundreds of miles across off-reservation territory in California before reaching their destination."[168]

Like California, Idaho recently brought an action against NWS concerning shipments of Grand River-manufactured cigarettes from the Las Vegas FTZ to businesses

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[164] Eckhart Declaration ¶¶ 10, 22. *See also* Eckhart Declaration, Exh. A - Declaration of Vincent Buehler ¶ 13, *California v. Native Wholesale Supply Company* (E.D. Cal. Sept. 19, 2008) (2:08-CV-01827-LKK-KJM).
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[165] Navigant Report, app. H (citing NAV-20); *see also* Eckhart Declaration ¶ 19

[166] Eckhart Declaration ¶ 19.

[167] Navigant Report ¶ 73.

[168] Eckhart Declaration ¶ 22.

located on reservations within the state,

[169]

[170]

Because Grand River is not listed on the state's Tobacco Directory, Idaho asserts that NWS' shipments of Grand River-manufactured cigarettes into Idaho violates the state's complementary legislation.[171] Idaho also asserts that NWS' actions violate a court judgment enjoining Grand River from selling any cigarettes within the state, whether directly or through an intermediary, because NWS has acted as an intermediary for Grand River with knowledge of the injunction.[172] According to Mr. DeLange, over 82% of non-compliant cigarette sales in the State of Idaho are attributable to shipments of Grand River-manufactured cigarettes from NWS.[173]

As stated by Mr. DeLange, "Grand River and Native Wholesale [Supply] are the only Native American-owned entities that have chosen to violate Idaho law and seek to distribute and sell their products without complying with Idaho's Tobacco Acts."[174] As further stated by Mr. DeLange, "Outside of Grand River and Native Wholesale, the State's relations with tobacco businesses owned by Native Americans has fundamentally been amicable and productive."[175] Mr. DeLange identifies five examples of tobacco businesses owned by Native Americans which are certified on Idaho's Tobacco

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[169] DeLange Declaration ¶¶ 21-22.

[170] DeLange Declaration ¶ 22.

[171] Verified Complaint ¶ 44, *Idaho v. Native Wholesale Supply Co*. (Idaho Dist. Ct. Aug. 14, 2008) (No. CV 0C 0815228).

[172] *Id*. ¶ 15.

[173] DeLange Declaration ¶ 27.

[174] DeLange Declaration ¶ 34.

[175] DeLange Declaration ¶ 31.

Directory: Native Trading Associates, King Mountain Tobacco Co., Inc., Skookum Creek Tobacco, Seneca Cayuga, and Smokin Joes.[176]

According to Idaho, NWS has imported, or caused to be imported, Grand River-manufactured cigarettes for sale and distribution in Idaho. The volume of such shipments has been as follows:

NWS SHIPMENTS OF GRAND RIVER-MANUFACTURED CIGARETTES INTO IDAHO (2004-2008)[177]

Year	Number of Cigarettes Shipped
2004	
2005	
2006	
2007	
2008	

[178]

[179]

[180]

[176] DeLange Declaration ¶¶ 31-33.

[177] Verified Complaint ¶ 30, *Idaho v. Native Wholesale Supply Co*. (Idaho Dist. Ct. Aug. 14, 2008) (No. CV 0C 0815228)

[178] DeLange Declaration ¶¶ 22, 29.

[179] DeLange Declaration ¶ 29.

[180] Navigant Report ¶ 73, n.68, app. H (citing NAV-20).

American resident per day.[181]

New Mexico also has brought an action against NWS concerning NWS' shipments of Grand River-manufactured cigarettes from the Las Vegas FTZ into the state, where Grand River does not appear on New Mexico's Tobacco Directory.[182] New Mexico previously had obtained a judgment against NWS for such shipments, which remains unpaid.[183]

According to New Mexico, NWS has shipped or caused to be shipped into New Mexico at least the following amounts of Grand River-manufactured cigarettes:

NWS SHIPMENTS OF GRAND RIVER-MANUFACTURED CIGARETTES INTO NEW MEXICO (2004-2008)[184]

Year	Number of Cigarettes Shipped
2004	
2005	
2006	
2007	
2008	

185

[181] Navigant Report ¶73.

[182] Complaint for Injunctive Relief, Civil Penalties, Contempt and Other Relief at 1-2, *New Mexico v. Native Wholesale Supply Co.* (N.M. Dist. Ct. Aug. 12, 2008) (No. D-101-CV-2008-02236) ("New Mexico Complaint").

[183] New Mexico Complaint at 2 (citing *New Mexico v. Native Wholesale Supply Co.*, First Judicial District Court Cause No. D-101-CV-2005-02823).

[184] New Mexico Complaint ¶¶ 11-12.

[185] New Mexico Complaint ¶ 10; Declaration of David K. Thomson ¶ 3 (Dec. 9, 2008) ("Thomson Declaration")

[186]

[187]

[188]

[189]

[190]

[191]

Oklahoma also has brought an action against NWS concerning the company's shipments of Grand River-manufactured cigarettes into the state, because Grand River does not appear on Oklahoma's Tobacco Directory.[192] According to Oklahoma, from approximately February 2007 through May 2008, NWS shipped approximately

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[186] New Mexico Complaint ¶¶ 20-22.

[187] New Mexico Complaint ¶¶ 23-24.

[189] *See* Navigant Report ¶ 73, n.68, app. H (citing NAV-20).

[190] Navigant Report ¶ 73.

[191] New Mexico Complaint ¶ 25.

[192] *See* Petition ¶¶ 1, 9-10, *Oklahoma v. Native Wholesale Supply Co*. (Okla. Dist. Ct.) (No. CIV-08-818-D).

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* * *

Several tobacco product manufacturers, including Grand River, have challenged the MSA and its related measures in U.S. courts under U.S. law. No U.S. court has held that the MSA or any of its related measures violate U.S. law.[195]

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[193] *Id*. ¶ 10.

[195] *See, e.g*., *KT&G Corp. v. Att'y Gen. of Oklahoma*, 535 F.3d 1114 (10th Cir. 2008) (affirming decisions of Kansas and Oklahoma courts, which dismissed claims alleging that the Kansas and Oklahoma allocable share amendments violate the Sherman Act and the U.S. Constitution); *Tritent Int'l Corp. v. Kentucky*, 467 F.3d 547 (6th Cir. 2006) (affirming dismissal of claims alleging that Kentucky escrow statute and complementary legislation were preempted by the Sherman Act); *Freedom Holdings v. Spitzer*, 408 F.3d 112 (2d Cir. 2005) (affirming denial of preliminary injunction against enforcement of New York escrow statute and complementary legislation); *Star Scientific v. Beales*, 278 F.3d 339 (4th Cir. 2002) (affirming dismissal of claims alleging that the MSA violated the Compact Clause, and that the Virginia escrow statute violated the Due Process, Equal Protection, and Commerce Clauses, of the U.S. Constitution); *Grand River Enters. Six Nations, Ltd. v. Beebe*, 418 F. Supp. 2d 1082 (W.D. Ark. 2006) (Arkansas allocable share amendment did not violate the Sherman Act, the First Amendment, the Due Process Clause, the Equal Protection Clause, the Commerce Clause, or the Supremacy Clause); *Omaha Tribe of Nebraska v. Miller*, 311 F. Supp. 2d 816 (S.D. Iowa 2004) (dismissing Indian Commerce Clause challenge to Iowa escrow statute by cigarette manufacturer owned by Indian tribe); *Sanders v. Lockyer*, 365 F. Supp. 2d 1093 (N.D. Cal. 2005), *aff'd*, 504 F.3d 903 (9th Cir. 2007), *cert. denied*, 128 S. Ct. 2427 (May 12, 2008) (affirming dismissal of claims alleging that the MSA, escrow statutes, and complementary legislation were preempted by the Sherman Act); *Mariana v. Fisher*, 226 F. Supp. 2d 575 (M.D. Pa. 2002), *aff'd on other grounds*, 338 F.3d 189 (3d Cir. 2003), *cert. denied sub nom. Mariana v. Pappert*, 540 U.S. 1179 (2004) (dismissing claims alleging that the MSA violated the Compact and Commerce Clauses and that the MSA and escrow statutes violated the Sherman Act).

ARGUMENT

I. JURISDICTION

Claimants fail to meet fundamental jurisdictional requirements for claims brought under Chapter Eleven. Under Article 1101, Claimants Grand River, Jerry Montour, and Kenneth Hill do not qualify as "investors" because they have failed to establish that they seek to make, are making, or have made an investment in the United States, and the challenged escrow statutes (in both their original and amended form) do not "relate to" the remaining Claimant, Arthur Montour, Jr., whose distribution companies are not subject to escrow obligations under those measures. Claimants also fail to address Article 2103, which limits the scope of challenges that can be brought against tax measures under NAFTA Chapter Eleven. Because Claimants fail to address whether the Michigan equity assessment statute falls within an exception under Article 2103, their challenge to that measure under Article 1102 and Article 1103 should be dismissed. Accordingly, the above claims should be dismissed for lack of jurisdiction.

Grand River manufactures Seneca cigarettes in Canada for export to the United States, where the cigarettes are distributed on-reservation by NTD/NWS and off-reservation by Tobaccoville. Claimants allege no financial interest in NTD/NWS or Tobaccoville held by Grand River, Jerry Montour, or Kenneth Hill, no profit sharing between Grand River and Tobaccoville or NTD/NWS,[196] and no common ownership of assets between Grand River and Tobaccoville or NTD/NWS. Rather, Grand River

[196] Claimants allege that in 1999 they "agreed on a basic formula to provide all parties with a share of the revenues from our Seneca® investment." Witness Statement of Jerry Montour ¶ 26 (July 9, 2008) ("Jerry Montour Statement"). But as alleged by Claimants, such "sharing" of revenues consisted of nothing more than Grand River earning profits on its sales of Seneca cigarettes to NTD/NWS, and NTD/NWS earning profits on their sales of Seneca cigarettes to on-reservation dealers. *See id.* ¶ 26. Claimants also refer to "consulting fees" to be paid by NTD/NWS to "some" Grand River shareholders, *see id.* ¶ 26, but do not address how such fees would be tied to profits from sales of Seneca cigarettes.

exports Seneca cigarettes to the United States, and Tobaccoville and NTD/NWS import Seneca cigarettes into the United States.

Recognizing that the mere export of goods to the United States does not meet jurisdictional requirements under NAFTA Article 1101(1), Claimants allege that Grand River and NTD/NWS are "corporate branches" of a larger enterprise aimed at the development of the Seneca brand in the United States.[197]

But the only documentary evidence provided by Claimants in support of such an enterprise is a "Tobacco Manufacturing Agreement" between Grand River and NTD (the predecessor of NWS), which merely outlines the terms by which Grand River would export Seneca cigarettes to NTD. Those terms include a "limited license" for Grand River to use the Seneca brand *solely for the purpose of* manufacturing and delivering Seneca cigarettes to NTD pursuant to the manufacturing agreement. Claimants cite no language from that manufacturing agreement establishing some parent enterprise aimed at developing the Seneca brand in the United States.

Further undermining the existence of Claimants' alleged U.S. parent enterprise are representations made by Grand River in multiple U.S. judicial proceedings, to the effect that Grand River merely sells Seneca cigarettes "F.O.B. Canada" to "third-party distributors," at which point Grand River loses all control over any subsequent distribution and/or sale of the cigarettes.

Moreover, Claimants in this case characterize Tobaccoville as a mere "third-party distributor,"[198] and thus fail to include their off-reservation sales within their alleged U.S. enterprise. Claimants have shown no investment by Grand River in the United States,

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[197] Mem. ¶ 111.

[198] *Id.* ¶ 206 and n.257.

and thus the claims brought by Grand River and two of its shareholders, Jerry Montour and Kenneth Hill, should be dismissed in their entirety for failure to meet Article 1101(1) requirements.

With respect to Claimant Arthur Montour, Jr., although his distribution companies (NTD/NWS) are based in the United States, the challenged escrow statutes (in both their original form and as amended) do not "relate to" Arthur Montour, Jr. or NTD/NWS, as required by Article 1101, because NTD/NWS are not subject to deposit obligations under the escrow statutes. Accordingly, Claimant Arthur Montour, Jr.'s claim arising from the escrow statutes (whether in their original form or as amended) should be dismissed for failure to meet Article 1101 requirements.

Unlike the escrow statutes, which apply only to Tobacco Product Manufacturers as defined under the statutes, the complementary legislation applies to, among others, any person who imports cigarettes that the person knows or should know are intended for distribution or sale in violation of the statute.[199] Thus, the complementary legislation applies to NTD/NWS, and those measures "relate to" the owner of those companies, Arthur Montour, Jr. But as discussed in the merits section below, the complementary legislation does not breach any Chapter Eleven obligations.

A. Claimants Fail To Meet Jurisdictional Requirements Under Article 1101(1)

The scope of NAFTA Chapter Eleven is set forth in Article 1101(1). That Article provides, in relevant part:

> **Article 1101: Scope and Coverage**
>
> 1. This Chapter applies to measures adopted or maintained by a Party relating to:

[199] *See* n. 69, *supra*.

(a) investors of another Party;

(b) investments of investors of another Party in the territory of the Party[.]

No claim for breach of a Chapter Eleven obligation may be submitted to arbitration unless the fundamental jurisdictional prerequisites under Article 1101(1) are established. As the tribunal in the *Methanex* case stated, Article 1101(1) is "the gateway leading to the dispute resolution provisions of Chapter 11. Hence the powers of the Tribunal can only come into legal existence if the requirements of Article 1101(1) are met."[200]

Article 1101(1) imposes two separate jurisdictional requirements. *First*, NAFTA Chapter Eleven applies only to *investors* of another NAFTA Party or their *investments*. As Article 1101(1)(b) expressly states, the only "investments" covered by Chapter Eleven are those of "investors of another Party *in the territory of the Party*" that has adopted or maintained the challenged measures.[201] The only "investors" covered by Chapter Eleven are those who are seeking to make, are making, or who have made an investment in another Party.[202]

Second, Article 1101(1) requires that the measures at issue in an arbitration, which have been adopted or maintained by a Party, "relate to" the investor or investment.

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[200] *Methanex Corp. v. United States*, NAFTA/UNCITRAL, First Partial Award ¶ 106 (Aug. 7, 2002) ("*Methanex v. United States*, First Partial Award").

[201] NAFTA art. 1101(1)(b) (emphasis added). *See also Bayview Irrigation District v. United Mexican States*, ICSID Case No. ARB(AF)/05/1, Award ¶ 105 (June 19, 2007) ("*Bayview v. Mexico*, Award") ("It is clear that the words 'territory of the Party' [in Article 1101(1)(b)] do not refer to the territory of the Party of whom the investors are nationals. [The phrase] requires investment in the territory of another NAFTA Party.").

[202] *See* NAFTA art. 1139 (defining "investor of a Party" as a national or enterprise of a Party "that seeks to make, is making, or has made an investment"); *Bayview v.Mexico*, Award ¶ 101 (in order to qualify as an "investor" under Articles 1101(1) and 1139, "an enterprise must make an investment in another NAFTA State, and not in its own").

As stated by the *Methanex* tribunal, the "relating to" language under Article 1101(1) requires a "legally significant connection" between a challenged measure and the investor or investment.[203]

The negative impact of a challenged measure on a claimant, without more, does not satisfy the "legally significant connection" standard. As stated by the *Bayview* tribunal:

> The simple fact that an enterprise in one NAFTA State is affected by measures taken in another NAFTA State is not sufficient to establish the right of that enterprise to protection under NAFTA Chapter Eleven: it is the relationship, the legally significant connection, with the State taking those measures that establishes the right to protection, not the bare fact that the enterprise is affected by the measures.[204]

In *Methanex*, the challenged measures applied to the gasoline oxygenate MTBE, but did not apply to the particular components of MTBE, including methanol.[205] The claimant, Methanex, manufactured methanol. The tribunal found that the claimant's allegations, as originally set forth in its notice of arbitration, did not establish a legally significant connection between the claimant's investment and the challenged measures, notwithstanding the alleged negative impact of the challenged measures on the investment. Thus, although an MTBE ban could negatively impact a manufacturer of MTBE components, the tribunal determined that such a nexus was insufficient to satisfy the "legally significant connection" standard.[206]

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[203] *Methanex v. United States*, First Partial Award ¶ 147.

[204] *Bayview v. Mexico*, Award ¶ 101.

[205] *Methanex v. United States*, First Partial Award ¶ 150.

[206] *See also Archer Daniels Midland Co. and Tate Lyle Ingredients Americas Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/04/05, Award ¶ 274 (Nov. 21, 2007) ("*ADM v. Mexico*, Award") (rejecting claim for lost profits on high-fructose corn syrup that the claimants would have produced in the United States, and exported to Mexico, but for the challenged Mexican tax measure) ("[t]he Tribunal has jurisdiction only to award compensation for the injury caused to Claimants in their investment made *in Mexic*o ….") (emphasis added); *S.D. Myers, Inc. v. Gov't of Canada*, NAFTA/UNCITRAL, Second Partial

As discussed below, Claimants Grand River, Jerry Montour, and Kenneth Hill do not qualify as "investors" under Article 1101(1) because they fail to support their bare allegations concerning the existence of an "investment" as defined under Article 1139, specifically their alleged U.S. parent enterprise aimed at the development of the Seneca brand in the United States. Such an enterprise would run directly contrary to Grand River's own representations in U.S. court proceedings, to the effect that Grand River merely sells Seneca cigarettes "F.O.B. Canada" to its "third-party distributors," NTD/NWS and Tobaccoville, and thereafter retains no control over the cigarettes.[207] Furthermore, Claimants do not even attempt to include Tobaccoville, and thus their off-reservation sales, within that alleged enterprise. The claims of Grand River, Jerry Montour, and Kenneth Hill should therefore be dismissed in their entirety for failure to meet Article 1101(1) requirements.

Likewise, the claim of Arthur Montour, Jr., to the extent that it challenges the escrow statutes (whether in their original form or as amended), should be dismissed for failing to meet Article 1101(1) requirements, given that those measures do not "relate to" his distribution companies, NTD/NWS, which are not subject to deposit obligations under the escrow statutes.

1. Claimants Fail To Include Tobaccoville, And Thus Their Off-Reservation Sales, Within Their Alleged Investment in the United States

Claimants' alleged "integrated commercial undertaking" to develop the Seneca brand in the United States does not include Tobaccoville, which Claimants

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Award ¶ 118 (Oct. 21, 2002) ("*S.D. Myers v. Canada*, Second Partial Award") (finding that a claimant under NAFTA Chapter Eleven can recover only those damages that result from "interference with [the claimant's] investment in the host state").

[207] *See* Facts Sec. VI.

characterize as a mere "third-party distributor."[208] Given Claimants' failure to include Tobaccoville within their alleged U.S. enterprise, and thus their failure to include their off-reservation sales within their alleged U.S. investment, the off-reservation claim should be dismissed for failure to meet Article 1101(1) requirements.

Grand River entered into a "Cigarette Production Agreement" with Tobaccoville, which set out the terms by which Grand River would manufacture Seneca cigarettes in Canada for distribution by Tobaccoville off-reservation in the United States. Under the Cigarette Production Agreement, Grand River is obligated to deliver Seneca brand cigarettes to a FTZ in the United States as designated by Tobaccoville prior to each delivery.[209] The Agreement grants Tobaccoville a "limited license" to use the Seneca brand name "for the sole purpose of importation and distribution" of Seneca brand cigarettes under the Agreement.[210] The Agreement further grants Tobaccoville an exclusive right to import and sell Seneca brand cigarettes in the United States "off of Native Territories," so long as Tobaccoville maintains certain minimum order levels.[211]

Nowhere do Claimants include Tobaccoville within their alleged "integrated commercial undertaking."[212] The lack of any corporate relationship between Grand River and Tobaccoville is further confirmed by the President of Grand River, who has asserted, when resisting jurisdiction in U.S. court

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[208] Mem. ¶ 206.

[209] Cigarette Production Agreement ¶ 3.

[210] *Id.* ¶ 8.

[211] *Id.* ¶ 11.

[212] Mem. ¶ 20.

proceedings, that Grand River has no affiliation with Tobaccoville "beyond the sale of its products" to the company.[213] Because Claimants do not include Tobaccoville within their alleged "integrated commercial undertaking," and thus do not include their off-reservation sales within their alleged investment in the United States, Claimants' off-reservation claim should be dismissed for failure to meet jurisdictional requirements under Article 1101(1).

2. Claimants' Bare Allegations Of A U.S. Parent Enterprise Aimed At The Development Of The Seneca Brand Should Be Rejected

Unlike their allegations with respect to Tobaccoville, Claimants do at least allege that NTD/NWS, and thus their on-reservation sales, are included within their purported investment in the United States. But Claimants' allegations of an "integrated commercial enterprise" between Grand River and NTD/NWS to develop the Seneca brand in the United States are unsupported by evidence and cannot be reconciled with the exact opposite representations made by Grand River in multiple U.S. judicial proceedings, to the effect that Grand River merely sells Seneca cigarettes "F.O.B. Canada" to "third-party distributors," at which point Grand River loses all control over the cigarettes. Accordingly, the claims of Grand River, Jerry Montour, and Kenneth Hill with respect to Grand River's on-reservation sales should be dismissed for failure to meet Article 1101(1) requirements.

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[213] Affidavit of Steve Williams in Support of Motion for Relief from Judgment ¶ 9 (Feb. 6, 2007) (Defendant's Motion to Vacate Judgment, *South Dakota v. Grand River Enters, Inc*. (6th Jud. Cir. S.D. 2007) (Civ. No. 01-465).

Grand River

Claimants allege that Grand River is a Canadian corporation, organized under the laws of Canada, whose principal office and production facility is located in Canada.[214] Claimants further allege that Grand River holds "exclusive U.S. manufacturing rights for the Seneca® brand."[215]

But Grand River manufactures Seneca cigarettes *in Canada*; the distribution and sale of those products in the United States is carried out by separate entities (NTD/NWS and Tobaccoville).[216] An enterprise does not qualify as an "investor" under Article 1101 merely by exporting goods to another NAFTA State; the enterprise must instead make an investment in that State.[217]

Recognizing that the mere export of goods to the host State does not satisfy Article 1101 requirements, Claimants allege that Grand River and NTD/NWS, while "legally distinct" entities, are in fact "corporate branches"[218] of a larger "formal venture" aimed at developing the Seneca brand in the United States.[219] As further characterized by Claimants, their tobacco-related

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[214] PSOC sec. D ¶ 1; Mem. ¶¶ 9, 13, 15; Jerry Montour Statement ¶ 2; Witness Statement of Kenneth Hill ¶ 2 (July 8, 2008) ("Kenneth Hill Statement").

[215] Mem. ¶ 22.

[216] PSOC sec. D ¶¶ 23-25; Mem. ¶ 22; Jerry Montour Statement ¶ 25; Arthur Montour Statement ¶¶ 20, 22.

[217] *See Bayview v. Mexico*, Award ¶ 101 (in order to qualify as an "investor" under Articles 1101(1) and 1139, "an enterprise must make an investment in another NAFTA State, and not in its own"); *ADM v. Mexico*, Award ¶ 273 (under Article 1101(1), Chapter Eleven protections apply only to "measures relating to investments of investors of one Party that are in the territory of the party that has adopted or maintained such measures").

[218] Mem. ¶ 111.

[219] Mem. ¶ 20. Claimants' varied characterizations of this "formal venture" include the following: a "vertically integrated enterprise," "constituted enterprise," "business enterprise," "investment enterprise," "U.S. business enterprise," "Seneca business venture," "business venture in the United States," "integrated commercial undertaking," "collective business venture," "relationship," "tobacco business," and "investment in the Seneca® brand." *See* Mem. ¶¶ 20, 5, 21, 23, 24, 26, 106, 101, 111, 114; Jerry Montour Statement ¶¶ 21, 36, 39.

"association and business arrangement" is "perhaps more common to Native American social norms than the formalistic rituals of European ("Western") business practice."[220]

But the NAFTA defines an "enterprise" not according to "formalistic rituals" but according to law, as "any entity *constituted or organized under applicable law* . . . including any corporation, trust, partnership, sole proprietorship, joint venture or other association."[221] Claimants allege that Grand River is organized "under the laws of Canada."[222] Claimants allege that NWS (formerly NTD) is organized "under the laws of the Sac and Fox Nation."[223] Claimants do not allege, however, that any parent enterprise of those purported "corporate branches" actually exists as a legal entity organized under any applicable law. To the contrary, Claimants in fact concede that such a parent enterprise has not been "evidence[d]" through any "written partnership agreement or formal parent-subsidiary corporate relationship."[224] Claimants' undocumented "venture" is not organized "under applicable law," and thus does not meet the definition of "enterprise" under NAFTA Article 201. Claimants cannot, therefore, establish an investment in the United States on the basis of such an "enterprise."

The only document produced by Claimants to support the existence of their purported venture is the 1999 Tobacco Manufacturing Agreement between

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[220] PSOC sec. D ¶ 10.

[221] NAFTA art. 201 (emphasis added).

[222] Mem. ¶ 9.

[223] *Id.* ¶ 9.

[224] *Id.* ¶ 118.

Grand River and NTD which, according to Claimants, "formalized" their "business plan."[225] Claimants also refer to an "almost identical" agreement between Grand River and NWS allegedly signed in 2000, but Claimants have not produced that document in this arbitration.[226] Claimants cite no language from either agreement in support of their purported venture.

The 1999 agreement, which concerns the manufacture and sale of tobacco products by Grand River to NTD, does not evidence the existence of a parent enterprise for which Grand River and NTD/NWS serve as "corporate branches." By its very title, the 1999 agreement is a "Cigarette Manufacturing Agreement,"[227] which Grand River has characterized as a "limited use license and manufacturing agreement."[228]

The "license" accorded to Grand River under the manufacturing agreement is merely a license to use the Seneca brand "for the sole purpose" of manufacturing and delivering the cigarettes to NTD pursuant to the agreement.[229] Such a "limited use license" in no way establishes Grand River's alleged "joint"

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[225] Arthur Montour Statement ¶ 14. Notably, in their response to U.S. discovery requests seeking "[a]ny documents concerning business plans or strategies prepared for or by Grand River, Native Tobacco Direct or Native Wholesale Supply since January 1, 1997," Claimants asserted that "Claimants do not have formal, written documents that recite the business plans or strategies." *See* Request for Production of Documents of Respondent United States of America at 4 (Jan. 22, 2007); Index to Document Production, Vol. Four, Document No. 11 (June 20, 2007).

[226] Claimants repeatedly cite to an Exhibit 17 in support of their "formal venture" allegation, *see, e.g.*, Mem. ¶ 21 (citing Exhibit 17 in support of assertion that Claimants had "adopt[ed] a corporate structure" and concluded "written agreements" with respect to the possession and use of intellectual property rights supporting their cigarette brands); Mem. ¶ 22 (citing Exhibit 17 when referring to Claimants' "express cross-licensing arrangement"). But in Claimants' Table of Exhibits, Exhibit 17 is identified as "Intentionally Blank."

[227] Cigarette Manufacturing Agreement, *see* n. 115, *supra*.

[228] Affidavit of Steve Williams in Support of Motion for Relief from Judgment ¶ 6 (Feb. 6, 2007) (Defendant's Motion to Vacate Judgment, *South Dakota v. Grand River Enters, Inc*. (6th Jud. Cir. S.D. 2007) (Civ. No. 01-465).

[229] Cigarette Manufacturing Agreement ¶ 8.

control over the Seneca brand,[230] much less the existence of a U.S. parent enterprise for which Grand River and NTD/NWS purportedly serve as corporate branches. Notably, Tobaccoville similarly was granted a "limited license" to use the Seneca brand name under its Tobacco Production Agreement with Grand River, but Claimants do not include Tobaccoville within their purported enterprise.

Furthermore, Claimants' own assertions in U.S. domestic court proceedings undermine any claim that Grand River and NTD/NWS serve as "corporate branches" of some larger enterprise to develop the Seneca brand in the United States. In those actions, Grand River is at pains to show that it is merely a foreign manufacturer and exporter that has no commercial business venture in the United States. Simply put, Grand River's characterizations of its relationship with NTD/NWS seem in fact to depend entirely on whether Grand River is seeking to establish, or to contest, jurisdiction in a particular case:

- When contesting jurisdiction before U.S. judicial authorities, Grand River does not allege, as Claimants do here, that the manufacturing agreements between Grand River and NTD/NWS constitute "cross-licensing arrangements effectively granting all Claimants joint and several control over" the Seneca brand;[231] rather, Grand River characterizes the contract between Grand River and NTD/NWS as a "limited use license and manufacturing agreement."[232]

- When contesting jurisdiction, Grand River does not allege that NTD/NWS operate as "the US marketing and distribution facility for Claimants' Seneca®

[230] Mem. ¶ 22.

[231] *Id.* ¶ 105.

[232] Affidavit of Steve Williams in Support of Motion for Relief from Judgment ¶ 6 (Feb. 6, 2007) (Defendant's Motion to Vacate Judgment, *South Dakota v. Grand River Enters, Inc*. (6th Jud. Cir. S.D. 2007) (Civ. No. 01-465); Memorandum of Law in Support of Defendant's Motion to Dismiss or For a Stay at 5, *Kansas v. Grand River Enters. Six Nations, Ltd.*, (D.C. Kan. July 18, 2008) (Case No. 08C207); Affidavit of Steve Williams in Support of Defendant's Motion to Dismiss or for a Stay, *Kansas v. Grand River Enters. Six Nations, Ltd.* (D.C. Kan. 2008) (Case No. 08C207).

business venture";[233] rather, Grand River asserts that it sells all of its cigarettes "F.O.B. Ontario to third parties," at which point Grand River loses "all control over the cigarettes."[234]

- When contesting jurisdiction, Grand River does not allege that Arthur Montour holds the Seneca trademark for the benefit of Grand River, Jerry Montour, and Kenneth Hill;[235] rather, Grand River asserts that the sale of its products in the United States is "completely within the control of third parties or other parties even farther down the distribution chain and more remote from Grand River."[236]

- When contesting jurisdiction, Grand River does not allege that NTD/NWS are required to consult with GRE "before making important strategic decisions about marketing and distribution of the Seneca® brand";[237] rather, Grand River asserts that once it ships Seneca tobacco products to NTD/NWS and Tobaccoville, "the third parties have the power to do with them as they wish and send them anywhere in the world."[238]

Furthermore, Claimants' own expert in this case, Professor Clinton, directly contradicts Claimants' allegations of an "integrated commercial enterprise" existing between Grand River and NTD/NWS. Professor Clinton states:

> As to the actions of the Haudenosaunee Claimants/Investors in manufacturing and selling cigarettes and other tobacco products (sold FOB the Six Nations Reserve in Canada) on-reserve in Canada to *third parties* . . . who then import them into the United States and *sell them under their own label*, the law could not be clearer that no state had authority to project its regulatory or tax laws outside its borders (and outside the borders of the United States) to reach *manufacturing and sales activities occurring*

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[233] Mem. ¶ 26.

[234] Defendant's Motion to Vacate Judgment at 24, *South Dakota v. Grand River Enters., Inc.* (6th Jud. Cir. S.D. Feb. 6, 2007) (Civ. No. 01-465).

[235] Mem. ¶ 21.

[236] Defendant's Motion to Vacate Judgment at 24, *South Dakota v. Grand River Enters., Inc.* (6th Jud. Cir. S.D. Feb. 6, 2007) (Civ. No. 01-465).

[237] Mem. ¶ 113.

[238] Defendant's Motion to Vacate Judgment at 26, *South Dakota v. Grand River Enters., Inc.* (6th Jud. Cir. S.D. Feb. 6, 2007) (Civ. No. 01-465).

> *completely within the nation of Canada* and outside of the jurisdiction of both the United States and any state thereof.[239]

The transactions described by Claimants above, in which Grand River sells cigarettes F.O.B. Canada to "third parties" (NTD/NWS), which import the cigarettes into the United States and "sell them under their own label," reflect ordinary commercial transactions for the sale of goods. Such transactions are expressly excluded from the definition of "investment" under Article 1139: "investment does not mean . . . claims to money that arise solely from . . . commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party." Here, the manufacturing agreements relied on by Claimants provide for the sale of goods (cigarettes) by a Canadian enterprise (Grand River) to an enterprise in the territory of the United States (NTD/NWS). Those contracts do not support the existence of an "investment" under Article 1139.

Furthermore, Grand River makes no attempt to reconcile its claimed exemption from U.S. taxation[240] with its allegations concerning its purported investment in the United States. As observed by Professor Isenbergh, the Harold J. and Marion F. Green Professor of Law at the University of Chicago Law School:

> [I]f the business relationship among or between Grand River, Tobaccoville, and NTD/NWS is properly characterized as a 'joint venture'—the operations of which would consist of the

[239] Expert Opinion Report of Prof. Robert N. Clinton at 48 ("Clinton Report").

[240] *See*, *e.g*., Mem. ¶ 111 (asserting that Claimants adopted their "corporate structure in order to minimize their tax liability"); Affidavit of Steve Williams in Support of Motion for Relief from Judgment ¶ 14 (Feb. 6, 2007) (Defendant's Motion to Vacate Judgment, *South Dakota v. Grand River Enters, Inc*. (6th Jud. Cir. S.D. 2007) (Civ. No. 01-465) (asserting that "Grand River is not subject to any U.S. federal regulation with respect to" its Seneca-related activities).

> manufacture of cigarettes in Canada and their distribution in the United States—the U.S. businesses of Tobaccoville or NTD/NWS would be imputed to Grand River Enterprises for U.S. tax purposes and income derived by Grand River Enterprises from the venture would be subject to U.S. income taxation.[241]

Notably, at no point do Claimants characterize their alleged "integrated enterprise" as a "joint venture." This is not surprising, given that Claimants almost certainly would not want the relationship between Grand River and NTD/NWS to be seen as a joint venture, because that would expose Grand River to U.S. taxation.[242] As Professor Isenbergh states:

> The only way Grand River Enterprises can remain beyond the reach of U.S. taxation within the framework of the Internal Revenue Code and the Canada-U.S. treaty is if Grand River's relationship to NTD/NWS and Tobaccoville falls outside the bounds of any form of partnership or joint venture, including a limited partnership.[243]

Thus, Claimants are left to argue that the Tobacco Manufacturing Agreement between Grand River and NTD supports the existence of a U.S. parent enterprise that satisfies the definition of "investment" under Article 1139, while carefully avoiding any allegation of a joint venture existing between Grand River and NTD. Claimants cannot have the best of both worlds. The manufacturing agreement merely evidences a sale of goods by a Canadian enterprise (Grand

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[241] Isenbergh Report ¶ 24.

[242] Notably, because Claimants allege no profit sharing between Grand River and NTD/NWS, and no ownership of partnership assets by those entities, Claimants' allegations would not support the existence of a joint venture between those entities under the law of the State of New York, where NTD/NWS is based. Under New York law, a joint venture requires: "'an agreement manifesting the intent of the parties to be associated as joint venturers, a contribution by the coventurers to the joint undertaking (i.e., a combination of property, financial resources, effort, skill or knowledge), some degree of joint proprietorship and control over the enterprise; and a provision for the sharing of profits and losses.'" *Kaufman v. Torkan*, 859 N.Y.S.2d 253, 255 (N.Y. App. Div. 2008) (quoting *Tilden of N.J., Inc. v. Regency Leasing Sys., Inc.*, 646 N.Y.S.2d 700, 701 (N.Y. App. Div. 1996) (alteration in original)).

[243] Isenbergh Report ¶ 37.

River) to an enterprise in the territory of the United States (NTD/NWS), which is expressly excluded from the definition of "investment" under Article 1139.

In a separate attempt to establish the existence of an "investment" in the United States, Claimants highlight the intellectual property and goodwill interests associated with the Seneca brand.[244] But Arthur Montour, Jr. owns the Seneca trademark, and thus any attempt by Claimants Grand River, Jerry Montour, and Kenneth Hill to rely on that trademark (or on the goodwill interest associated with the Seneca brand) to establish an "investment" in the United States only begs the question of whether any "integrated enterprise" exists between Grand River and NTD/NWS concerning the Seneca brand.[245] Furthermore, although goodwill may play some part in the *valuation* of an investment,[246] the three NAFTA parties

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[244] Mem. ¶¶ 102-07.

[245] Regarding the Opal trademark, Claimants made no reference to the Opal brand in their Notice of Intent, Notice of Arbitration, Particularized Statement of Claim, or Allocable Share Claim. *Cf.* PSOC sec. D ¶ 83 (alleging threatened lawsuits and demands against Claimants "as manufacturers, as trademark-holders and as the distributors of the Seneca Brand in each State where these measures have been imposed"). As observed by the NAFTA Chapter Eleven tribunal in *Methanex*, the statement of claim required under UNCITRAL Article 18 must set out a claimant's "specific factual allegations, including all specific inferences to be drawn from those facts." *Methanex v. United States*, First Partial Award ¶ 162. Here, Claimants failed to allege any facts concerning the Opal brand, including Grand River's alleged trademark rights with respect to that brand, at any point prior to the submission of their Memorial. Such failure does not meet Article 18 requirements, and does not provide "sufficient notice" of the claim, which "fundamental fairness and good order require." Decision on Objections to Jurisdiction ¶ 94 (July 20, 2006). Claimants' allegations concerning the Opal brand, therefore, should not be considered as part of Claimants' claim. In any event, Claimants have apparently discontinued production of Opal cigarettes, *see* Jerry Montour Statement ¶ 41, and make no attempt to quantify any amount of damages attributable to that brand.

[246] *See, e.g.*, *Mitchell v. Dem. Rep. of Congo*, ICSID Case No. ARB/99/7, Decision on Annulment ¶ 35 (Nov. 1, 2006) (recognizing goodwill as an "investment" for valuation of a company in the context of alleged expropriation); *Sola Tiles Inc. v. Iran*, 14 Iran-U.S. Cl. Trib. Rep. 223, Award ¶¶ 61-62 (Apr. 22, 1987) (considering goodwill as an "investment" for lost profits analysis); *Asian Agric. Prods. Ltd. v. Rep. of Sri Lanka*, ICSID Case No. ARB/87/3, Final Award ¶¶ 102-03 (June 27, 1990) (recognizing goodwill for valuation of a company); *Técnicas Medioambientales Tecmed, S.A. v.United Mexican States*, ICSID Case No. ARB/AF/00/2, Award ¶¶ 194-95 (May 29, 2003) ("*Tecmed v. Mexico*, Award") (mentioning goodwill in the context of company valuation analysis).

agree that goodwill, by itself, cannot constitute an "investment" under Article 1139.[247]

Claimants also highlight various forms of "cooperation" between Grand River and NTD/NWS, including Grand River's contribution of a delivery truck to NWS for its distribution activities as well as Grand River's "revolving inventory loan," first made available to NTD and subsequently to NWS.[248] But such "cooperation" provides no support for the existence of Claimants' undocumented "integrated" parent enterprise, for which Grand River and NTD/NWS allegedly serve as corporate branches.

Finally, Claimants contend that funds placed by Grand River into escrow—as required by the challenged escrow statutes—themselves constitute an "investment" under Article 1139.[249] In support of this assertion, Claimants cite, without discussion, subparagraphs (g) and (h) of the definition of "investment" under Article 1139,[250] but neither of those subparagraphs would include a company's compliance with its legal obligations in the form of deposits made to

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[247] *See Methanex v. United States*, Mexico's Fourth Article 1128 Submission ¶¶ 7-8 (Jan. 30, 2004) (stating, "the definition of 'investment' in Article 1139, although broad, is exhaustive, and anything excluded from, or not listed therein cannot qualify as an investment interest protected by Chapter Eleven. Since goodwill, market share or customer base are not included within the definition of 'investment' they are not treaty-protected property rights for the 'purposes of this Chapter [Eleven]', and therefore do not fall within the ambit of Article 1110"); *Methanex v. United States*, Final Award on Jurisdiction and Merits, pt. IV, ch. D, ¶ 17 (Aug. 3, 2005) ("*Methanex v. United States*, Final Award") (stating that goodwill may "figure in valuation" but that it was "difficult to see" how goodwill might "stand alone" as an investment under Article 1139); *Merrill & Ring Forestry L.P. v. Canada*, NAFTA/UNCITRAL, Gov't of Canada Counter-Memorial ¶ 276 (May 13, 2008) (stating that goodwill is "'too vague to be regarded as a separate property right apart from the enterprise to which it is attached . . . The most that can be said is that goodwill constitutes an element of the value of an enterprise'") (quoting GILLIAN WHITE, NATIONALISATION OF FOREIGN PROPERTY 49 (1961)).

[248] Mem. ¶¶ 114, 116.

[249] *Id.* ¶ 119.

[250] *Id.* ¶ 119.

an escrow account in anticipation of potential future liabilities.[251] Claimants' bare assertion should be rejected.

Jerry Montour

Claimants allege that Jerry Montour serves as Chief Executive Officer of Grand River and owns 30% of Grand River's common shares.[252] Claimants do not allege any ownership interest held by Jerry Montour in NTD, NWS, or Tobaccoville USA. Claimants allege that "Jerry Montour and Kenneth Hill share a relationship with Arthur Montour and his distribution company in the United States, which is distinct from the arrangements agreed to by and among that company and Grand River[.]"[253] Claimants do not articulate, however, what that relationship is as a matter of law, how such a relationship could meet the definition of "investment" under Article 1139, or how the challenged measures would "relate to" such an investment. The bare assertion should be rejected.

Kenneth Hill

Claimants allege that Kenneth Hill serves as Senior Officer in charge of marketing and supply for Grand River and owns 10% of Grand River's common shares.[254] Claimants do not allege any ownership interest held by Kenneth Hill in NTD, NWS, or Tobaccoville USA. As discussed above, Claimants allege that

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[251] Subparagraph (g) concerns property "acquired in the expectation or used for the purpose of economic benefit or other business purposes." Grand River does not "acquire" property when complying with its escrow obligations. Subparagraph (h) concerns interests arising from the commitment of capital or other resources "to economic activity" in the territory of a party. NAFTA arts. 1139(g)-(h). When complying with its escrow obligations, Grand River is contributing to an escrow account that would serve as a funding source in the event of a future tobacco-related judgment against Grand River; Grand River does not commit "capital" to fund "economic activity" when making such deposits.

[252] PSOC sec. D ¶ 4 (citing to the June 24, 2005 Affidavit of Jerry Montour (PSOC Exh. 5)); Mem. ¶ 20.

[253] Mem. ¶ 9 n.2.

[254] PSOC sec. D ¶ 4.

Kenneth Hill and Jerry Montour share a relationship with Arthur Montour which is "distinct" from the "arrangements agreed to" between Grand River and NTD/NWS. But also as discussed above, Claimants do not articulate what that relationship is as a matter of law, how such a relationship could meet the definition of "investment" under Article 1139, or how the challenged measures would "relate to" such an investment.

* * *

For the reasons set forth above, Claimants Grand River, Jerry Montour, and Kenneth Hill provide no support for their bare allegations concerning the existence of an investment in the territory of the United States, and thus do not qualify as "investors" under Article 1101(1). The Tribunal, therefore, does not have jurisdiction over their claims.

3. The Escrow Statutes (In Their Original Form Or As Amended) Do Not "Relate To" Arthur Montour, Jr., As Required By Article 1101(1), Because NTD/NWS Are Not Subject To Deposit Obligations Under Those Measures

Claimants allege that Arthur Montour, Jr. is the sole named shareholder and President of NTD and NWS.[255] NTD and NWS operate under charters granted by the Sac and Fox Nation of Oklahoma, and maintain a principal place of business in New York.[256]

As discussed above, Article 1101(1) requires more than an investment in the territory of another Party. Article 1101(1) also requires that the measures challenged by a

[255] PSOC sec. D ¶ 5; Mem. ¶ 9; Arthur Montour Statement ¶¶ 2, 7.

[256] PSOC sec. D ¶ 5; Mem. ¶ 20; Arthur Montour Statement ¶ 2.

claimant "relate to" the investor or investment, which requires a "legally significant connection" between a challenged measure and the investor or investment.[257]

Because NTD/NWS are not subject to deposit obligations under the escrow statutes (in their original form or as amended), those measures do not "relate to" the owner of those companies, Arthur Montour, Jr. NTD/NWS are importers and distributors, not manufacturers. Deposit obligations under the escrow statutes can apply to importers *only if* the manufacturer does not intend for their tobacco products to be sold in the United States.[258] Here, Grand River clearly does intend for Seneca cigarettes to be sold in the United States, and thus deposit obligations arising from those sales run to the manufacturer, Grand River, and not to the importer, NTD/NWS. Like the methanol producer in *Methanex*,[259] NTD and NWS may be affected by, but have no legally significant connection to, the challenged measures.

Claimants do not address this issue. Instead, Claimants make a blanket assertion that the "legally significant connection" between the challenged measures and their investment is "obvious," given that the challenged measures "have been designed, implemented and – most importantly – enforced in order to prevent the investors from carrying on their tobacco business as they had been operating it prior to the MSA[.]"[260] Thus, when addressing the "legally significant connection" requirement under Article 1101(1), Claimants refer only in vague terms to the connection between the challenged

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[257] *Methanex v. United States*, First Partial Award ¶ 147.

[258] Facts Sec. VII.

[259] *See Methanex v. United States*, First Partial Award ¶ 150 (finding that the claimant's allegations, as originally pleaded, did not establish a legally significant connection between the claimant and the challenged measures, where the claimant merely manufactured a component (methanol) of the ultimate end-product (the gasoline oxygenate MTBE) that was the subject of the challenged measures).

[260] PSOC sec. E ¶ 12. Notably, Claimants were not even selling Seneca cigarettes in the United States prior to the MSA. *See* Facts Sec. V.

measures and their "tobacco business," rather than addressing the applicability, if any, of the deposit obligations under the escrow statutes to NTD/NWS. Because those deposit obligations do not apply to NTD/NWS, the escrow statutes do not "relate to" those companies or their owner, Arthur Montour, Jr. or his distribution companies, NTD/NWS. Accordingly, Arthur Montour, Jr.'s claim, to the extent it challenges the escrow statutes or allocable share amendments, should be dismissed for failure to meet Article 1101(1) requirements.

Unlike the escrow statutes, the complementary legislation does "relate to" Arthur Montour, Jr. under Article 1101(1) because NTD/NWS are subject to those measures, which apply to the ownership, possession, importation, distribution, and sale of tobacco products.[261] But as discussed in the merits section below, the complementary legislation does not violate any Chapter Eleven obligations.

* * *

For the reasons discussed above, the Tribunal lacks jurisdiction over the claims brought by Grand River, Jerry Montour, and Kenneth Hill, who have not established an "investment" in the United States. Specifically, with respect to their off-reservation sales, Claimants fail to include Tobaccoville within their alleged integrated enterprise, and with respect to their on-reservation sales, Claimants fail to support their bare allegations of a U.S. parent enterprise that is served by the "corporate branches" of Grand River and NTD/NWS. Grand River, Jerry Montour, and Kenneth Hill therefore do not qualify as "investors" under Article 1101(1). Furthermore, the challenged escrow statutes and allocable share amendments do not "relate to" the remaining Claimant,

[261] *See* Facts Sec. III.

Arthur Montour, Jr., because his distribution companies, NTD/NWS, are not subject to any deposit obligations under those measures. Arthur Montour, Jr.'s claim challenging those measures, therefore, should be dismissed for failure to meet Article 1101(1) requirements.

B. Claimants Fail To Address Jurisdictional Requirements Under Article 2103 For Tax Measures

Tax measures are covered by NAFTA Chapter Eleven only to the extent they are specified in Article 2103. As Article 2103 states, "Except as set out in this Article, nothing in this Agreement shall apply to taxation measures."

Under Article 2103, national treatment and most-favored-nation obligations under Article 1102 and Article 1103 can apply to tax measures, except that they do not apply to:

> any new taxation measure aimed at ensuring the equitable and effective imposition or collection of taxes and that does not arbitrarily discriminate between persons, goods or services of the Parties or arbitrarily nullify or impair benefits accorded under those Articles, in the sense of Annex 2004.[262]

Under Article 2103, therefore, the Chapter Eleven national treatment and most favored nation obligations do not apply to new taxation measures that have adequate tax policy justifications.[263] Although they allege violations of Article 1102 and Article 1103

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[262] NAFTA art. 2103(4)(g). In an exchange of letters in March 1994, all three NAFTA Parties articulated their "agreed interpretation" concerning NAFTA Article 2103 and characterized the operation of Article 2103(4)(g) as follows: "a property tax imposed by a province of Canada or a state of the United States of America or of the United Mexican States would be subject to the national treatment obligation under Article 1102(3) of the NAFTA *if the tax was neither permitted under a "grandfather clause" nor allowed as an "equitable and effective imposition or collection of taxes." See* Letter from Samuel Y. Sessions, Deputy Assistant Secretary (Tax Policy), U.S. Dept. of Treasury, to Kevin Dancey, Assistant Deputy Minister, Canadian Dept. of Finance, March 25, 1994, 1.04.

[263] *See* Department of External Affairs, *North American Free Trade Agreement: Canadian Statement on Implementation, in* CANADA GAZETTE 68, 217 (Jan. 1, 1994) (explaining that the test set forth in subparagraph 4(g) "permits tax measures that have a tax policy justification (equitable and effective imposition or collection of taxes), to the extent that the measure does not arbitrarily discriminate or arbitrarily nullify or impair benefits accorded by subparagraphs 4(a) or 4(b)"); *see also* NORTH AMERICAN FREE TRADE AGREEMENT, IMPLEMENTATION ACT, STATEMENT OF ADMINISTRATIVE ACTION, H.R. DOC. No. 103-159, Vol. 1, 103d Cong., 1st Sess., 450, 668 (1993) ("subparagraph (g) makes clear that NAFTA governments can generally adopt taxation measures in the future that are inconsistent with those rules

arising from a tax measure—Michigan's equity assessment statute—Claimants fail to address Article 2103.[264]

The Michigan equity assessment statute "imposes a levy of 1.75 cents, termed an 'equity assessment,' on each cigarette sold in Michigan" by an NPM.[265] As confirmed by Professor Isenbergh, the Michigan equity assessment statute constitutes a "taxation measure" under Article 2103 because the levy under the measure is not imposed "in consequence of an adjudicated infraction of law," and does not return to the one paying it "a specific benefit in the form of goods or services of value closely equivalent to the amount paid."[266] Accordingly, for purposes of Claimants' Article 1102 and Article 1103 claims, the Michigan equity assessment statute must be examined in the context of the specific limitations of Article 2103.

Claimants do not address, under Article 2103, whether the Michigan Equity Assessment Statute is "aimed at ensuring the equitable and effective imposition or collection of taxes[.]"[267] The Michigan House of Representatives adopted the Equity Assessment Statute to "ensure that manufacturers of non-settlement cigarettes pay fees to the state that are comparable to costs attributable to the use of cigarettes" in the state, and to "prevent manufacturers of nonsettlement cigarettes from undermining the state's policy of discouraging underage smoking by offering nonsettlement cigarettes at prices

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where such measures are 'aimed at ensuring the equitable and effective imposition or collection of taxes.'").

[264] *See* Mem. ¶¶ 276-77 (alleging that the Michigan equity assessment statute affords PMs "more favorable treatment" than NPMs and makes Michigan "the most prohibitively expensive place" in the United States for it to do business, in violation of Chapter Eleven's national treatment and most-favored-nation obligations). Notably, Claimants allege no damages arising from the Michigan equity assessment statute.

[265] Isenbergh Report ¶ 9 (citing Michigan Compiled Laws (MCL) section 205.426d).

[266] *Id.* ¶ 13.

[267] Article 2103(3)(g).

substantially below the cigarettes of other manufactures."[268] In fact, Claimants make no argument that the Michigan statute falls within an exception to the general exclusion of taxation measures under Article 2103. Given their failure to address Article 2103, Claimants' national treatment and most-favored-nation claims arising from the Michigan equity assessment statute should be dismissed.

II. MERITS – LIABILITY

A. Claimants Fail To Meet Any Of The Required Elements For A National Treatment Claim Under Article 1102 Or A Most-Favored-Nation Treatment Claim Under Article 1103

Under NAFTA Article 1102, each Party is obligated to accord to investors, of another Party, or their investments, "treatment no less favorable than it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." As discussed below, a national treatment claim brought under Article 1102 must demonstrate (i) *treatment* with respect to a foreign investor's investment; (ii) *like circumstances* between the foreign investor or investment and the domestic investor or investment; and (iii) *less favorable* treatment of the foreign investor or investment as compared to the domestic investor or investment.

Likewise, a most-favored-nation claim brought under Article 1103 must demonstrate (i) *treatment* with respect to the foreign investor's investment; (ii) *like circumstances* between the foreign investor or investment and an investor or investment of "any other Party or of a non-Party," and (iii) *less favorable treatment* of the foreign

[268] *See Nonparticipating Cigarette Manufacturers*, Mich., H. Legis. Analysis Section, H. B. 5221, at 4 (November 12, 2003), *available at* http://www.legislature.mi.gov/documents/2003-2004/billanalysis/House/pdf/2003-HLA-5221-a.pdf (last visited Dec. 20, 2008).

investor or investment as compared to the investor or investment of "any other Party or of a non-Party."[269]

Claimants' Article 1102 and Article 1103 claims fail to meet any of these required elements. The "treatment" at issue here concerns the deposit obligations under the amended escrow statutes, which do not apply to any U.S. investment held by the Claimants. Rather, those obligations apply to Grand River, a Canadian cigarette manufacturer that exports cigarettes to the United States.

Regarding the "like circumstances" requirement, Claimants allege that Grand River is in like circumstances with *all* manufacturers in the U.S. tobacco sector, regardless of whether those manufacturers are subject to payment obligations and advertising restrictions under the MSA. But under NAFTA Chapter Eleven, operating within the same economic sector is only a "first step" for determining whether a proposed comparator is in like circumstances with an investor or investment, and Claimants offer no second step in support of their alleged industry-wide comparator. In fact, Claimants are in like circumstances with other NPMs, which include both domestic and foreign manufacturers.

Claimants also have not shown less favorable treatment. Grand River is accorded the same treatment accorded to all NPMs, whether they are foreign or domestic manufacturers. Claimants ultimately demand *more* favorable treatment for Grand River, by seeking an exemption from the deposit obligations applicable to all other NPMs. Claimants cannot hope to turn their lack of *more* favorable treatment into a claim of *less*

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[269] Article 1103 obligates each Party to accord to "investors" and "investments of investors" of another Party "treatment no less favorable" that the Party accords, in like circumstances, to investors and investments of investors "of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

favorable treatment. Claimants also make no attempt to show that any alleged less favorable treatment has been accorded to them on the basis of nationality, as required under Chapter Eleven. For the above reasons, Claimants' Article 1102 and Article 1103 claims should be dismissed.

1. Claimants Fail To Meet Any Of The Required Elements For A National Treatment Claim Under NAFTA Article 1102

As set forth in the *UPS v. Canada* NAFTA Chapter Eleven decision:

> [T]here are three distinct elements which an investor must establish in order to prove that a Party has acted in a manner inconsistent with its obligations under article 1102. These are:
>
> a) The foreign investor must demonstrate that the Party . . . accorded *treatment* to it . . . with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments[;]
>
> b) The foreign investor or investment must be *in like circumstances* with local investors or investments; and
>
> c) The NAFTA Party must treat the foreign investor or investment *less favorably* than it treats the local investor or investments.[270]

As further found by the *UPS* tribunal, "[f]ailure by the investor to establish one of those three elements will be fatal to its case. This is a legal burden that rests squarely with the Claimant. That burden never shifts to the Party."[271]

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[270] *United Parcel Serv. of Am., Inc. v. Gov't of Canada*, NAFTA/UNCITRAL, Award ¶ 83 (May 24, 2007) ("*UPS v. Canada*, Award") (emphasis added).

[271] *UPS v. Canada*, Award ¶ 84. Claimants cite to the Separate Opinion in *UPS* in support of the proposition that the burden for establishing a claim under Article 1102 can, in some circumstances, shift to the Respondent. Mem. ¶ 260. Claimants fail to acknowledge, however, that the Majority Opinion in *UPS* squarely rejected the potential for burden shifting in the context of an Article 1102 claim, finding that the legal burden for such claims "never shifts" to the Respondent. *UPS v. Canada*, Award ¶ 84.

a. Treatment: The "Treatment" Challenged By Claimants Has Not Been Accorded To Grand River With Respect To Any U.S. Investment

A claimant raising a national treatment claim under Article 1102 first must demonstrate that a Party has accorded "treatment" to an investor or its investment "with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."[272] Although the allocable share amendments accord "treatment" to Grand River—by adjusting the criteria for obtaining a release of escrow payments under the escrow statutes—that treatment has not been accorded with respect to any investment held by Grand River in the United States.[273] Rather, the allocable share amendments accord "treatment" to Grand River with respect to its exports of cigarettes to the U.S. market. As discussed above,[274] Grand River holds no investment in the United States, and thus the allocable share amendments do not

[272] NAFTA art. 1102; *UPS v. Canada*, Award ¶ 82.

[273] In addition to alleging unfavorable treatment by the allocable share amendments, Claimants also briefly allege that the "Ongoing Regulatory Dialogue Launched With The MSA" favored OPMs over NPMs, and that MSA membership "entitles" PMs "to have access to more potential retail customers" than NPMs. Mem. at 113 (heading) and ¶ 275. But Claimants have made clear in this arbitration that the MSA does not constitute a measure that could give rise to a claim under NAFTA Chapter Eleven. *See* Claimants' Rejoinder to Respondent's Reply on Jurisdiction at 9 (Feb. 27. 2006) (stating, "Claimants could not have been clearer in describing how the MSA did not, and could not in and of itself, constitute a 'measure' that could be made the subject of a claim under NAFTA Chapter 11").

Notably, Claimants' assertion that MSA membership was "unreasonably withheld" from them, Mem. ¶ 275, is baseless; Grand River filed its MSA application with NAAG on April 3, 2006, and argued in U.S. court proceedings that its failure to receive an approval within *ten days*—by April 13, 2006—constituted an effective denial of the application. The court found that the circumstances surrounding Grand River's MSA application "smack[ed] of pretext": "Ten days is not enough time for NAAG to consider an application to join the MSA, let alone one involving an applicant litigating to have the MSA declared illegal." *Grand River Enters. Six Nations, Ltd. v. Pryor*, 2006 WL 1517603, at *7 (S.D.N.Y. May 31, 2006), *aff'd*, 481 F.3d 60 (2d Cir. 2007).

Claimants also briefly assert that PMs are in a better position than NPMs with respect to the Michigan Equity Assessment Act. *See* Mem. ¶ 276. As discussed above, however, Claimants fail to address the applicable standard under Article 2103 for challenges to taxation measures brought under Articles 1102 and 1103. *See* Jurisdiction Sec. I.B., *supra*. Claimants also offer no argument under Article 1102 or 1103 with respect to any treatment accorded by the complementary legislation.

[274] *See* Jurisdiction Sec. I.A., *supra*.

accord "treatment" with respect to any Grand River investment in the United States, but rather add to the cost of Grand River's exports from Canada into the U.S market.

b. Like Circumstances: Claimants Have Failed To Identify An Appropriate Comparator

As part of their claim under Article 1102, Claimants must also identify a domestic investor or investment that is in like circumstances with Claimants. Identifying appropriate domestic comparators for purposes of a "like circumstances" analysis under Article 1102 is a highly fact-specific inquiry.[275]

As clarified by the NAFTA Chapter Eleven tribunal in *Pope & Talbot v. Canada*, while the treatment accorded to a foreign investment should be compared, for purposes of an Article 1102 analysis, with the treatment accorded to domestic investments "in the same business or economic sector,"[276] simply being in the same sector or selling the same product is *not* sufficient to demonstrate "like circumstances."[277] In *Pope & Talbot*, the U.S. investor in Canada was obliged to pay export fees, while the investor's proffered comparators were Canadian lumber producers that were not subject to the fees.[278] The *Pope & Talbot* tribunal rejected the investor's alleged comparators and instead selected

[275] *Pope & Talbot v. Gov't of Canada*, NAFTA/UNCITRAL, Award on the Merits of Phase 2, ¶ 75 (Apr. 10, 2001) ("*Pope & Talbot v. Canada*, Phase 2 Merits Award").

[276] *Pope & Talbot v. Canada*, Phase 2 Merits Award ¶ 78 (citing OECD, *National Treatment for Foreign-Controlled Enterprises*, 22 (Paris 1993) ("As regards the expression 'in like situations', the comparison between foreign-controlled enterprises established in a Member country and domestic enterprises in that Member country is valid only if it is made between firms operating in the same sector.").

[277] *See Pope & Talbot v. Canada*, Phase 2 Merits Award ¶¶ 84-89; *see also Methanex Corp. v. United States*, NAFTA/UNCITRAL, Final Award on Jurisdiction and Merits, pt. IV, ch. B,¶ 19 (Aug. 3, 2005) ("*Methanex v. United States*, Final Award").

[278] *See Pope & Talbot*, Phase 2 Merits Award ¶¶ 84-89.

entities that were in the *most* "like circumstances," *i.e.*, Canadian lumber producers that were subject to the export fees at issue.[279]

The same "most like circumstances" analysis applies here: as observed by the *Methanex* tribunal, "It would be a forced application of Article 1102 if a tribunal were to ignore the identical comparator and to try to lever in an, at best, approximate (and arguably inappropriate) comparator."[280] In *Methanex*, the tribunal found that competition between methanol producers and ethanol producers in the oxygenate market was insufficient to establish like circumstances.[281]

Furthermore, as Claimants acknowledge, the *Pope & Talbot* tribunal "cautioned" that a comparison between investments in the same business or economic sector was merely a "first step" in a like circumstances analysis.[282] But Claimants never reach a second step in their analysis, simply asserting that the "appropriate comparators" for the "like circumstances" analysis in this case are *all* enterprises marketing "other value brands in the same territories" as Claimants, including "Exempt SPMs, in addition to other SPMs and NPMs," as well as, to a lesser extent, OPMs.[283] Thus, Claimants contend that they are in "like circumstances" with *all* "value" tobacco product manufacturers whose cigarettes are sold in the U.S. market, or at least in the states in which Senecas are sold.

But as found by the *Pope & Talbot* tribunal, the comparators in the most "like circumstances" are those that operate under the same legal framework (in that case,

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[279] *See Pope & Talbot*, Phase 2 Merits Award ¶¶ 84-89.

[280] *Methanex Corp. v. United States*, Final Award, pt. IV, ch. B ¶ 19.

[281] *Methanex Corp. v. United States*, Final Award, pt. IV, ch. B ¶¶ 6, 19.

[282] Mem. ¶ 247.

[283] *See* Mem. ¶¶ 262-63.

lumber producers operating under the export fee regime at issue). Similarly, Grand River is in the most like circumstances with those cigarette manufacturers that have opted not to sign the MSA, *i.e.*, NPMs. OPMs and SPMs, by contrast, are subject not only to separate payment obligations under the MSA, but also to strict restrictions on marketing and advertising which do not apply to NPMs.[284] As confirmed by the *Pope & Talbot* tribunal, operating in the same economic sector or selling the same product is not sufficient to establish that two competitors are in "like circumstances."[285]

Claimants make no attempt to address how a tobacco product manufacturer that has signed the MSA is in like circumstances with a manufacturer that has opted not to

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[284] *See* Facts Sec. I; Evidentiary Submissions in Support of Claimant's Memorial – Merits Phase Volume IV (July 10, 2008), exh. 51 – Brattle Group, Final Determination pursuant to NPM Procedures Agreement § 19 in the 2003 NPM Adjustment Proceeding Pursuant to Master Settlement Agreement § IX(d)(1)(C) at 13-23 ("In addition to advertising and marketing restrictions, the MSA requires dissolution of certain industry organizations and mandates public disclosure of specified materials. The PMs also may not lobby against certain legislative proposals related to reducing youth tobacco consumption."); Evidentiary Submissions in Support of Claimant's Memorial – Merits Phase Volume I (July 10, 2008), exh. 13 – Expert Report of David M. Eisenstadt, Ph.D. and Serdar Dalkir, Ph.D. ¶¶ 14-20 ("In contrast to PMs, NPMs such as Claimants make potentially refundable or recoverable MSA payments in the form of escrow deposits."); *see* Expert Report of Prof. Jonathan Gruber ¶ 4, 6, 8 (Dec.19, 2008) ("Gruber Report") (noting that OPMs and SPMs are responsible for making payments under the MSA, while NPMs are not); *id.* ¶ 11 ("In fact, under the escrow arrangement the NPMs incur less of a burden than they would as participants in the MSA.").

[285] *See Pope & Talbot*, Phase 2 Merits Award ¶¶ 84-88. The NAFTA Chapter Eleven decisions relied on by Claimants do not support the proposition that competing within the same economic sector or industry alone constitutes "like circumstances" under Article 1102 or Article 1103. *See UPS v. Canada*, Award ¶¶ 175-81 (finding that UPS was not in like circumstances with Canada Post with respect to the services at issue in the case, even though both competed in the express courier services sector, because Canada Post also offered additional mail services necessary to achieve the ends of the Canadian program at issue), Sep. Op. ¶ 16 ("It is possible for two investors or enterprises to be in the same sector or to be in competition and nonetheless be quite unlike in respect of some characteristic critical to a particular treatment."); *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, Award ¶¶ 155-58 (Jan. 9, 2003) ("*ADF Group v. United States*, Award") (determining that "in like circumstances" required a comparator not only in the same economic or business sector as the claimant, but also one subject to the same requirements under U.S. law); *Feldman v. United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award ¶¶ 171-72 (Dec. 16, 2002) ("*Feldman v. Mexico*, Award") (selecting only a subset of cigarette retailers that were engaged in similar commercial conduct as being in like circumstances with the claimant's company as a result of distinctions made under Mexican tax laws); *S.D. Myers Inc. v. Canada*, NAFTA/UNCITRAL, First Partial Award ¶¶ 248-250 (Nov. 13, 2000) ("*S.D. Myers v. Canada*, First Partial Award") (finding that in addition to the claimant's economic or business sector, the interpretation of "like circumstances" must also take into account "general principles" emerging from the relevant legal context and other policy objectives that can justify government regulations distinguishing between domestic and foreign investors and investments).

sign the MSA. The Article 1102 claim, which is based on the wrong comparators, should therefore be dismissed.

c. Less Favorable: Claimants Fail To Establish That They Have Been Accorded Less Favorable Treatment Than That Accorded To Other NPMs

Claimants likewise fail to establish the third required element of a national treatment claim under Article 1102, that a foreign investor or investment has received less favorable treatment than a domestic investor or investment in like circumstances.

Under the allocable share amendments, Grand River, like all NPMs, can no longer obtain a release of escrowed funds by concentrating sales of its cigarettes in only a few states. All NPMs—including Grand River—are treated identically under the allocable share amendments. Indeed, Claimants ultimately seek treatment that is *different* than that accorded to all NPMs under the allocable share amendments, asserting that the Settling States were obligated to consult and reach an "acceptable resolution" with Grand River prior to the adoption of the allocable share amendments, and that such resolution could have been achieved by exempting Grand River from escrow obligations.[286]

When using the correct comparators, it becomes clear that, as observed by Professor Carole Goldberg, Distinguished Professor of Law at UCLA School of Law, "[t]he gravamen of [Claimants'] complaint is that they have been treated exactly the same as other NPMs."[287] Thus, Claimants' allegations of "less favorable treatment" at bottom concern the failure to accord Grand River *more* favorable treatment than that accorded to other NPMs.

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[286] *See* Mem. ¶¶ 216-17.

[287] *See* Expert Opinion Report of Prof. Carole Goldberg ¶ 14 (December 18, 2008) ("Goldberg Report").

In addition, even assuming that Grand River were in like circumstances with PMs, the allocable share amendments do not accord less favorable treatment to NPMs than that accorded to PMs under the MSA. To the contrary, as confirmed by Professor Gruber, the allocable share amendments eliminated an "enormous" advantage for NPMs, and thereby restored a level playing field between PMs and NPMs.[288] Indeed, as addressed by Professor Gruber, NPMs under the escrow statutes as amended still incur less of a burden than they would as participants under the MSA.[289]

Professor Gruber's analysis echoes the findings of a U.S. federal court in response to one of Grand River's domestic court challenges to the allocable share amendments. In *Grand River Enterprises Six Nations, Ltd. v. Beebe*,[290] the court found that "[t]he Allocable Share Amendment does not require Grand River, or any other NPM, to pay more *per cigarette* into escrow than it would pay *per cigarette* under the MSA if it were a PM."[291] The court observed that the original allocable share release provision "provided NPMs with substantial competitive advantages from concentrating their efforts on regional distribution,"[292] and thus, "[w]hen viewed in the context of the statutes at issue, it becomes clear that what Grand River is really complaining about is the loss of the competitive advantage that could be enjoyed" under the original allocable share release provision.[293] Thus, Claimants ultimately seek special treatment, in the form of an

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[288] *See* Gruber Report ¶ 19.

[289] *See* Gruber Report ¶¶ 11-14.

[290] 418 F. Supp. 2d 1082 (W.D. Ark. 2006).

[291] *Id* at 1092. (emphasis in original).

[292] *Id.* at 1092 (citing *Freedom Holdings, Inc. v. Spitzer*, 447 F. Supp. 2d 230, 241 (S.D.N.Y. 2004)).

[293] *Id.* at 1093 (holding that the allocable share amendment did not violate the Equal Protection Clause or substantive due process).

exemption from the allocable share amendments, in order to restore the competitive advantage they enjoyed under the original escrow statutes.

Finally, Claimants make no attempt to demonstrate that any alleged less favorable treatment has been accorded to NPMs on the basis of nationality, as required for any national treatment claim under Article 1102. As recognized by the *Loewen* tribunal, the national treatment obligation under Article 1102 proscribes only "nationality-based discrimination and . . . demonstrable and significant indications of bias and prejudice on the basis of nationality."[294] Similarly, as found by the *S.D. Myers v. Canada* tribunal, analysis under Article 1102 involves considerations of "whether the practical effect of the measure is to create a disproportionate benefit for nationals over non nationals," and "whether the measure, on its face, appears to favour its nationals over non-nationals who are protected by the relevant treaty."[295] All three NAFTA Parties agree that the national treatment obligation under Article 1102 is intended to protect against discrimination against an investor or investment on the basis of nationality.[296]

But Claimants fail to address the fact that neither the MSA, nor any of its related measures, discriminates on the basis of nationality. SPMs, including grandfathered SPMs, include both domestic and foreign manufacturers.[297] Similarly, NPMs include both domestic and foreign manufacturers.[298] Claimants make no attempt to tie the deposit obligations for NPMs under the amended escrow statutes, or the availability of

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[294] *Loewen Group, Inc. and Raymond L. Loewen v. United States*, ICSID Case No. ARB(AF)/98/3, Award ¶ 139 (June 26, 2003) ("*Loewen Group v. United States*, Award").

[295] *S.D. Myers v. Canada*, First Partial Award ¶ 252.

[296] *See Pope & Talbot*, U.S. First Article 1128 Submission ¶ 3 (Apr. 7, 2000); U.S. Second Article 1128 Submission ¶ 3 (May 25, 2000); Mexico's Supplemental Article 1128 Submission, Section A.1 at 2-3 (May 25, 2000); *Methanex v. United States*, Canada's Fourth Article 1128 Submission ¶ 5 (Jan. 30, 2004).

[297] *See* Facts Sec. I.

[298] *See* Facts Sec. III.

grandfathered SPM status under the MSA, to the nationality of a tobacco product manufacturer. Claimants' Article 1102 claim should be dismissed.

2. Claimants Fail To Meet Any Of The Required Elements For An Article 1103 Claim

Claimants' Article 1103 claim consists of an isolated reference in a footnote to Japan Tobacco as an example of a foreign-owned grandfathered SPM that is receiving more favorable treatment than Grand River.[299] The claim should be rejected.

Article 1103 obligates the NAFTA Parties to accord treatment to investors or investments of another Party that is no less favorable than that accorded to investors or investments "of any other Party or of a non-Party."[300] Thus, like a claim under Article 1102, a claimant asserting a most-favored-nation claim under Article 1103 must establish the required elements of (1) being accorded treatment with respect to an investment; (2) identifying a comparator that is in like circumstances; and (3) demonstrating that the treatment accorded to the investor or investment was less favorable than that accorded to the comparator in like circumstances. The only major analytical difference between Article 1102 and Article1103 concerns the like circumstances element, in that, under Article 1103, a comparator be a foreign, rather than a domestic, national.

Claimants' Article 1103 argument begins and ends with their isolated reference in a footnote to the grandfathered SPM, Japan Tobacco. Grandfathered SPMs are particularly inappropriate as comparators to Grand River because grandfathered SPMs, unlike Grand River, were selling cigarettes in the U.S. market at the time the MSA was

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[299] *See* Mem. ¶ 109, n.307.

[300] NAFTA art. 1103.

signed.[301] Because it had no U.S. market share in 1997 or 1998, a grandfather share would be worthless to Grand River.

For their claim under Article 1103, Claimants have not identified any foreign-owned NPM as a comparator, much less a foreign-owned NPM that receives more favorable treatment than Grand River. Nor have Claimants shown any treatment accorded by the allocable share amendments with respect to a U.S. investment. Accordingly, Claimants' most-favored-nation claim, like their national treatment claim, fails to meet any of the required elements for claims brought under Article 1102 or Article 1103. Both claims should be dismissed.

3. Claimants' National Treatment and Most-Favored-Nation Claims Cannot Be Salvaged By General NAFTA Objectives Under Article 102(1)

Claimants assert that the general NAFTA objectives set out in Article 102(1) should be "seriously considered and employed in a broad and remedial fashion" when interpreting the "specific provisions" of NAFTA, including Articles 1102 and 1103.[302] As discussed below, although the Article 102 objectives may inform the interpretation of specific NAFTA provisions, such general objectives cannot transform the nature of those obligations; nor do they impose independent obligations on the Parties to the Agreement.

The cardinal rule of treaty interpretation is set out in Article 31(1) of the Vienna Convention on the Law of Treaties: a treaty must be interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of

[301] Transcript of the Hearing on Jurisdiction, Volume 2, 0517: 7-18 (Mar. 24, 2006) (confirming that Grand River began to manufacture cigarettes for the U.S. market in 1999).

[302] Mem. ¶ 237.

its object and purpose."[303] The relevant context includes the treaty's text, its preamble and annexes, and any related agreements or instruments.[304] The Preamble of the NAFTA and Article 102 both shed light on the NAFTA's "object and purpose." Article 102(1), for example, lays out several objectives, "as elaborated more specifically through [the NAFTA's] principles and rules," that motivated the States Parties in negotiating the NAFTA. These objectives include "eliminat[ing] barriers to trade in, and facilitat[ing] the cross-border movement of, goods and services between the territories of the Parties"; "promot[ing] conditions of fair competition in the free trade area"; and "increas[ing] substantially investment opportunities in the territories of the Parties."[305] Notably, the objectives also include "preserv[ing the States Parties'] flexibility to safeguard the public welfare."[306]

As the *Canadian Cattle Claims* NAFTA Chapter Eleven tribunal observed, while Chapter Eleven "must be considered in light of its larger context," that fact:

> does not mean that Chapter Eleven itself must bear the whole weight of the diverse purposes set out in Article 102. Those purposes, it is clear, apply to the treaty in its complex entirety, and some are wholly irrelevant to Chapter Eleven. . . . [P]articular segments of the treaty may reflect a much more limited set of purposes than the overall purposes clause sets forth.[307]

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[303] Vienna Convention on the Law of Treaties, May 23, 1969, art. 31(1), 1155 U.N.T.S. 331 ("Vienna Convention").

[304] Vienna Convention, art. 31(2).

[305] NAFTA art. 102(1).

[306] NAFTA pmbl.

[307] *In re NAFTA Chapter Eleven/UNCITRAL Cattle Cases, Claimants v. United States*, Award on Jurisdiction ¶ 166 (Jan. 28, 2008). Similar to the Claimants' Article 201 argument in this case, the claimants in *Canadian Cattle Cases* argued that general NAFTA objectives required Chapter Eleven to be extended to cover claims brought by investors arising out of investments located in their home State. But the tribunal rejected that argument: "The fact that the NAFTA indisputably seeks to promote economic integration among industries in the three States Parties does not mean that the border has been eliminated for purposes of investor protection, no matter how similar or integrated the industries on each side of the border may be." *Id.* ¶ 169.

Thus, the key to interpreting the provisions of the NAFTA must be the text itself, as informed by the treaty's context, object, and purpose, only to the extent those additional sources are relevant to, and consonant with, the substantive provision at issue. This approach is grounded in the well-accepted principle that general objectives can shed light on treaty provisions, but cannot impose independent obligations on treaty signatories.[308]

Claimants cannot rely on general NAFTA objectives under Article 102 to transform the nature of national treatment and most-favored-nation obligations under Article 1102 and Article 1103. Given Claimants' failure to meet required elements under Article 1102 and Article 1103, both claims should be dismissed.

B. Claimants Fail To Establish That Their Alleged Investments Were Not Accorded The Minimum Standard of Treatment Under Article 1105

Article 1105, the minimum standard of treatment provision of NAFTA Chapter Eleven, obligates Parties to "accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." Claimants put forward several obligations which, they contend, are included within the minimum standard of treatment obligation under Article 1105.

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[308] *See Oil Platforms Case* (Iran v. U.S.), 1996 I.C.J. 803, ¶¶ 24-31 (Dec. 12, 1996) (rejecting Iran's suggestion that Article I of the Treaty of Amity, Economic Relations and Consular Rights of August 15, 1955, which provided for a "firm and enduring peace and sincere friendship" between the parties, conferred any independent obligations on the Parties; finding, rather, that such general language only "throw[s] light on the interpretation of the other Treaty provisions"); *Sale v. Haitian Ctrs. Council, Inc.*, 509 U.S. 155, 178-79 (1993) (holding that the "broad remedial goals" of the United Nations Protocol Relating to the Status of Refugees could not be interpreted to impose extraterritorial obligations on its signatories); WORLD TRADE ORGANIZATION, REPORT OF THE APPELLATE BODY NO. AB-1997-4, EC MEASURES CONCERNING MEAT AND MEAT PRODUCTS (HORMONES) ¶¶ 211-13, WTO DOC. NO. WT/DS26/AB/R (Jan. 16, 1998) (finding that the general objective in Article 5.5 of the Agreement on the Application of Sanitary and Phytosanitary measures of achieving "consistency in the application of the concept of appropriate level of sanitary or phytosanitary protection" was a prospective goal that did not establish a legal obligation of consistency on Parties to the agreement).

Claimants then assert that such obligations have been violated in this case. As discussed below, Claimants fail on both counts.

NWS and Tobaccoville distribute and sell billions of Grand River-manufactured cigarettes throughout the United States. As an NPM, Grand River is not subject to the payment obligations or advertising restrictions that apply to participating manufacturers under the MSA. The escrow statutes adopted by all Settling States were intended to level the playing field between PMs and NPMs by imposing deposit obligations on NPMs that were roughly comparable to the payment obligations imposed on PMs under the MSA. Escrow payments under the original escrow statutes were subject to the allocable share release provision, which was premised on the assumption that NPMs sold cigarettes nationally.[309]

Grand River, like many NPMs, was able to exploit that assumption by concentrating its sales in a few Settling States and thereby obtain refunds of large portions of its escrow payments. As stated by Professor Gruber, the allocable share release "unintentionally skewed the competitive playing field dramatically in favor" of NPMs that concentrated their sales in a few Settling States.[310] The allocable share amendments restored the level playing field between PMs and NPMs by amending the release provision to foreclose the ability of NPMs to obtain refunds by concentrating their sales in only a few states.

Claimants assert that the allocable share amendments violated the customary international law minimum standard of treatment of aliens. But the allocable share amendments apply to all NPMs equally, and were adopted through open, democratic

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[309] *See* Facts Sec. IV.

[310] Gruber Report ¶ 31.

processes in which both PMs and NPMs participated. Claimants operate in the highly-regulated tobacco industry. Given the plainly unanticipated loophole in the allocable share release provision, the amendment of that provision was both reasonable and predictable.

Faced with these facts, Claimants rest their Article 1105 claim on unsupported, and unsupportable, assertions. *First*, Claimants allege that the Settling States made the following "unilateral offer" to tobacco manufacturers: if opting not to sign the MSA, a manufacturer, as an NPM, would be "entitled" to obtain refunds on escrow payments "reflecting their proportionate share of the national market."[311] But the "entitlement" alleged by Claimants was in fact an unanticipated loophole that undermined the very purpose of the escrow statutes: to ensure an adequate source of funds for Settling States to satisfy any potential future tobacco-related judgments against NPMs.

Second, Claimants assert that they took "state officials . . . at their word" that the escrow statutes would provide a level playing field between "regional" NPMs and grandfathered SPMs operating on a national basis. This assertion is not only unsupported, but directly contrary to the basic assumption underlying the escrow statutes, that NPMs would sell their products nationally.[312]

In addition, as discussed above in connection with Claimants' Article 1102 and Article 1103 claims, the "discrimination" alleged by Claimants ultimately concerns the failure to accord Grand River special treatment, different from that accorded to all other NPMs. Specifically, Grand River seeks an exemption from deposit obligations that is not

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[311] Mem. ¶ 203.

[312] *See* Facts Sec. IV.

available to any other NPM. But such an exemption is not justified by their status as members of Canadian First Nations.

Furthermore, the deposit obligations under the amended escrow statutes apply to Grand River, a Canadian exporter of cigarettes, which has no investment in the United States. Article 1105 obligates each Party to accord *investments* of investors of another Party treatment in accordance with the law minimum standard of treatment. The deposit obligations do not apply to any U.S. investment of Claimants, and thus cannot support a claim under Article 1105. Nevertheless, even if the escrow deposit obligations did apply to an investment of the Claimants in the United States, the minimum standard of treatment has not been violated with respect to such an investment.

This section responds to Claimants' arguments under Article 1105 as follows. *First*, the section provides an overview of the content of the minimum standard of treatment, as well as the requirements for demonstrating a rule of customary international law. *Second*, the section addresses how Claimants have failed to take such requirements into account when putting forward an alleged obligation not to frustrate an investor's "basic" expectations. *Third*, assuming *arguendo* the existence of Claimants' alleged "expectations" obligation, the section addresses Claimants' failure to support their particular expectations arguments with respect to the Jay Treaty, federal Indian law, and the regulatory environment for the tobacco industry. *Fourth*, with respect to Claimants' allegations of discrimination under Article 1105, the section refers back to the earlier analysis of Claimants' Article 1102 and Article 1103 claims, which observed that the "discrimination" alleged by Claimants ultimately concerns the failure to accord Grand River special treatment, different from the treatment accorded to all other NPMs. *Fifth*,

and finally, the section addresses Claimants' denial of justice claim, which fails because the challenged measures do not limit Claimants' access to U.S. courts. For the reasons set forth below, Claimants' Article 1105 claim should be dismissed in its entirety.

1. A Claim Under Article 1105(1) Must Arise From The Failure To Accord The Minimum Standard Of Treatment To An Alien's Investment

Article 1105(1) requires that "[e]ach 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."[313] As the NAFTA Free Trade Commission ("FTC") confirmed in its 2001 interpretation, the scope of Article 1105(1) extends only to those investment protections that are recognized under customary international law:

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to *investments* of investors of another Party.

2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).[314]

Under Article 1131, the FTC's interpretation "of a provision of this Agreement shall be binding on a Tribunal established under this Section."[315] In addition, NAFTA Chapter Eleven tribunals, as well as the Supreme Court of British Columbia, have

[313] NAFTA art. 1105(1) (emphasis added).

[314] NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, ¶ B (July 31, 2001) (emphasis added).

[315] NAFTA art. 1131(2).

recognized the authority of the interpretation.[316] Furthermore, "'an agreement as to the interpretation of a provision reached after the conclusion of the treaty represents an authentic interpretation by the parties which must be read into the treaty for purposes of its interpretation.'"[317] Claimants do not dispute the valid and binding nature of the FTC interpretation.[318]

a. The Scope of Article 1105(1) Includes Only Protections Recognized Under The Minimum Standard of Treatment

As confirmed by the FTC interpretation, Article 1105(1) protects only the property rights and interests of aliens, *i.e.*, the "investments of investors," that are recognized under the minimum standard of treatment, which "provid[es] for a minimum

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[316] *See, e.g.*, *Int'l Thunderbird Gaming Corp. v. United Mexican States*, NAFTA/UNCITRAL, Award ¶¶ 192-93 (Jan. 26, 2006) ("*Int'l Thunderbird Gaming v. Mexico*, Award"); *Methanex v. United States of America*, Final Award, pt. IV, ch. C, ¶¶ 20-24 (noting that even if the interpretation had altered the meaning of Article 1105(1)—which it did not—it would nonetheless be "entirely legal and binding on a tribunal seized with a Chapter 11 case" under the terms of the Vienna Convention on the Law of Treaties); *Waste Mgmt., Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award ¶¶ 90-91 (Apr. 30, 2004) ("*Waste Mgmt. v. Mexico*, Award"); *Loewen Group v. United States*, Award ¶¶ 124-28; *ADF Group v. United States*, Award ¶¶ 175-78; *United Parcel Serv. of Am.,Inc. v. Gov't of Canada*, 7 ICSID Rep. 288, Award on Jurisdiction ¶ 97 (Nov. 22, 2002) ("*UPS v. Canada*, Award on Jurisdiction"); *Mondev Int'l Ltd. v. United States*, ICSID Case No. ARB(AF)/99/2, 42 I.L.M. 85, Award ¶¶ 100-25 (Oct. 11, 2002) ("*Mondev v. United States*, Award"); *United Mexican States v. Metalclad Corp.*, 5 ICSID Rep. 236 ¶¶ 61-65 (Sup. Ct. B.C.) (May 2, 2001); Christoph Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, 6 J. WORLD INVEST. & TRADE 357, 362-63 (noting, *inter alia*, that Article 1105(1)'s text "suggest[s] that . . . fair and equitable treatment is part of international law, specifically of its rules on the minimum standard of treatment").

[317] *Methanex Corp. v. United States*, Final Award, pt. II, ch. B, ¶ 19 (quoting International Law Commission Report, vol. 2, at 221, and noting the ICJ's approval of this passage in the *Kasikili/Sedudu Island Case* (Bots. v. Namib.), 1999 I.C.J. Rep. 1045 ¶ 49). *See also* ROBERT JENNINGS & ARTHUR WATTS, 1 OPPENHEIM'S INTERNATIONAL LAW § 630 (9th ed. 1992) ("The parties to a treaty often foresee many of the difficulties of interpretation likely to arise in its application, and in the treaty itself define certain of the terms used. Or they may in some other way and before, during, or after the conclusion of the treaty, agree upon the interpretation of a term, either informally (and executing the treaty accordingly) or by a more formal procedure, as by an interpretive declaration or protocol or a supplementary treaty. Such authentic interpretations given by the parties override general rules of interpretation.") (footnotes omitted) (quoted with approval in the *Methanex v. United States* Final Award at pt. II, ch. H, ¶ 23); ARTHUR WATTS, 2 THE INTERNATIONAL LAW COMMISSION 1949-1998, PART TWO 688-89 (1999) (Commentary to final draft article 27) (same); *see also* Campbell McLachlan, *The Principle of Systemic Integration & Art. 31(3)(C) of the Vienna Convention*, 54 INT'L & COMP. L.Q. 279, 287 (2005) ("For much of the time, interpretation of contracts and treaties alike will be a matter of ascertaining and giving effect to the intention of the parties by reference to the words they have used.").

[318] *See* Mem. ¶ 154 (citing the FTC interpretation with approval).

set of principles which States, regardless of their domestic legislation and practices, must respect when dealing with foreign nationals and their property."[319] As such, this standard establishes an absolute minimum "floor below which treatment of foreign investors must not fall."[320]

Currently, this "floor" defines certain categories of treatment that thereby constitute the protection accorded to investments under Article 1105(1). One such category is a State's obligation to prevent a "denial of justice," which arises, for example, when its judiciary administers justice to aliens in a "notoriously unjust"[321] or "egregious"[322] manner "which offends a sense of judicial propriety."[323] Another such standard is a State's responsibility to provide a minimum level of internal security and law and order, which is found in the customary international legal obligation to accord

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[319] OECD DIRECTORATE FOR FIN. AND ENTER. AFFAIRS, WORKING PAPERS ON INTERNATIONAL INVESTMENT NO. 2004/3, FAIR AND EQUITABLE TREATMENT STANDARD IN INTERNATIONAL INVESTMENT LAW 8 n. 32 (2004) ("OECD WORKING PAPER ON FAIR AND EQUITABLE TREATMENT").

[320] *S.D. Myers v. Canada*, First Partial Award ¶ 259; *see also* Edwin Borchard, *The 'Minimum Standard' of the Treatment of Aliens*, 33 AM. SOC'Y OF INT'L PROC. 51, 58 (1939). Likewise, the OECD Working Group on Fair and Equitable Treatment expressly recognized that the minimum standard of treatment of foreign direct investment under customary international law "is an 'absolute,' 'non-contingent' standard of treatment, . . . as opposed to the 'relative standards' embodied in 'national treatment' . . . ." OECD WORKING PAPER ON FAIR AND EQUITABLE TREATMENT 2, 8 n.32.

[321] Jan Paulsson, DENIAL OF JUSTICE IN INTERNATIONAL LAW 44 (2005) (citing J. Irizarry y Puente, *The Concept of "Denial of Justice" in Latin America*, 43 MICH. L. REV. 383, 406 (1944)); *id.* at 4 ("[A] state incurs responsibility if it administers justice to aliens in a fundamentally unfair manner.") (emphasis omitted); *Chattin Case* (U.S. v. Mex.), 4 R. INT'L ARB. AWARDS 282, 286-87 (1927), *reprinted in* 22 AM. J. INT'L L. 667, 672 (1928) ("Acts of the judiciary … are not considered insufficient unless the wrong committed amounts to an outrage, bad faith, wilful neglect of duty, or insufficiency of action apparent to any unbiased man.") (emphasis omitted); D.P. O'Connell, 2 INTERNATIONAL LAW 948 (2d ed. 1970) ("Bad faith and not judicial error seems to be the heart of" a denial of justice claim) (footnotes omitted).

[322] Jan Paulsson, DENIAL OF JUSTICE IN INTERNATIONAL LAW 60 (2005) ("The modern consensus is clear to the effect that the factual circumstances must be egregious if state responsibility is to arise on the grounds of denial of justice.").

[323] *Loewen Group v. United States*, Award ¶ 132 (a denial of justice may arise where there has occurred a "[m]anifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety").

"full protection and security" to investments of investors.[324] The minimum standard of treatment also bars direct and indirect expropriation without prompt, adequate, and effective compensation.[325] NAFTA Chapter Eleven, however, sets out the expropriation obligation in its own provision, Article 1110.

The NAFTA Parties agreed that the minimum standard of treatment obligation under Article 1105(1) would extend only to the "investments of investors of another Party," *i.e.*, the foreign investor's economic stake in the host State. Thus the treatment accorded to matters other than a foreign investor's investment in the host State cannot support a claim under Article 1105(1). This limitation is consistent with the commentary to the OECD Draft Convention on the Protection of Foreign Property, which states that the minimum standard of treatment reflects the "well-established general principle of international law that a State is bound to respect and protect the *property* of nationals of other States."[326]

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[324] *See, e.g.*, *Asian Agric. Prods., Ltd. v. Rep. of Sri Lanka*, ICSID Case No. ARB/87/3, Final Award ¶¶ 85-86 (June 27, 1990) (finding that Sri Lanka violated the full protection and security obligation under the minimum standard when it failed to take measures which would have prevented harm to farm in the course of counter-insurgency); *Am. Mfg. & Trading, Inc. v. Zaire*, ICSID Case No. ARB/93/1, Award ¶ 6 (Feb. 21, 1997) (explaining that the obligation to provide full protection and security under international law makes it incumbent upon the State receiving an investment to "take all measures necessary" to ensure the physical security of an investment and finding that Zaire violated that obligation when it failed to prevent looting of American Manufacturing's property).

[325] *See, e.g.*, OECD DIRECTORATE FOR FIN. AND ENTER. AFFAIRS, WORKING PAPERS ON INTERNATIONAL INVESTMENT NO. 2004/4, "INDIRECT EXPROPRIATION" AND THE "RIGHT TO REGULATE" IN INTERNATIONAL INVESTMENT LAW at 2 (2004) ("It is a well recognized rule of international law that the property of aliens cannot be taken, whether for public purposes or not, without adequate compensation ."); G.C. Christie, *What constitutes a Taking of Property Under International Law*, 38 BRIT. Y.B. INT'L L. 307, 307 (1962) (examining "the question of what constitutes a taking of the kind that brings into operation the widely recognized rule of international law that the property of aliens cannot normally be taken, whether for public purpose or not, without adequate compensation"); IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 535-36 (5TH ED. 1998) ("The rule supported by all leading 'Western' governments and many jurists in Europe and North America is as follows: the expropriation of alien property is lawful if prompt, adequate, and effective compesation is provided for.").

[326] OECD Draft Convention on the Protection of Foreign Property, Oct. 12, 1967, *reprinted in* 7 I.L.M. 117 (1968) (emphasis added). Likewise, the 2004 U.S. Model BIT recognizes that the customary international law minimum standard of treatment "refers to all customary international law principles that protect the

Furthermore, because the minimum standard of treatment sets an absolute minimum "floor below which treatment of foreign investors must not fall,"[327] that floor cannot provide special treatment for particular classes of investors or investments.

Finally, as provided in the FTC interpretation, a "determination that there has been a breach … of a separate international agreement, does not establish that there has been a breach of Article 1105(1)."[328] The investor-State dispute resolution provisions of Chapter Eleven do not provide a forum for enforcing rights that a claimant may have under other international agreements.[329] Nor can Claimants import obligations indirectly from separate international legal instruments by characterizing those obligations as "relevant rules of international law" for purposes of interpreting Article 1105(1).[330] "[R]elevant rules of international law" under Article 31(3)(c) of the Vienna Convention cannot override a treaty provision, much less a treaty provision that has been expressly interpreted by the Parties.[331] Claimants' attempt to the contrary should be rejected.

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economic rights and interests of aliens." 2004 Model BIT, Annex A (emphasis added). Recent Bilateral Investment Treaties ("BITs") and Free Trade Agreements ("FTAs") signed by the United States have included the same language. *See, e.g.*, U.S.-Uru. Bilateral Investment Treaty, Nov. 4, 2008, Annex A; U.S.-Rwanda Bilateral Investment Treaty, Feb. 19, 2008, Annex A; U.S.-S. Korea Free Trade Agreement, June 30, 2007, Annex 11-A. *See also* Alireza Falstafi, *The International Minimum Standard of Treatment of Foreign Investors' Property: A Contingent Standard*, 30 SUFFOLK TRANSNAT'L L. REV. 317, 356-57 (2007) ("The minimum standard of treatment must operate within the framework of international rules regarding the treatment of foreign investment or property" or risk creating a standard that could "accommodate *any* claim of responsibility for injury." Such an approach "is vulnerable to the substitution of the subjective perception of the observer for the international law on the treatment of foreign investors' property.").

[327] *See S.D. Myers*, *supra* n. 320, ¶259.

[328] FTC Interpretation ¶ B(3).

[329] *See Mondev v. United States*, Award ¶ 121 ("If there had been an intention to incorporate by reference extraneous treaty standards in Article 1105 and to make Chapter 11 arbitration applicable to them, some clear indication of this would have been expected.").

[330] *See* Vienna Convention art. 31(3)(c) ("any relevant rules of international law applicable in the relations between the parties" shall be taken into account when interpreting a treaty provision, together with the treaty's context).

[331] *See, e.g.*, Alexander Orakhelashvili, *Restrictive Interpretation of Human Rights Treaties in the Recent Jurisprudence of the European Court of Human Rights*, 14 EUR. J. INT'L L. 529, 537 (2003) ("Relevant

In sum, Article 1105(1) affords the investments of investors only the customary international law minimum standard of treatment of aliens—no more and no less.

b. The Obligations Alleged By Claimants, Which They Have Not Shown To Be Included Within The Minimum Standard Of Treatment, Were In Any Case Not Violated Here

Claimants attempt to derive two broad minimum standard of treatment obligations from the international legal principle of "good faith," which they hope to insert within the minimum standard of treatment: (i) a prohibition against frustrating an investor's "basic" expectations about the regulatory environment and other specific legal obligations that were in place when the investor chose to invest and (ii) a general prohibition on discrimination against foreign investors.[332] Claimants fail to demonstrate that such alleged obligations are part of the minimum standard of treatment. Specifically, Claimants fail to establish that their alleged obligations are supported by (i) consistent state practice; and (ii) *opinio juris*, or an understanding that such practice is required by law.[333] Even if Claimants were able to establish such obligations, however, such obligations have not been violated in this case.

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rules" under Article 31(3)(c) may not, generally speaking, override or limit the scope or effect of a provision for whose clarification they are referred."); *RosInvestCo UK Ltd. v. Russian Fed.* SCC Case No. V079/2005, Award on Jurisdiction ¶ 39 (Oct. 1, 2007) (observing that Article 31(3)(c) should not "amount to a general licence to override" terms of a treaty).

[332] *See* Mem. ¶¶ 161-68, 178.

[333] *See Continental Shelf Case* (Libya v. Malta), 1985 I.C.J. Rep. 13, 29 (June 3, 1985) ("It is of course axiomatic that the material of customary international law is to be looked for primarily in the actual practice and opinio juris of States . . . ."); *Military and Paramilitary Activities in and Against Nicaragua Case* (Nicar. v. U.S.), 1986 I.C.J. 14 , 108-09 (Nov. 26, 1986) ("[F]or a new customary rule to be formed, not only must the acts concerned 'amount to a settled practice,' but they must be accompanied by the opinio juris sive necessitates. Either the States taking such action or other States in a position to react to it, must have behaved so that their conduct is 'evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it.'"); *see also* CLIVE PARRY ET AL., ENCYCLOPAEDIC DICTIONARY OF INTERNATIONAL LAW 81-82 (1986) (customary international legal rule emerges from "a concordant

When arguing that the "principle of good faith" is part of the minimum standard of treatment, Claimants mischaracterize the role of "good faith" under customary international law.[334] "The principle of good faith is … 'one of the basic principles governing the creation and performance of legal obligations'; … [but] *it is not in itself a source of obligation where none would otherwise exist*."[335] As such, customary international law does not impose a free-standing, substantive obligation of "good faith" that, if breached, can result in State liability. Absent a specific treaty obligation, a Claimant "may not justifiably rely upon the principle of good faith" to support a claim.[336] Claimants submit no evidence of State practice or *opinio juris* to contradict this well-

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practice of a number of States acquiesced in by others; and a conception that the practice is required by or consistent with the prevailing law (the *opinio juris*)").

The party relying on custom "must prove that this custom is established in such a manner that it has become binding on the other Party," *Asylum Case* (Colom. v. Peru), Judgment, 1950 I.C.J. Rep. 266, 276 (Nov. 20, 1950). The relevant state practice "should have been both extensive and virtually uniform in the sense of the provision invoked; -- and should moreover have occurred in such a way as to show a general recognition that a rule of law or legal obligation is involved." *North Sea Continental Shelf Cases* (F.R.G. v. Den.; F.R.G. v. Neth.), 1969 I.C.J. 3, 43, ¶ 74 (Feb. 20, 1969). Once the claimant has demonstrated a particular custom, the claimant must then show that the State has engaged in conduct that violated the applicable rule. *See, e.g.*, *Tradex Hellas S.A. v. Albania*, ICSID Case No. ARB/94/2, Final Award ¶ 74 (Apr. 29, 1999) ("[I]t is the claimant who has the burden of proof for the conditions required in the applicable substantive rules of law to establish the claim. … A Party having the burden of proof must not only bring evidence in support of his allegations, but must also convince the Tribunal of their truth, lest they be disregarded for want, or insufficiency, of proof.") (internal quotation omitted); BIN CHENG, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS 334 (1987) ("[T]he general principle [is] that the burden of proof falls upon the claimant …."); *Feldman v. Mexico*, Award ¶ 177 ("[I]t is a generally accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a claim or defence."). *See also* NGUYEN QUOC DINH, PATRICK DALLIER & ALAIN PELLET, DROIT INTERNATIONAL PUBLIC 334-35 § 214 (7th ed. 2002) (burden is placed on the party "who relies on a custom to establish its existence and exact content") ("qui s'appuie sur une coutume d'en établir l'existence et la portée exacte") (translation from French by counsel); IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 12 (6th ed. 2003) ("In practice the proponent of a custom has a burden of proof the nature of which will vary according to the subject-matter and the form of the pleadings.").

[334] *See* Mem. ¶¶ 161-63, 171-74.

[335] *Border and Transborder Armed Actions Case* (Nicar. v. Hond.), 1988 I.C.J. Rep. 69, 105, ¶ 94 (Dec. 20, 1988) (emphasis added).

[336] *Land and Maritime Boundary Case* (Cameroon v. Nig.), 1998 I.C.J. 275, 297, ¶ 39 (June 11, 1998).

settled rule.[337] Claimants' attempt to characterize the international law principle of good faith as a free-standing obligation should be rejected.[338]

Furthermore, Claimants' attempts to derive "expectations" and discrimination obligations from the principle of "good faith" are equally unsound. A general principle of international law that does not impose any substantive obligations on a State toward foreign investors cannot itself create *additional* State obligations toward such investors. Even if such additional obligations could be read into the minimum standard of treatment, however, Claimants have failed to show that the minimum standard of treatment protects a foreign investor's "basic" expectations, whether it be to a "transparent and predictable business and regulatory environment,"[339] certain treatment under the Jay Treaty;[340] or U.S. federal Indian law.[341] Likewise, Claimants have failed to demonstrate that the minimum standard of treatment provides a blanket prohibition against discrimination

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[337] The arbitral decisions on which Claimants rely do not find good faith to be a free-standing obligation under customary international law. *See, e.g.*, *Sempra Energy Int'l v. Argentine Rep.*, ICSID Case No. ARB/02/16, Award ¶ 298 (Sept. 28, 2007) (referring to the "good faith requirement" in the context of an existing treaty obligation of fair and equitable treatment); *Siemens A.G. v. Argentina*, ICSID Case No. ARB/02/8, Award ¶ 308 (Feb. 6, 2007) (finding that the "fair and equitable treatment" obligation includes a "principle of good faith"); *Tecmed v. Mexico,* Award ¶ 154 (analyzing existing treaty obligation of fair and equitable treatment "in light of the good faith principle established by international law").

[338] Claimants similarly fail to establish a free-standing obligation under the rule of *pacta sunt servanda* – that "[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith." Vienna Convention art. 26; *see also* Report of the International Law Commission Covering Its 16th Session, 727th Meeting, 20 May 1964, [1964] 1 Y.B. INT'L L. COMM'N 27-32, ¶ 70, U.N. Doc. A/CN.4/SER.A/1964 ("[A] treaty must be applied and observed not merely according to its letter, but in good faith" including "abstain[ing] from acts which would inevitably affect [the Parties'] ability to perform the treaty."). A rule of treaty interpretation, *pacta sunt servanda* cannot be transformed into an open-ended source for claimants to import other international obligations. In support of their argument, Claimants rely on the Separate Opinion of Judge Cancado Trindade in *Hilaire, Constantine, and Benjamin v. Trindidad and Tobago*, Series C No. 94 [2002] IACHR 4 (June 21, 2002). But that Separate Opinion addressed the rule of *pacta sunt servanda* in the context of Trinidad and Tobago's fulfillment of "the international obligations that it has assumed." *See id.* ¶ 43.

[339] *See* Mem. ¶¶ 164-68, 202-12.

[340] *See* Mem. ¶¶ 220-29.

[341] *See* Mem. ¶¶ 220-29.

against foreign investors.[342] Finally, even if such obligations were protected by the minimum standard of treatment, Claimants fail to demonstrate that their claims would prevail.

2. The Minimum Standard Of Treatment Does Not Obligate States To Protect An Investor's Expectations

Contrary to Claimants' assertions,[343] States are not obligated to protect a foreign investor's expectations—legitimate or otherwise—under the minimum standard of treatment.[344]

Notably, as a factual matter and contrary to their assertions, Claimants could not possibly have had any "legitimate expectation" that the allocable share release mechanism under the original escrow statutes would not be amended. Under the original escrow statutes, for NPM sales in 2003, NPMs obtained releases of approximately $137 million dollars (out of approximately $236 million in escrowed funds).[345] Such a shortfall of available funds for Settling States to satisfy potential future tobacco-related judgments against NPMs plainly was unsustainable. As discussed below, the allocable share amendments were both reasonable and predictable.

As a matter of international law, although an investor may develop its own expectations about the legal regime that governs its investment, those expectations do not impose a legal obligation on the State.[346] Even if, unlike in this case, Claimants had

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[342] *See* Mem. ¶¶ 179-92.

[343] *See* Mem. ¶¶ 161-63.

[344] Claimants' arguments with respect to their alleged open-ended discrimination obligation under Article 1105 are addressed in Merits-Liability Sec. II.B.3 below.

[345] Hering Declaration ¶ 3.

[346] *CMS Gas Transmission v. Argentine Rep.*, ICISD No. ARB/01/8, Annulment Proceeding, ¶ 89 (Sept. 25, 2007) ("Although legitimate expectations might arise by reason of a course of dealing between the investor and the host State, these are not, as such, legal obligations.").

entered into a contractual relationship with the Settling States, a mere breach of contract cannot, by itself, amount to a breach of the minimum standard of treatment.[347] To breach the minimum standard of treatment, something more is required, such as a complete repudiation of the contract or a denial of justice in the execution of the contract.[348] NAFTA Chapter Eleven tribunals recognize this point.[349]

Similarly, Claimants' assertion that a foreign investor's "detrimental reliance" on the investment climate of a host State can violate the minimum standard of treatment

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[347] *See SGS Société Générale de Surveillance S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Decision on Jurisdiction ¶ 167 (Aug. 6, 2003) (noting "the widely accepted principle . . . that under general international law, a violation of a contract entered into by a State with an investor of another State, is not, by itself, a violation of international law"); *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction ¶ 122 (Jan. 29, 2004) (citing *SGS v. Pakistan* with approval); *Draft Articles on Responsibility of States for Internationally Wrongful Acts Adopted by the Drafting Committee on Second Reading*, art. 4, cmt. ¶ 6, 53rd Sess. [2001] 2:2 Y.B. INT'L L. COMM'N 40, U.N. Doc. A/56/10 ("Of course the breach by a State of a contract does not as such entail a breach of international law."); F.V. García-Amador, Special Rapporteur, *International Responsibility: Fourth Report*, [1959] 2 Y.B. INT'L L. COMM'N 30, ¶ 123, U.N. Doc. A/CN.4/119 (Feb. 26, 1959) ("Diplomatic practice and international case-law have traditionally accepted almost as dogma the idea that the mere non-performance by a State of its obligations under a contract with an alien individual does not in itself necessarily give rise to international responsibility."); F. A. Mann, *State Contracts and State Responsibility*, 54 AM. J. INT'L L. 572, 578 (1960) (pointing out that no States other than Switzerland and France have adopted the view that mere contractual breaches give rise to a breach of international law and that the United States "has, for more than a century and a half, been clearly opposed to it").

[348] *See Draft Articles on Responsibility of States for Internationally Wrongful Acts*, art. 4, cmt. ¶ 6, 53rd Sess. [2001] 2:2 Y.B. INT'L L. COMM'N 40, U.N. Doc. A/56/10 ("Something further is required before international law becomes relevant, such as a denial of justice by the courts of the State in proceedings brought by the other contracting party."); *Compañía de Aguas del Aconquija S.A. v. Argentine Rep.*, ICSID Case No. ARB/97/3, Decision on Annulment ¶ 110 n.78 (July 3, 2002) ("*Vivendi II*") (explaining that the determination of whether particular conduct violates a treaty cannot be satisfied by an examination of that conduct in context of contractual rights and duties alone; also citing ROBERT JENNINGS & ARTHUR WATTS, OPPENHEIM'S INTERNATIONAL LAW 927 (9th ed. 1992): "It is doubtful whether a breach by a state of its contractual obligations with aliens constitutes per se a breach of an international obligation, unless there is some additional element as denial of justice, or expropriation, or breach of treaty, in which case it is that additional element which will constitute the basis for the state's international responsibility.").

[349] *See Azinian v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award ¶ 87 (Nov. 1, 1999) ("NAFTA does not, however, allow investors to seek international arbitration for mere contractual breaches. Indeed, NAFTA cannot possibly be read to create such a regime, which would have elevated a multitude of ordinary transactions with public authorities into potential international disputes."); *Waste Mgmt. V. Mexico*, Award ¶ 115 (explaining that "even the persistent non-payment of debts by a municipality is not equated with a violation of Article 1105, provided that it does not amount to an outright and unjustified repudiation of the transaction and … some remedy is open to the creditor to address the problem").

cannot withstand scrutiny.[350] Claimants provide no evidence of State practice establishing such an obligation. In fact, tribunals discussing state practice confirm the opposite; namely, that a State acting in its sovereign capacity does not incur liability for an investor's purported detrimental reliance on the state of the business or regulatory climate in which it invests. The *Methanex* panel, for example, rejected claimant's argument that it was entitled to the preservation of the preferences it had received for access in the MTBE market because "the very market for MTBE in the United States was the result of precisely this [the MTBE] regulatory process."[351]

The weakness of Claimants' "expectations" theory is further illustrated by the principal authority on which they rely for support. Claimants place particular weight on the *Tecmed v. Mexico* award,[352] but that decision has been criticized for exceeding the scope of international obligations that bind States. As the *ad hoc* tribunal in the *MTD Equity v. Chile* annulment observed, "the *TECMED* Tribunal's apparent reliance on the foreign investor's expectations as the host State's obligations … is questionable" because "[t]he obligations of the host State towards foreign investors derive from the terms of the

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[350] *See* Mem. ¶¶ 161-63.

[351] *Methanex Corp. v. United States*, Final Award, pt. IV, ch. D ¶ 9. Similarly, the Permanent Court of International Justice concluded in the *Oscar Chinn* case that a State's business and regulatory regime does not create "vested rights," *i.e.*, actionable rights, that would prevent a State from changing its regulatory environment to meet new needs or address economic problems. *See Oscar Chinn Case*, 1934 P.C.I.J. (Ser. A/B) No. 63, at 88-89 (Dec. 12, 1934) (rejecting British claim of violation of "general principles of international law" of "vested rights" on behalf of national) ("Favourable business conditions and goodwill are transient circumstances, subject to inevitable changes . . . [when industries are] exposed to the danger of ruin or extinction if circumstances change . . . no vested rights are violated by the State."); s*ee also* G. Kaeckenbeeck, *The Protection of Vested Rights in International Law*, 17 BRIT. Y.B. INT'L L. 1, 2-3 (1936) (noting that the "liberty to embark upon industry or commercial activity" was not a "vested right"); *see also id.* at 3 ("By vested right, however, is not as a rule here meant every legal relation of a determinate person. Abstract faculties or qualities of all men or of whole classes of men, *as well as expectations founded on the law*, are not vested rights, and are normally destroyed by a new law.").

[352] *Tecmed v. Mexico*, Award, *supra* note 246.

applicable investment treaty and not from any set of expectations investors may have or claim to have."[353]

Claimants submit no evidence of State practice establishing a legal obligation not to frustrate an investor's expectations formed at the time the investor made its investment. State practice, in fact, tends to support the opposite view. As Claimants acknowledge,[354] under customary international law, States may regulate to achieve legitimate objectives to benefit the public welfare and will not incur liability solely because the change interferes with an investor's "expectations" about the state of the business environment.[355] The protection of public health falls squarely within that regulatory authority under international law.[356]

As the *S.D. Meyers* tribunal recognized, the determination of a breach of the obligation of 'fair and equitable treatment' by the host State "must be made in the light of the high measure of deference that international law generally extends to the right of

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[353] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile*, ICSID Case No. ARB/01/7, Decision on Annulment ¶ 67 (Mar. 21, 2007).

[354] *See* Mem. ¶ 154 (recognizing that the minimum standard of treatment obligation under Article 1105 "requires due respect for the right of a sovereign State to regulate in the best interests of its citizens").

[355] *Feldman v. Mexico*, Award ¶ 112 ("Governments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social consideration. Those changes may well make certain activities less profitable or even uneconomic to continue.").

[356] *See, e.g.*,LOUIS B. SOHN AND R.R. BAXTER, CONVENTION ON THE INTERNATIONAL RESPONSIBILITY OF STATES FOR INJURIES TO ALIENS, FINAL DRAFT WITH EXPLANATORY NOTES, ART. 10(5) (1961), REPRINTED IN F.V. GARCÍA-AMADOR ET AL., RECENT CODIFICATION OF THE LAW OF STATE RESPONSIBILITY FOR INJURIES TO ALIENS 204-05 (1974) ("An uncompensated taking of an alien property or a deprivation of the use or enjoyment of property of an alien which results from the execution of tax laws; from a general change in the value of currency; from the action of the competent authorities of the State in the maintenance of public order, health, and morality; or from the valid exercise of belligerent rights or otherwise incidental to the normal operation of the laws of the State shall not be considered wrongful."); *see also* OECD Draft Convention on the Protection of Foreign Property, Oct. 12, 1967, *reprinted in* 7 I.L.M. 117, accompanying note to Article 3 ("Article 3 acknowledges, by implication, the sovereign right of a State, under international law, to deprive owners, including aliens, of property which is within its territory in the pursuit of its political, social,or economic ends. To deny such a right would be [to] attempt to interfere with its powers to regulate – by virtue of its independence and autonomy, equally recognized by international law – its political and social existence.").

domestic authorities to regulate matters within their own borders."[357] As such, a host State is accorded "wide discretion with respect to how it carries out [its public welfare] policies by regulation" and is free to change such policies to address legitimate public needs.[358] Tribunals are consequently reluctant to second-guess decisions made by State officials because "[g]overnments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive."[359] None of Claimants' authorities contradicts these principles.

a. Claimants Fail To Demonstrate Any Obligation To Provide Investors With A "Transparent And Predictable Business And Regulatory Climate" Under The Minimum Standard Of Treatment

Claimants fail to demonstrate that the minimum standard of treatment obligates States to provide a "transparent" and "stable" or "predictable" regulatory environment.[360] The authorities cited by Claimants do not demonstrate that "transparency" is protected by the minimum standard of treatment.[361] Claimants' main support for a "transparent" regulatory environment, *Metalclad v. Mexico*,[362] has been set aside on this precise point by the Supreme Court of British Columbia. The Court found that Metalclad had failed to

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[357] *S.D. Myers v. Canada*, First Partial Award ¶ 263.

[358] *Int'l Thunderbird Gaming v. Mexico*, Award ¶ 127.

[359] *S.D. Myers v. Canada*, First Partial Award ¶ 261

[360] Mem. ¶¶ 200(a), 202-12.

[361] Similarly, Claimants point to no case interpreting the minimum standard of treatment or identifying State practice that establishes an obligation to provide an investor with a "predictable" regulatory environment.

[362] *United Mexican States v. Metalclad Corp.*, 5 ICSID REP. 236 ¶ 70 (Sup. Ct. B.C.) (May 2, 2001).

introduce any evidence of any kind "to establish that transparency has become a part of customary international law" and held that the *Metalclad* tribunal had exceeded its authority because it had "misstated the applicable law to include transparency obligations and then made its decision on the basis of the concept of transparency."[363] By comparison, NAFTA tribunals that have rejected the notion of transparency as an element of customary international law have based their conclusion on State practice and are, as such, more persuasive authorities for interpreting the scope of Article 1105(1).[364]

Indeed, the NAFTA itself, in Chapter Eighteen, imposes specific transparency obligations that are limited to publication, notification and provision of information, administrative proceedings, and review and appeal.[365] Claims that a Party has violated one of these Chapter Eighteen obligations may not be brought by individuals but must be resolved on a State-by-State basis under Chapter Twenty.[366] Moreover, as confirmed by the binding FTC interpretation, a "breach of another provision of the NAFTA does not establish that there has been a breach of Article 1105(1)."[367]

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[363] *Id. See also* OECD DIRECTORATE FOR FIN. AND ENTER. AFFAIRS, WORKING PAPERS ON INTERNATIONAL INVESTMENT NO. 2004/3, FAIR AND EQUITABLE TREATMENT STANDARD IN INTERNATIONAL INVESTMENT LAW at 37 (2004) (concluding that "[i]n a few cases, Arbitral Tribunals have defined "fair and equitable treatment" drawing upon a relatively new concept *not generally considered a customary international law standard: transparency*") (emphasis added).

[364] *See, e.g., S.D. Myers, Inc. v. Canada*, First Partial Award (Sep. Op. by B. Schwartz (concurring in part)) ¶ 241 (Nov. 13, 2000) (noting the "absence of evidence" of acceptance "by states throughout the world" supporting the proposition that "transparency in the making of regulations is part of general international law"); *Feldman v.Mexico*, Award ¶ 133 ("[I]t is doubtful that lack of transparency alone rises to the level of violation of NAFTA and international law.").

[365] *See* NAFTA arts. 1802-1805.

[366] *See* NAFTA arts. 2004-2019.

[367] FTC interpretation, ¶B(3).

b. Even Assuming That The Minimum Standard Of Treatment Obligates States To Provide Foreign Investors With A "Transparent And Predictable" Regulatory Environment, Claimants Fail To Demonstrate A Violation Of That Standard

Even if the minimum standard of treatment protected an investor's "expectations" of a "transparent and predictable" regulatory environment,[368] the allocable share amendments were not only transparent, but reasonable and predictable.

i. The Settling States Made No "Offer" Allowing NPMs To Avoid Escrow Deposit Obligations By Adopting A "Regional" Sales Strategy

In an attempt to allege some kind of specific assurance, Claimants make unsupported assertions for the first time in these proceedings that the Settling States, through the MSA, made a "unilateral offer" to the NPMs that they could avoid escrow payments by operating on a regional, rather than national, basis.[369] Claimants provide no evidence of such an offer.[370]

Claimants' lack of evidence to support their alleged "unilateral offer" is not surprising. Such an offer would have been directly contrary to the very purpose of the escrow statutes, which was to ensure that adequate funds would be available to satisfy potential future tobacco-related judgments against NPMs. To "offer" NPMs the option of avoiding escrow payments by concentrating sales in only a few States would have been to ensure that Settling States would *not* have adequate funds for future judgments. The escrow statutes were premised on the assumption that NPMs would operate on a national

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[368] Mem. ¶ 165.

[369] Mem. ¶ 203.

[370] In his witness statement, Jerry Montour alleges that he was advised by *counsel* that the MSA and escrow statutes would allow regional tobacco enterprises to effectively compete under the new regime, so long as they did not attempt to expand sales of their brand beyond a limited number of states. *See* Jerry Montour Statement ¶ 43. Advice from counsel cannot be transformed into a "unilateral offer" by the Settling States.

basis.[371] It was that very assumption that enabled NPMs, like Grand River, to exploit the allocable share release provision by concentrating their sales in only a few Settling States. Claimants' baseless allegation of a "unilateral offer" by the Settling States should be rejected.

ii. Claimants' Bare Assertion That State Officials Promised A "Level Playing Field" Between Regional NPMs and Grandfathered SPMs Operating On A National Basis Should Be Rejected

Claimants also assert that the original allocable share release mechanism was "obviously intended" to provide a level playing field between regional NPMs and grandfathered SPMs operating on a national basis, and that Claimants were entitled to take "state officials . . . at their word" on this point.[372] Claimants provide no evidence of any discussion concerning the "playing field" allegedly existing between regional NPMs and grandfathered SPMs. The very concept of a "regional NPM" runs directly contrary to the escrow statutes, which assumed that NPMs would operate on a national basis.[373] As stated by Professor Gruber, the allocable share release mechanism provided an "enormous" advantage for NPMs that concentrated their sales in a particular State.[374] It was the *amendment* of the release provision that leveled the playing field contemplated by "state officials," namely the playing field between PMs and NPMs.

Claimants' growth in the U.S. market and substantial increases in revenue and income demonstrate the extent to which they benefited from this competitive advantage

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[371] Facts Sec. IV.

[372] Mem. ¶ 209.

[373] Facts Sec. IV; Gruber Report ¶ 18.

[374] Gruber Report ¶ 19.

[375] This growth is reflected in the overall increase in NPM market share following the MSA's implementation, from 1.6 percent in 1999 to 8.1 percent in 2003.[376]

The MSA was not intended to grant such a windfall to NPMs. Claimants' allegations of an uneven playing field between "regional" NPMs and grandfathered SPMs operating on a national basis should be rejected.

iii. The Amendments Closing the Loophole In the Allocable Share Release Provision Were Enacted In A Transparent Manner

Claimants' allegation that the allocable share release provisions were not enacted in a transparent manner because "NAAG officials" met privately with the OPMs on "the immediate elimination" of the release provisions should be rejected.[377] The only support Claimants provide for this assertion are three documents in which the allocable share release provisions, and the need to amend them, appear to have been discussed by NAAG representatives and some PMs.[378]

The fact that NAAG officials held private meetings with PMs and their representatives to discuss the MSA, including the concern that the allocable share release provisions had created a loophole, does not amount to a lack of transparency. The

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[375] Facts Sec. IX.

[376] Facts Sec. IV.

[377] Mem. ¶ 207.

[378] *See* Mem. Exh. 38.

tribunal in *Methanex* recognized that private meetings are a part of the democratic process and do not alone support the inference that a legislative process lacks transparency because "[l]egislation in democratic systems involves, by its nature, participation by a wide spectrum of private individuals and interest groups in addition to the members of the legislature and the executive, insofar as its endorsement is also necessary for a bill to become law."[379] The fact that NPMs were not included in some private communications between those tobacco manufacturers who elected to sign the MSA and NAAG, an association that coordinates efforts among state Attorneys General, including Attorneys General of the Settling States, simply does not amount to a lack of transparency.

In fact, the amendments were drafted and passed through transparent legislative procedures.[380] During the adoption of the amendments, the legislatures in the Settling States held hearings at which both the PMs and NPMs expressed their views for and against the measures.[381] Even if there were a transparency obligation under Article 1105(1), allowing the participation in the legislative process of all those affected by the proposed amendments fully satisfied any transparency obligation owed to Claimants.

iv. The Amendments Closing The Loophole In The Allocable Share Release Provision Were Predictable

Finally, Claimants' allegations that the amendments to the allocable share release provisions were not predictable because they created a "roller coaster effect"[382] is

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[379] *Methanex v. United States*, Final Award, Part. III, Ch. B, ¶ 46.

[380] Facts Sec. IV.

[381] Facts Sec. IV.

[382] Mem. ¶ 166.

untenable.[383] As discussed below, the amendments to the allocable share release provisions were a predictable correction, *i.e.*, one that an investor could anticipate, to the problem of excess escrow releases to NPMs that emerged in the operation of the escrow statutes. In response to the emergence of a competitive advantage for NPMs that undermined the basic objectives of the MSA, there was *one* change to the escrow statutes—the elimination of the loophole that allowed NPMs to avoid their escrow obligations by concentrating their sales in only a few states rather than selling their cigarettes nationally, as the escrow statutes assumed was the practice.[384] This change was made beginning in 2003, four years after the MSA was executed, which was the time it took for the Settling States to realize the impact of the unanticipated loophole that was discovered in the allocable share release provision. The escrow statutes clearly have not been long-standing, nor were they adopted in a way that created uncertainty, through repeated changes, about what rules governed NPM escrow obligations.[385]

States may regulate one step at a time to correct errors in regulations or to address problems that may arise as new regulations are implemented.[386] Moreover, where an industry is already highly regulated, reasonable extensions of those regulations are foreseeable.[387] Given the public health concerns that arise from the use of cigarettes and

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[383] Mem. ¶¶ 202-12.

[384] Facts Sec. IV.

[385] *See* Mem. ¶¶ 164-168.

[386] *See Eastern Sugar B.V. v. Czech Rep.*, UNCITRAL, SCC No. 088/2004, Partial Award ¶ 272 (Mar. 27, 2007) ("[A] BIT may also not be invoked each time the law is flawed or not fully and properly implemented by a state. Some attempt to balance the interests of the various constituents within a country, some measure of inefficiency, a degree of trial and error, a modicum of human imperfection must be overstepped before a party may complain of a violation of a BIT. Otherwise, every aspect of any legislation of a host state or its implementation could be brought before an international arbitral tribunal under the guise of a violation of the BIT. This is obviously not what BITs are for.").

[387] *See, e.g.*, *Methanex v. United States*, Final Award, Part IV, Ch. D ¶ 9 (rejecting indirect expropriation claim because "Methanex entered a political economy in which it was widely known, if not notorious, that

other tobacco products, the sale and use of cigarettes are subject to numerous types of regulation at the federal,[388] state,[389] and local[390] level, which exist separate from the MSA regime. Even Claimants concede that an investor cannot expect a State never to change its regulatory environment.[391] On these grounds alone, Claimants' arguments should be rejected.

Additionally, the need to correct the error in the escrow statutes was predictable, for four reasons. *First*, the allocable share release provisions undermined the goal of the escrow statutes to "effectively and fully neutralize[] the cost disadvantages" suffered by PMs relative to NPMs.[392] Under the MSA regime, payment obligations for PMs, and deposit obligations for NPMs, were intended to be roughly equivalent, as in fact they are

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governmental environmental and health protection institutions at the federal and state level, operating under the vigilant eyes of the media, interested corporations, non-governmental organizations and a politically active electorate, continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons").

[388] *See, e.g. Food and Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 137-38 (2000) ("Congress has directly addressed the problem of tobacco and health through legislation on six occasions since 1965. See Federal Cigarette Labeling and Advertising Act (FCLAA), Pub. L. 89-92, 79 Stat. 282; Public Health Cigarette Smoking Act of 1969, Pub. L. 91-222, 84 Stat. 87; Alcohol and Drug Abuse Amendments of 1983, Pub. L. 98-24, 97 Stat. 175; Comprehensive Smoking Education Act, Pub. L. 98-474, 98 Stat. 2200; Comprehensive Smokeless Tobacco Health Education Act of 1986, Pub. L. 99-252, 100 Stat. 30; Alcohol, Drug Abuse, and Mental Health Administration Reorganization Act, Pub. L. 102-321, § 202, 106 Stat. 394."); *see id.* at 143 ("Those statutes, among other things, require that health warnings appear on all packaging and in all print and outdoor advertisements . . . .").

[389] *See, e.g.*, Michael Whatley, *The FDA v. Joe Camel: An Analysis of the FDA's Attempt To Regulate Tobacco and Tobacco Products Under the Federal Food, Drug And Cosmetic Act*, 22 J. LEG. 121, 126-27 (1996) ("There is currently regulation of these [cigarette] products in all fifty states … includ[ing] restrictions on tobacco and tobacco products use by minors, licensing requirements, and restrictions on vending machine and loose cigarette sales.") (internal citations omitted).

[390] *See, e.g.*, Peter D. Enrich & Patricia A. Davidson, *Local And State Regulation Of Tobacco: The Effects Of The Proposed National Settlement*, 35 HARV. J. LEG. 87 , 88-89 (1998) ("Across the United States, local governments, including city councils, town meetings, county governments, and local health boards and programs, have led the way in adopting the most stringent and innovative tobacco control measures. The toughest youth access, environmental tobacco smoke ("ETS"), and point of sale restrictions have emerged from local communities mobilized to protect themselves and their vulnerable youth from the reach of the tobacco industry.") (internal citations omitted).

[391] *See* Mem. ¶ 154.

[392] MSA § IX(d)(2)(E).

today, with each group subject to obligations of approximately $0.025 per cigarette.[393] Before the allocable share release provision was amended to close the loophole, however, Grand River apparently contributed only "either 30 or 50 cents a carton"[394]—roughly *$0.003* a cigarette—into its escrow account.[395] Given the imbalance in payment obligations between PMs and NPMs such as Grand River, it was predictable that the Settling States would act to close the unintended loophole in the allocable share release provision.

Second, permitting the NPMs to avoid their escrow payments would have undermined another core objective of the escrow statutes, which was to ensure that adequate funds would be available to satisfy any potential future tobacco-related judgments obtained by Settling States against NPMs.[396] By avoiding their escrow obligations, NPMs were no longer making such funds available to the Settling States.

Third, by avoiding their escrow obligations, NPMs undermined the escrow statute goal of ensuring that tobacco manufacturers internalized the health care costs that their cigarettes impose on Settling States.[397] Through operation of the allocable share release, such costs were borne in large part by the Settling States, rather than Grand River.

Fourth, Claimants' assertion that they had "no obvious reason to suspect" that state officials would amend the allocable share release amendments to eliminate this

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[393] *See* Gruber Report ¶¶ 5, 7, 8.

[394] Testimony of Jerry Montour, p. 270, *Grand River Enters. Six Nations, Ltd. v. Pryor*, (S.D.N.Y., May 1, 2006) (No. 02 Civ. 05068).

[395] *See* Facts Sec. VIII.

[396] *See* Facts Sec. IV.

[397] *See* Gruber Report ¶ 10.

loophole is untenable.[398] Claimants had *every* reason to suspect that the Settling States would amend the allocable share release provisions to close the loophole that Grand River so successfully exploited, as their financial performance attests.[399]

In sum, the allocable share amendments were predictable. Even assuming that States are obligated to provide a predictable regulatory environment, such an obligation cannot *prevent* a state from enacting new measures that affect the existing regulatory climate, in particular when such measures are designed to correct an obvious defect in the original regulatory scheme. Claimants' allegations to the contrary should be rejected.

c. Claimants Could Not Have Had Any Legitimate Expectation That Their Distribution And Sale Of Seneca Cigarettes In The United States Would Be Free From Regulation Based On Article 3 Of The Jay Treaty

Claimants contend that the United States violated the minimum standard of treatment obligation incorporated in Article 1105 by frustrating their expectation—ostensibly based on two 200-year-old treaties—that they would be able to participate in the U.S. tobacco industry without any regulatory interference from state governments.[400] Claimants assert that they have relied on Article 3 of the 1794 Jay Treaty and Article 9 of the 1814 Treaty of Ghent when making their alleged investment in the United States,[401]

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[398] *See* Mem. ¶ 209.

[399] *See* Facts Sec. VIII..

[400] *See* Mem. ¶ 227.

[401] *See* Treaty of Amity, Commerce and Navigation, Between His Britannic Majesty and the United States of America, By Their President, with the Advice and Consent of Their Senate, Nov. 19, 1794, U.S.-U.K., T.S. No. 105 ("Jay Treaty"); Treaty of Peace and Amity, Between His Britannic Majesty and the United States of America, Dec. 24, 1814, U.S.-U.K., T.S. No. 109 ("Treaty of Ghent"). Article 3 of the Jay Treaty provides in relevant part:

> It is agreed that it shall at all times be free to his Majesty's subjects, and to the citizens of the United States, and also to the Indians dwelling on either side of the said boundary line, freely to pass and repass by land or inland navigation, into the respective territories and countries of the two parties, on the

claiming that Article 3 gives them the "legitimate expectation" that they can manufacture and distribute billions of deadly cigarettes free from state regulation.[402]

Claimants' reliance on the Jay Treaty, however, does not support finding a breach of Article 1105. *First*, the 1794 Jay Treaty and the 1814 Treaty of Ghent do not provide, and never have provided, a basis for Claimants' purported expectation that they could distribute billions of cigarettes throughout the United States free of any state regulation. *Second*, Claimants could not rely on the duty exemption under Article 3 of the Jay Treaty for any "legitimate expectation" of exemption from state regulation, because the United States has maintained for decades that Article 3 remains in force only to the extent that it relates to the right of Indians to pass across the border. *Third and finally*, even if the provisions of the Jay Treaty and Treaty of Ghent gave rise to an expectation of exemption from state regulation, it already has been established by agreement of the NAFTA

> continent of America . . . and to navigate all the lakes, rivers and waters thereof, and freely to carry on trade and commerce with each other.
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> . . .
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> No duty of entry shall ever be levied by either party on peltries brought by land, or inland navigation into the said territories respectively, nor shall the Indians passing or repassing with their own proper goods and effects of whatever nature, pay for the same any impost or duty whatever. But goods in bales, or other large packages, unusual among Indians, shall not be considered as goods belonging bona fide to Indians.

Article 9 of the Treaty of Ghent provides in relevant part:

> The United States of America engage to put an end, immediately after the ratification of the present treaty, to hostilities with all the tribes or nations of Indians with whom they may be at war at the time of such ratification; and forthwith to restore to such tribes or nations, respectively, all the possessions, rights, and privileges, which they may have enjoyed or been entitled to in one thousand eight hundred and eleven, previous to such hostilities: ....

At the time the United States signed these treaties, Canada was still controlled by Great Britain. As Claimants recognize, Canada acceded to all international law obligations of the United Kingdom in respect of the Dominion of Canada in 1931. *See* Mem. ¶147, n.173.

[402] *See* Mem. ¶ 229.

Parties, as confirmed by the binding FTC interpretation, that a breach of a separate international agreement does not establish a breach of Article 1105.[403]

The United States and Great Britain signed the Jay Treaty on November 19, 1794, in an effort to resolve numerous trade and boundary disputes that arose in the years following the Revolutionary War.[404] Article 3 of that Treaty delineated the effect of the northern border of the United States on the constituents of both nations, as well as on Indians, and is regarded as containing two separate provisions, which conferred distinct privileges.[405] *First*, it contained a "free passage" provision that entitled citizens of the United States and Great Britain, as well as Native Americans, to cross the border in both directions without hindrance.[406] *Second*, it contained a "duty free" provision that entitled everyone to a duty exemption for pelts, and enabled Native Americans, specifically, to transport their "own proper" goods and effects, not in "bales or other large packages," across the border without the payment of any customs duty or fee.[407] Neither of these

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[403] *See* NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, ¶ B(3) (July 31, 2001), *available at* http://www.state.gov/documents/organization/38790.pdf (last visited Dec. 20, 2008) ("A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).").

[404] Among other things, the Jay Treaty provided for the withdrawal of British troops from the northern border of the United States and established a border commission to resolve boundary disputes. It also set forth general principles to govern free trade and navigation between the two nations and established a claims commission to resolve monetary disputes brought by their respective constituents. *See, e.g.*, Jay Treaty arts. 2, 4, 5, 6, 7, 11.

[405] *See Akins v. United States*, 551 F.2d 1222, 1224 (C.C.P.A. 1977) (describing Article 3 as protecting "the free passage rights of the Indians to cross the new boundary" and providing them with "a duty exemption . . . for 'their own proper goods and effects of whatever nature'"); Marcia Yablon-Zug, *Gone But Not Forgotten: The Strange Afterlife of the* Jay Treaty*'s Indian Free Passage Right*, 33 QUEEN'S L.J. 565, 572 (2008) (describing Article 3 as conferring two separate rights).

[406] *See* Jay Treaty art. 3 ("It is agreed that it shall at all times be free to his Majesty's subjects, and to the citizens of the United States, and also to the Indians dwelling on either side of the said boundary line, freely to pass and repass . . . .").

[407] *See* Jay Treaty art. 3 ("No duty of entry shall ever be levied by either party on peltries brought by land, or inland navigation into the said territories respectively, nor shall the Indians passing or repassing with their own proper goods and effects of whatever nature, pay for the same any impost or duty whatever. But

provisions conveyed to Indians an exemption from taxation or other regulation of their cross-border commercial activities.

In his report filed in support of Claimants' Memorial, Professor Clinton contends "the Claimants had every right to expect . . . that their sale of tobacco products, both with respect to the on-reserve and off-reserve sales, would be completely free of interference, taxation, or regulation by the states of the United States" based on these provisions.[408] Professor Clinton's opinion, however, conflates the Jay Treaty's free passage right and duty exemptions, and vastly overstates the rights those provisions actually conferred.

At the time the Jay Treaty was negotiated, the Lieutenant Governor of Upper Canada explained to members of the Six Nations in Canada that Article 3 conferred the following rights: "Upon these principles the present Treaty is established, you have a right to go to the British settlements, or those of the U. States, as shall suit your convenience, nor shall your passing or repassing with your own proper goods and effects of whatever nature, pay for the same any impost or duty whatever."[409] This language affirmed for Indians that the Jay Treaty would ensure both the free passage of persons, and the free passage of their own proper goods, without payment of duties.[410]

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goods in bales, or other large packages, unusual among Indians, shall not be considered as goods belonging bona fide to Indians.").

[408] Expert Opinion Report of Prof. Robert N. Clinton on Behalf of the Claimants/Investors at 22 ("Clinton Report").

[409] *Mitchell v. Minister of Nat'l Revenue*, 1997 Fed. Ct. Trial LEXIS 741 (Fed. Ct. 1997) (No. T-434-90) (*citing* 2 THE CORRESPONDENCE OF LIEUTENANT GOVERNOR JOHN GRAVES SIMCOE 332 (E.A. Cruikshank ed., 1924)).

[410] *See, e.g.*, Bryan Nickels, *Native American Free Passage Rights Under the 1794 Jay Treaty: Survival Under United States Statutory Law and Canadian Common Law*, 24 B.C. INT'L & COMP. L. REV. 313, 313 & n.3 (2001) (describing the Artile 3 free passage right, but noting that the Article "also allows Indians to transport 'their own proper goods' without imposition of U.S. or Canadian duties"); Marcia Yablon-Zug, *Gone But Not Forgotten: The Strange Afterlife of the* Jay Treaty*'s Indian Free Passage Right*, 33 QUEEN'S L.J. 565, 571 (2008) (describing Article 3 as "establishing that the new boundary line was to have no effect on [Indians'] right to cross the border freely and to take their goods across duty free").

But Article 3's duty exemption was not unqualified: the treaty provision expressly stipulated that "goods in bales, or other large packages, unusual among Indians, shall not be considered as goods belonging bona fide to Indians" and therefore, would be subject to duties.[411] Five years after the treaty was executed, the United States Congress codified Article 3's duty exemption for Indians in the Tariff Act of 1799 and reiterated that the duty exemption did not apply to "goods in bales or other large packages unusual among Indians."[412] This legislation confirmed that the Article 3 duty exemption for Indians would not apply to large quantities of goods or goods in packages that Indians would not have carried at that time.

Courts in Canada have interpreted the restriction on "large packages unusual among Indians" to mean that Article 3 was never intended to confer upon Indians "the right to traffic in commercial goods duty-free" across the border.[413] Specifically, in *Regina v. Vincent*, the Court of Appeal for Ontario found that even if Article 3 had been available to the claimant, the importation of "seven large cardboard boxes" of tobacco would not be exempt from duty because importing tobacco in such "large packages"

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[411] Jay Treaty art. 3; *see Akins v. United States*, 551 F.2d 1222, 1224 (C.C.P.A. 1977) ("Large packages or bales of goods were not excluded from the duty.").

[412] *See An Act To Regulate the Collection of Duties On Imports and Tonnage*, enacted Mar. 2, 1799, 1 Stat. 627, 702, § 105 ("That no duty shall be levied or collected on the importation of peltries brought into the territories of the United States, nor on the proper goods and effects of whatever nature, of Indians passing, or repassing the boundary line aforesaid, unless the same be goods in bales or other large packages unusual among Indians, which shall not be considered as goods belonging bona fide to Indians, nor be entitled to the exemption from duty aforesaid.").

[413] *Regina v. Vincent*, 1993 Ont. Rep. LEXIS 275, at *15 (Ont. Ct. App. 1993); *see also id.* at *12-14 (concluding that the expression "their own proper goods and effects of whatever nature" in Article 3 "refers to personal goods which belong to the Indians, for their use or consumption, but does not include commercial goods which are subject to duty" and concluding that there was no evidence Indians had "the right and privilege to import their commercial goods from the United States free of duty . . . at the time the Jay Treaty took effect"); *see also Minister of Nat'l Revenue v. Mitchell*, 1998 Fed. Ct. Appeal LEXIS 345, at *28 (Fed. Ct. 1998) (No. A-657-97) ("The limited exception to the payment of customs duties given to Indians travelling with their own proper Goods and Effects, in my view, refers to goods for their personal use as well as goods belonging to their own community for collective or common use by the members of that community.").

would have been "unusual among Indians" at the time the Jay Treaty was negotiated.[414] The volume of tobacco at issue in this case does not concern several boxes, but rather *billions* of machine-made and sealed cigarettes, packaged in modern packets and distributed by motorized trucks or other modern conveyance in cartons and boxes. Claimants cite no authority interpreting Article 3's duty exemption as according Indians a blanket exemption from all regulatory interference in their commercial affairs, which in this case involves the distribution and sale of billions of cigarettes throughout the United States.

Finally, the United States has maintained for decades that Article 3 of the Jay Treaty remains in force only "so far as it relates to the right of Indians to pass across the border."[415] The United States has clearly articulated this position in its annual publication, *Treaties in Force*, every year since 1973.[416] In 1977, the United States specifically amended *Treaties in Force* to acknowledge the Court of Customs and Patent

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[414] *Regina v. Vincent*, 1993 Ont. Rep. LEXIS 275, at *14 (Ont. Ct. App. 1993).

[415] *See* TREATIES IN FORCE, A LIST OF TREATIES AND OTHER INTERNATIONAL AGREEMENTS OF THE UNITED STATES IN FORCE ON NOVEMBER 1, 2007 at 38. The free passage provision in Article 3, to the extent it relates to Indians, was codified by statute in 1928, when Congress indicated that nothing in its previous immigration acts shall "be construed to apply to the right of American Indians born in Canada to pass the borders of the United States." Act of April 2, 1928, c. 308, 45 Stat. 401, codified at 8 U.S.C. § 226a (1928) (replaced by 8 U.S.C. 1359 (1952)).

The United States recently reconfirmed this limited treaty right, as part of the Western Hemisphere Travel Initiative in 2006, in which the U.S. Departments of Homeland Security and State recognized "the right of Native Americans born in Canada to 'pass the borders of the United States'" without hindrance under the Jay Treaty when they travel by land, but maintained that this right did not eliminate the need for Native Americans to carry valid passports when entering or departing the United States by air. *See* Final Air Rule 71 Fed. Reg. 68412, 68418 (2006). *But see* Final Land and Sea Rule, 73 Fed. Reg. 18384, 18397 (2008) ("The Jay Treaty of 1794 and other treaties do not prevent the Departments [of Homeland Security and State] from requiring documentary evidence of identity and citizenship from Native Americans and Canadian Indians.").

[416] *See* TREATIES IN FORCE, A LIST OF TREATIES AND OTHER INTERNATIONAL AGREEMENTS OF THE UNITED STATES IN FORCE ON JANUARY 1, 1973, at 30. Each year the U.S. Department of State publishes a list of treaties and other international agreements "to which the United States has become a party and which are carried on the records of the Department of State as being in force as of its stated publication date" entitled, "TREATIES IN FORCE." TREATIES IN FORCE (2007), *Foreward.*

Appeals holding in *Akins v. United States*, which stated "that Congress intended to terminate the Indian duty exemption" in the Jay Treaty when it repealed the same exemption from domestic legislation in the Tariff Act of 1897.[417] Accordingly, Claimants could not rely on the Article 3 duty exemption as part of any "legitimate expectation" of exemption from state regulation.

Nor would Article 9 of the Treaty of Ghent support any such expectation. The purported treaty rights asserted by Claimants are *Jay Treaty* rights; Claimants rely on the Treaty of Ghent only to argue that their alleged Jay Treaty rights survived the War of 1812. Whatever the status, in 1814, of the Article 3 duty exemption, the United States has maintained for decades that Article 3 remains in force only to the extent that it relates to the right of Indians to pass across the border.

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[417] *See* TREATIES IN FORCE, A LIST OF TREATIES AND OTHER INTERNATIONAL AGREEMENTS OF THE UNITED STATES IN FORCE ON JANUARY 1, 1977, at 28. In *Akins*, the Court of Customs and Patent Appeals examined a Penobscot Indian's challenge to the imposition of a duty on a pair of hiking boots purchased for personal use when he crossed the border from Canada to the United States. *See Akins v. United States*, 551 F.2d 1222, 1223 (1977). After examining the U.S. Supreme Court's holding in *Karnuth v. United States*, as well as its own prior holding in *United States v. Garrow*, the court concluded that Congress had terminated Article 3's duty exemption for Native Americans. *See Akins*, 551 F.2d at 1229-30. In *Karnuth v. United States*, the U.S. Supreme Court held that Article 3 of the Jay Treaty had been abrogated by the War of 1812, which discharged the treaty Parties from the obligation to accord free passage to non-Indians. *See Karnuth*, 279 U.S. 231, 233-35 (1929). Almost ten years later, in *United States v. Garrow*, the Court of Customs and Patent Appeals considered the impact of *Karnuth* on the ability of the United States to impose a duty on baskets carried by a Canadian-born Indian into the United States. *See United States v. Garrow*, 88 F.2d 318 (C.C.P.A. 1937). The *Garrow* court noted that the U.S. Congress had codified the Article 3 duty exemption for Native Americans in the Tariff Act of 1799, but deleted the exemption from the Tariff Act of July 24, 1897. *See Garrow*, 88 F.2d at 321. The *Garrow* court reasoned, based on *Karnuth*, that if the War of 1812 abrogated Article 3 as to Canadian non-Indians, it must have had the same effect on provisions affecting Native Americans. *See Garrow*, 88 F.2d at 323. Consequently, the *Garrow* court concluded that there was no existing treaty obligation that would exempt Indian goods from duties when Congress deleted the exemption from the Tariff Act in 1897. *See Garrow*, 88 F.2d at 323.

Prof. Clinton challenges as "incorrect" the *Garrow* court's finding that the War of 1812 abrogated the Article 3 rights of the Haudenosaunee. Clinton Report at 18. But the U.S. Supreme Court's decision in *Karnuth* compelled that conclusion.

For the above reasons, the Jay Treaty and the Treaty of Ghent do not provide a basis for Claimants' purported expectation that they could distribute billions of cigarettes throughout the United States free of any state regulation.

d. Claimants Could Not Have Had Any Legitimate Expectation, Under U.S. Federal Indian Law, That Their Tobacco-Related Operations Would Be Exempt From State Regulation

Claimants assert that under U.S. federal Indian law, they were "entitled to expect that none of their business activities would ever be subjected to the Escrow Statutes, the Allocable Share Amendments, the Contraband Laws or any Equity Assessment Legislation."[418] For the reasons discussed below, Claimants hold no such entitlement.

i. Claimants Grand River, Jerry Montour, and Kenneth Hill Are Not Members Of Any Federally Recognized Indian Tribe And Their Activities Do Not Occur Within "Indian Country" Under Federal Indian Law

As stated by Professor Carole Goldberg, Distinguished Professor of Law at UCLA School of Law, "[w]hether federal Indian law allows states to regulate and enforce their legal requirements depends, in the first instance, on the location of the activities targeted for regulation."[419] While federal Indian law imposes significant constraints on the reach of state law within "Indian country"— defined by federal statute as including all reservation lands, regardless of title status[420]— Indian activities occurring outside Indian country "are subject to nondiscriminatory state laws absent express federal law to the contrary."[421] For activities occurring partially within and partially outside Indian

[418] Mem. ¶ 331.

[419] Goldberg Report at 9.

[420] *See* 18 U.S.C. § 1151.

[421] Goldberg Report at 9 (citing *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 148-49 (1973) (upholding state gross receipts tax on off-reservation ski resort owned by Tribe)).

country, federal Indian law allows the activity to be treated as off-reservation for purposes of state regulatory power.[422]

As found by the U.S. Court of Appeals for the Second Circuit, in federal court litigation brought by Grand River challenging the very state laws that are at issue in this case, "Grand River itself operates *only* on land that is outside of the United States. Thus, the activities of Grand River in Canada are [to be considered] off-reservation activities…."[423] The court's finding was based on the federal Indian law designation of reservations as "Indian country" under 18 U.S.C. § 1151(a); under that provision, reservations must be "under the jurisdiction of the United States Government" to qualify as Indian country. Reservations that are not within the jurisdiction of the U.S. Government, such as the Grand River Reserve in Ohsweken, Ontario, on which Grand River operates, do not qualify as "Indian country" under U.S. federal Indian law.

As stated by Professor Goldberg, "[b]y conducting their business activities in Canada, Claimants Grand River, Jerry Montour, and Kenneth Hill, have placed those activities into the non-reservation/non-Indian country category under general principles of federal Indian law."[424] Accordingly, "[i]t follows from this off-reservation location that as to Claimants Grand River, Jerry Montour, and Kenneth Hill, federal Indian law allows for the application of state regulations absent some federal law providing an exemption or some evidence of discrimination against Indian commerce."[425] Finding no such federal law, or such evidence of discrimination, Professor Goldberg concludes that

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[422] Goldberg Report at 10 (citing *Okla. Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450 (1995) (upholding imposition of state income tax on tribal members who earned income within Indian country, but resided outside Indian country, in the absence of a treaty provision to the contrary)).

[423] *Grand River Enters. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 174 (2d Cir. 2005).

[424] Goldberg Report at 13.

[425] Goldberg Report at 13.

"as a manufacturer operating outside Indian country, Claimant Grand River will be subject to state escrow requirements under general principles of federal Indian law."[426]

Regardless of whether Claimants Grand River, Jerry Montour, and Kenneth Hill were operating outside of Indian country under federal Indian law, they also are considered non-Indian for purposes of that law, because they are not members of any federally recognized tribe. Under federal Indian law, the non-Indian status of those Claimants can support state jurisdiction to regulate sales of the Seneca cigarettes they manufacture wherever those activities occur. "For purposes of federal Indian law, a member of a First Nation of Canada – in fact, any member of any indigenous group located outside the United States – is considered a non-Indian."[427] This is because to qualify as Indian under federal Indian law, "the individual must not only have indigenous ancestry, but must *also* belong to a group or entity that enjoys a government-to-government relationship with the United States."[428] As stated in Cohen's Handbook of Federal Indian Law:

> As a general proposition of federal Indian law, only tribes that have retained or established formal political relations with the federal government are entitled to exercise powers of self-governance over their members and activities occurring on tribal lands, and to participate in the

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[426] Goldberg Report at 14. Rather than address Grand River's lack of operations within Indian country as defined under U.S. law, Prof. Fletcher, Claimants' federal Indian law expert, argues that the escrow statutes and complementary legislation "smack of . . . impermissible discrimination" because the measures "trump" the regulatory authority of governing tribes "to regulate the affairs of Native Americans lawfully conducting business within their territorial jurisdiction." Expert Opinion of Matthew L.M. Fletcher at 16-17 (July 10, 2008). But as Prof. Goldberg states, there is "no indication that the escrow requirements and Complementary Acts at issue in this proceeding are applied so as to discriminate against Indian commerce. Indeed, Claimants are challenging the states' failure to grant them special treatment – that is, exemptions from the deposit requirements under the escrow statutes as amended – due to the location of their operation on Canadian Indian lands and their membership in Canadian Indian nations. The gravamen of their complaint is that Grand River has been treated exactly the same as other NPMs." Goldberg Report at 13-14.

[427] Goldberg Report at 14-15.

[428] Goldberg Report at 15.

> range of federal programs and services provided to Indian people because of their status as Indians.[429]

Accordingly, "[f]ederal recognition of tribal status is what triggers federal protection for inherent tribal sovereignty, and the associated constraints on state authority within Indian country."[430]

All federally recognized tribes appear in a regularly updated list published by the U.S. Department of the Interior[431] and only individuals belonging to such groups may qualify as Indians for purposes of federal Indian law.[432]

With respect to Six Nations or Haudenosaunee tribes, Professor Goldberg observes:

> [D]espite their historic residence in territory that spans the current United States-Canada border, the United States has recognized only groups whose territory is exclusively within the United States. Thus, for example, the Mohawk people of Akwesasne have a federally recognized nation in the United States, known as the Saint Regis Mohawk Tribe (New York), and a Canadian counterpart, the Mohawk Council of Akwesasne (Quebec and Ontario). The Canadian Mohawk Council of Akwesasne does not appear on the list of federally recognized tribes and has no government-to-government relationship with the United States.[433]

As Claimants have stated, each of the Grand River shareholders in this case – Jerry Montour and Kenneth Hill – is not only a "citizen[] of Canada"[434] but also an "aboriginal

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[429] NELL JESSUP NEWTON ET AL., COHEN'S HANDBOOK OF FEDERAL INDIAN LAW 169, § 302[9] (LexisNexis, 2005)

[430] Goldberg Report at 17.

[431] *See* 25 U.S.C. § 479a-1 (requiring annual publication of the list).

[432] Goldberg Report at 18.

[433] Goldberg Report at 18.

[434] Mem. ¶ 8.

national[] of Canada."[435] According to his Canadian-Government-issued Certificate of Indian Status (issued by Indian and Northern Affairs Canada ("INAC")), Jerry Montour is a member of the Wahta Mohawk tribe,[436] which is "a small Mohawk community located in the Muskoka region of central Ontario, Canada."[437] Kenneth Hill's INAC Certificate of Indian Status (issued in February 2002) registers him as a member of the Lower Mohawk,[438] which is one of 13 Indian Registry Groups that belong to the Six Nations of the Grand River tribe.[439] The Six Nations of the Grand River tribe is located on the Six Nations Reserve No. 40, which encompasses 46,000 acres within southern Ontario, Canada.[440] As individuals of indigenous Haudenosaunee descent who belong to tribes or First Nations that are not formally recognized by the United States, Claimants Jerry Montour and Kenneth Hill are considered non-Indian under U.S. federal Indian law.

Grand River cannot claim to be federally recognized by the United States as an Indian entity as it is incorporated in Canada, its principal place of business is located within a Canadian Indian tribal reserve,[441] and its controlling shareholders, Jerry Montour and Kenneth Hill, are Canadian Indians who have alleged no membership in a federally

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[435] PSOC ¶ 3.

[436] *See* PSOC, exh. 2.

[437] Wahta Mohawks Website, *available at* http://www.wahta.ca/ (last visited Dec. 10, 2008); *see also* INDIAN AND NORTHERN AFFAIRS CANADA, BAND CLASSIFICATION MANUAL 11 (May 2005) (listing all First Nations in Canada, their remoteness and environmental indices, city centre, service centre, and the most populated reserve/settlement used to determine the indices as of April 2005).

[438] *See* PSOC, exh. 3.

[439] *See* INDIAN AND NORTHERN AFFAIRS CANADA, BAND CLASSIFICATION MANUAL 11 (May 2005).

[440] *See* Six Nations of the Grand River Website, Governance, available at http://www.sixnations.ca/Governance.htm (last visited Dec. 10, 2008); Six Nations of the Grand River Website, Community Profile, available at http://www.sixnations.ca/CommunityProfile.htm (last visited Dec. 10, 2008) (identifying the reserve as being "located approximately 25 km southwest of the city of Hamilton, Ontario; between the cities of Brantford, Caledonia, and Hagersville").

[441] Grand River Enterprises Six Nations, Ltd. is "a Canadian corporation organized under the laws of Canada on April 29, 1996" and has "at all relevant times since its incorporation maintained a principal office and tobacco products production facility located on the Grand River Reserve, in Ohsweken, Ontario, Canada." PSOC ¶ 1; *see also* Mem. ¶ 9.

recognized Indian tribe. Thus, under U.S. federal Indian law, U.S. sales of the Seneca cigarettes manufactured by Grand River can be subject to state regulation regardless of whether Grand River's activities are treated as occurring within or outside Indian country.

ii. The Distribution Activities of NTD/NWS Occur Partially Off-Reservation, With Substantial Off-Reservation Effects

With respect to Arthur Montour, Jr., the distribution activites of NTD/NWS occur partially off-reservation and produce significant off-reservation effects. Thus, under federal Indian law, Arthur Montour Jr. cannot claim exemption from the operation of the Settling States' complementary legislation.

NTD and NWS do not manufacture cigarettes and are not subject to deposit obligations under the escrow statutes. Those companies are, however, subject to state complementary legislation, which covers the transport, possession, importation, and use of cigarettes whose brands and manufacturers are not listed on the applicable state tobacco directory.[442]

Unlike the escrow statutes, the complementary legislation does not focus on discrete transactions, such as individual sales of cigarettes, but rather regulates ongoing activities. Under the complementary legislation, as observed by Professor Goldberg:

> As soon as a cigarette whose manufacturer is not listed on the applicable directory of compliant manufacturers/brands enters the state, it is subject to the ban on possessing, holding, or owning such cigarettes. If any non-Indian country portions of the state must be traversed to reach an Indian

[442] *See, e.g.*, CAL. REV. & TAX CODE § 30165.1(e) (making it unlawful to stamp, sell, offer or possess for sale cigarettes not listed in the directory, or to acquire, hold, own, possess, transport, import, or cause to be imported cigarettes that the person knows or should know are intended for sale or distribution in violation of the statute); IDAHO CODE ANN. § 39-8403(3) (same); N.M. STAT. § 6-4-22(A), (E) (same); 68 OKLA. STAT. tit. 68, § 360.4(C) (also making it unlawful to import noncompliant brands for personal consumption).

> country retailer, such activity (and the application of state law to that activity) would be considered off-reservation for purposes of federal Indian law, even if some other component of an importer or distributor's activities occurred within Indian country. Furthermore, because the act of importing the cigarettes first occurs as soon as the cigarettes enter the regulating state and before the cigarettes have reached a reservation, that activity is likewise taking place outside Indian country. And if cigarettes sold to on-reservation retailers are later possessed, transported, and sold off-reservation by the on-reservation purchasers, then the state regulations likewise will be analyzed as burdens on off-reservation activities.[443]

In addition, as stated by Mr. DeLange, the initial triggering event for applying the complementary legislation occurs when NWS "introduces cigarettes into Idaho," which is off-reservation activity.[444] The distribution of Seneca cigarettes from the Las Vegas FTZ to reservations located in Idaho and California illustrates the amount of off-reservation territory that must be traversed for Senecas sold by NWS to reach their on-reservation destinations. For example, Seneca cigarettes from the Las Vegas FTZ are transported hundreds of miles off-reservation before reaching the on-reservation retailer, Big Sandy Rancheria.[445]

Furthermore, the large volume of Seneca cigarettes being sold by small, on-reservation retailers illustrates the extent to which NWS' distribution activities ultimately have off-reservation effects, as confirmed in the Declarations of Mr. Eckhart and Mr. DeLange.[446]

[447] NWS' 2007

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[443] Goldberg Report at 22 (citation omitted).

[444] DeLange Declaration ¶ 28.

[445] *See* Declaration of Dennis Eckhart, Senior Assistant Attorney General for the State of California and Head of the California Attorney General's Tobacco Litigation and Enforcement Section ¶ 22.

[446] *See* DeLange Declaration ¶ 29; Eckhart Declaration ¶ 22.

[447] *See* Facts Sec. X.

[448]

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Claimants mischaracterize the activities of NTD/NWS as occurring exclusively on-reservation and as serving an exclusively on-reservation market.[450] Furthermore, as discussed by Professor Goldberg, and as illustrated by the examples above, much of the activity being regulated by state complementary legislation occurs off-reservation, even if the cigarettes being imported and transported ultimately are sold to on-reservation retailers. Under federal Indian law, state power to regulate wholly or partly off-reservation activity will be upheld absent a congressional directive or treaty right to the contrary.[451] Accordingly, and as concluded by Professor Goldberg, under federal Indian

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[448] *See id.*

[449] *See id.* Notably, given the significant off-reservation effects that result from such volumes of "on-reservation" sales, as well as the strong public health interests at stake, under federal Indian law states would have a strong interest in regulating on-reservation activity occurring on this scale. *See New Mexico v. Mescalero Apache Tribe*, 462 U.S. 324, 336-42 (1983) (noting that "[a] State's regulatory interest will be particularly substantial if the State can point to off-reservation effects that necessitate State intervention," and denying New Mexico concurrent regulatory authority over hunting and fishing on tribal land because tribal regulation had not produced any adverse off-reservation effects).

[450] *See* PSOC ¶ 24; Mem. ¶ 21; Arthur Montour Statement ¶ 21 (characterizing Claimants' approach to Tobaccoville as a "decision to allow our investment in the Seneca brand to expand outside of Indian Country").

[451] Goldberg Report at 22 (citing *Wagnon v. Prairie Band Potawatomi Nation*, 546 U.S. 95 (2005), and *Okla. Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450 (1995)). In *Wagnon*, the U.S. Supreme Court held that Kansas could impose a tax on motor fuel that was being transported onto a reservation for sale to a gas station that was operated by the governing tribe. 546 U.S. at 110-15. In *Chickasaw*, the U.S. Supreme Court upheld imposition of a state income tax on tribal members who earned income within Indian country, but resided outside Indian country, in the absence of a treaty provision to the contrary. 515 U.S. at 462-67. *See also Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 148-49 (1973) (upholding State authorities' right to tax Indians engaging in activities outside "Indian country" and off-reservation); *Puyallup Tribe v. Dep't of Game of Wash.*, 391 U.S. 392, 398-400 (1968) (upholding State of Washington's authority to regulate on-reservation fishing by tribal members where Treaty expressly subjects a tribe's hunting and fishing rights to the common rights of nonmembers and in which a State's interest in conserving a scarce, common

law the owner of NTD/NWS, Arthur Montour, Jr., is subject to state complementary legislation.[452]

For the above reasons, under federal Indian law, Claimants could not have had any legitimate expectation that their U.S. tobacco operations would be exempt from state regulation. Claimants Grand River, Jerry Montour, and Kenneth Hill do not operate within Indian country as defined by federal law, and are not members of federally recognized tribes, and thus are not exempt from state regulation. Concerning Claimant Arthur Montour, Jr., a significant component of the distribution activities undertaken by his companies, NTD/NWS, occurs off-reservation, and the large number of cigarette sales made by those companies to small on-reservation retailers results in significant off-reservation effects. Accordingly, federal Indian law does not shield NTD/NWS from state regulation under the complementary legislation.[453]

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supply justifies State intervention); *Organized Village of Kake v. Egan*, 369 U.S. 60, 75-76 (1962) (upholding Alaska state law prohibiting Indians from using fish traps on off-reservation location); *Tulee v. Washington*, 315 U.S. 681, 683-84 (1942) (finding that state license fees could not be reconciled with federal treaty granting Yakima Indians exclusive fishing rights).

[452] Goldberg Report at 23-24.

[453] Given that Claimants are not engaged in exclusively "on-reservation" activities, their reliance on Article IV of the Treaty of Canandaigua of 1794 between the United States Government and the Six Nations Tribes as part of their legitimate expectations argument is unavailing. *See* Clinton Report at 15; Mem. ¶ 223. Article IV of the Treaty of Canandaigua entitles Claimants to "the free use and enjoyment" of the 6 million acres of land reserved to them in the United States. *See* Treaty Between the United States and the Six Nations, Nov. 11, 1794, 7 Stat. 44, art. IV ("United States having thus described and acknowledged what lands belong to the Oneidas, Onondagas, Cayugas and Senekas, and engaged never to claim the same, *nor to disturb them, or any of the Six Nations, or their Indians friends residing thereon and united with them, in the free use and enjoyment thereof.*") (emphasis added). But as discussed above, Grand River's manufacturing activities occur in Canada, and NWS' distribution activities occur throughout the United States and, to a significant degree, off-reservation.

Additionally, Claimants cannot invoke the Treaty of Canandaigua as a basis for their expectations under international law because treaties between States and indigenous nations do not confer international rights and obligations. *See Island of Palmas Case* (Neth. v. U.S.), 2 R. INT'L ARB. AWARDS 829, 871 (Perm. Ct. Arb. 1928) ("As regards *contracts between a State* or a Company such as the Dutch East India Company and *native princes or chiefs of peoples* not recognized as members of the community of nations, they are not, in the international law sense, treaties or conventions capable of creating rights and obligations such as may, in international law, arise out of treaties."); ROBERT JENNINGS & ARTHUR WATTS, OPPENHEIM'S INTERNATIONAL LAW: PEACE 1217-18, n.2 (9th ed.1992) (stating that while it was the practice in the 19th

3. There Is No Basis To Find That The United States Has Impermissibly Discriminated Against Claimants, And The Minimum Standard of Treatment Of Aliens in Article 1105 Does Not Include An Obligation To Proactively Consult With Indigenous Tribes

As discussed in the Merits-Liability Section II.A regarding Article 1102 and Article 1103 above, Claimants' allegations of "discrimination" in this case are baseless. Claimants contend that the minimum standard of treatment obligation in Article 1105(1) must be interpreted "in accordance with pre-emptory norms of customary international law such as non-discrimination."[454] Regardless of the merits of this assertion, there simply has been no discrimination against Claimants' alleged investments here. None of the measures Claimants challenge distinguishes between domestic and foreign investments or between indigenous and non-indigenous manufacturers or distributors. Both domestic and foreign manufacturers are included among SPMs, including grandfathered SPMs, and both domestic and foreign manufacturers are included among NPMs. The "discrimination" alleged by Claimants' concerns only the failure to accord them *special* treatment. Claimants acknowledge that Grand River is treated *exactly the same* as any other NPM, which in fact serves as the gravamen of their claim.[455] As a factual matter, Claimants' allegations of discrimination cannot be countenanced.

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century and before to designate agreements "between colonizing settlers and indigenous peoples . . . as 'treaties,'" those instruments are only now "regarded as treaties for purposes of municipal law, even though they may not have that status in international law."); DOUGLAS M. JOHNSTON, THE HISTORICAL FOUNDATIONS OF WORLD ORDER: THE TOWER AND THE ARENA 610 (2008) ("The *treaties* of indigenous nations have always been regarded as falling outside the statist framework of 'international agreements' which are recognized as creative of rights and obligations under public international law and subject to the specific rules of the law of treaties."). Thus, the interpretation of treaties between the United States and Indian tribes is a matter of U.S. law. *See, e.g.*, *United States v. Lara*, 541 U.S. 193, 201 (2004) (observing that Congress ended the practice of entering into treaties with the Indian tribes in 1871 and now has the plenary power to regulate questions of tribal sovereign authority).

[454] Mem. ¶ 185.

[455] Goldberg Report at 13-14.

As a legal matter, Claimants' assertion that Article 1105(1) contains an open-ended prohibition on discrimination against aliens is unsupported. Because the NAFTA Parties specifically prohibited discrimination against foreign investors and their investments in particular provisions of Chapter Eleven, and did not include an express prohibition against discrimination in Article 1105(1), that provision should not be read to include an open-ended prohibition on discrimination against foreign investments.[456] To the extent that the customary international law minimum standard of treatment incorporated in Article 1105 prohibits discrimination, it does so in the context of other established, customary international law rules, including the prohibitions against denials of justice and unlawful expropriation, as well as the obligation of full protection and security.[457] Furthermore, under Article 1105(1), those obligations extend only to the treatment of "investments of investors."

In addition, Claimants' assertion that the United States has violated the *minimum* standard of treatment by failing to provide them with *special* treatment, allegedly due to them because of their status as members of Canadian First Nations, fundamentally misconstrues the nature of the obligation in Article 1105.[458] As the United States has demonstrated, NAFTA Article 1105 guarantees only a floor of treatment for "*investments of investors*" below which the conduct of host nations must not fall.[459] It does not

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[456] *See Methanex v. United States*, Final Award, pt. IV, ch. C, ¶ 24 (explaining that the impact of the "FTC interpretation of Article 1105" was not to "exclude non-discrimination from NAFTA Chapter 11" but "to confine claims based on alleged discrimination to Article 1102, which offers full play for a principle of non-discrimination.").

[457] *See id.* ¶¶ 25-26 (explaining that customary international law has established exceptions to the broad rule that "a State may differentiate in its treatment of nationals and aliens," but noting that those exceptions must be proven rules of custom, binding on the Party against whom they are invoked).

[458] *See* Mem. ¶159.

[459] *See supra* Merits-Liability Sec. II.B.

provide any guarantee of treatment for *investors*—separate and apart from their investments—much less require special treatment for particular classes of investors or their investments.[460]

Claimants also contend that there is an "emerging" customary international law norm which requires States to "pro-actively consult" with "First Nations investors" before taking regulatory action that will substantially affect their interests.[461] Claimants allege that this "emerging norm" is reflected in UN reports and a UN treaty body's non-binding recommendation, as well as in various provisions of the International Labor Organization's *Convention No. 169* ("ILO 169") and in the *United Nations Declaration on the Rights of Indigenous Peoples* ("UN Indigenous Declaration").[462] Claimants fail to demonstrate that either the documents or international instruments on which they rely were "intended for adherence by states generally and are in fact widely accepted" and thus, are reflective of customary international law.[463] Furthermore, Claimants simply fail

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[460] *See supra* Merits-Liability Sec. II.B.

[461] Mem. ¶¶ 184-92, 213-14.

[462] *See* Mem. ¶¶ 188-90; U.N. Econ. & Soc. Council [ECOSOC], Comm'n on Human Rights, *Report on the United Nations Seminar on the Effects of Racism and Racial Discrimination on the Social and Economic Relations between Indigenous Peoples and States*, U.N. Doc. E/CN.4/1989/22 (Feb. 8, 1989); Comm. on the Elimination of Racial Discrimination, *General Recommendation 23, Rights of Indigenous Peoples*, U.N. Doc. A/52/18, annex V, at 122 (Aug. 18, 1997); *United Nations Declaration on the Rights of Indigenous Peoples*, G.A. Res. 61/295, U.N. Doc. A/RES/61/295 (Sept. 13, 2007); International Labor Organization, *Convention Concerning Indigenous and Tribal Peoples in Independent Countries* (Sept. 5, 1991), adopted by the General Conference of the ILO on June 27, 1989, in force beginning Sept. 5, 1991, *available at* http://www.ilo.org/ilolex/cgi-lex/convde.pl?C169; (last visited December 20, 2008).

[463] RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 102(3) (1987); *see also North Sea Continental Shelf Cases* (F.R.G. v. Den.; F.R.G. v. Neth.), 1969 I.C.J. 3, 43 (Feb. 20, 1969) (stating that in order to establish a rule of customary international law, it is "an indispensable requirement" to demonstrate that "[s]tate practice, including that of States whose interests are specially affected, should have been both extensive and virtually uniform in the sense of the provision invoked; . . . and should moreover have occurred in such a way as to show a general recognition that a rule of law or legal obligation is involved").

Prof. Baxter argues that a treaty, or particular provisions of a treaty, may reflect an existing rule of customary international law in the following circumstances: "(*a*). [t]he treaty may state, generally in its preamble, that it is declaratory of customary international law[;] (*b*). [t]he final act of the conference that

to demonstrate the state practice and *opinio juris* required to establish the existence of a customary international law obligation to consult with indigenous tribes in the factual context of this case.[464] It goes without saying that in the absence of proof that this norm has become accepted by States as a matter of customary international law, it could not have evolved even further to become a peremptory norm of international law.[465]

Even if Claimants had established the existence of such an "emerging" norm, the United States clearly and consistently has articulated its view that the UN Indigenous Declaration and its provision requiring consultation prior to the adoption of legislation does not reflect customary international law. Given that "in principle, a [S]Tate that indicates its dissent from a practice while the law is still in the process of development is

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drew up the treaty or the *travaux préparatoires* of the treaty may indicate that the entire treaty was intended by its draftsmen to be declaratory of customary international law[;] (*c*). [t]he *travaux préparatoires* for a particular article may show that the article was intended to be declaratory of customary international law, even though other provisions of the treaty were not[; and] (*d*). [a] comparison of the terms of a particular article with the state of customary international law may indicate that the article is an accurate formulation of a rule of customary international law." R.R. Baxter, *Multilateral Treaties as Evidence of Customary International Law*, 41 BRIT. Y.B. INT'L L. 275, 287 (1965-66). He notes that "if proof cannot be adduced in one of these ways, the treaty cannot be taken as evidence of customary international law as it existed at the time of the adoption of the treaty." *Id.* at 287, n.2.

[464] The documents and instruments referenced by Claimants in support of their consultation argument address only consultations between a State and indigenous tribes which meet specific criteria and are located within the territory of that State. They do not address consultations between a State and indigenous individuals within a tribe, nor do they address consultations between a State and indigenous tribes located outside its territory.

[465] As the International Law Commission explained in its commentary on the Draft Vienna Convention, "the majority of the general rules of international law" do not have the character of peremptory norms. *See* Report of the International Law Commission on the work of its Eighteenth Session, [1966] 2 Y.B. INT'L L. COMM'N 172, U.N. Doc. A/6309/Rev.1 169, 248 (1966) (providing examples of "some of the most obvious and best settled" examples of treaty provisions which would conflict with peremptory norms: "(*a*) a treaty contemplating an unlawful use of force contrary to the principles of the Charter, (*b*) a treaty contemplating the performance of any other act criminal under international law, and (*c*) a treaty contemplating or conniving at the commission of acts, such as trade in slaves, piracy or genocide, in the suppression of which every State is called upon to co-operate").

not bound by that rule even after it matures," the United States cannot be bound by any consultation requirements contained in the UN Indigenous Declaration.[466]

As discussed above in the context of their Article 1102 and Article 1103 claims, Claimants' allegations of discrimination in this matter are unsupported. Furthermore, as discussed in the Merits-Liability Sections II.B.4 and II.C below, Claimants' denial of justice and expropriation claims fail for reasons independent of their failure to show discrimination. Claimants' allegations of discrimination therefore do not give rise to any violation of NAFTA Chapter Eleven.

a. Customary International Law Prohibits Discrimination against Aliens Only In Specific Contexts, Not Applicable Here

The customary international law minimum standard of treatment obligation under Article 1105(1) does not include a general non-discrimination obligation that incorporates

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[466] RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 102, cmt. d (1987). The International Court of Justice has recognized this principle in two cases. *First*, in the Asylum Case, the International Court of Justice rejected Colombia's claim that a rule of custom "peculiar to Latin-American States" granted them the unilateral authority to determine the kinds of offenses for which asylum could be granted, finding "even if it could be supposed that such a custom existed between certain Latin-American States only, it could not be invoked against Peru which, far from having by its attitude adhered to it, has, on the contrary, repudiated it by refraining from ratifying" two conventions which Colombia had argued were the first to articulate such a rule. (Colom. v. Peru), 1950 I.C.J. 266, 276-78 (Nov. 20, 1950). *Second*, in the Fisheries Case, the International Court of Justice found that Norway could not be bound by an emerging custom governing the fixing of baselines for the delimitation of fisheries zones, because in its legislation, diplomatic practice and domestic jurisprudence, Norway had clearly and consistently expressed its view that it was not bound to apply such a norm. *Fisheries Case* (U.K. v. Nor.), 1951 I.C.J. 116, 129-39 (Dec. 18, 1951). This principle is frequently referred to as the persistent objector rule, which States and scholars regard as central to the legitimacy of an international legal order governed by rules of customary international law. *See* Prosper Weil, *Towards Relative Normativity in International Law?*, 77 AM. J. INT'L L. 413, 433-34 (1983) ("The classic theory of custom depends on a delicate, indeed precarious, equilibrium between two opposite concerns: on the one hand, to permit customary rules to emerge without demanding the individual consent of every state; on the other hand, to permit individual states to escape being bound by any rule they do not recognize as such. . . . It is this opportunity for each individual state to opt out of a customary rule that constitutes the acid test of custom's voluntarist nature."); *see also* ANDREW T. GUZMAN, SAVING CUSTOMARY INTERNATIONAL LAW, AMERICAN LAW & ECONOMICS ASSOCIATION ANNUAL MEETINGS, PAPER NO. 30, at 27 (2005) (explaining that in order to object successfully to an emerging rule of customary international law, a State "must make its objections widely known, must do so before the practice solidifies into a rule of CIL, and the objection must be made on a consistent basis") (footnote omitted); Ted L. Stein, *The Approach of the Different Drummer: The Principle of the Persistent Objector in International Law*, 26 HARV. INT'L. L. J. 457, 457 (1985) (explaining that according to the principle of the "persistent objector," "a state that has persistently objected to a rule of customary international law during the course of the rule's emergence is not bound by the rule.").

all non-discrimination principles in international law. Rather, the minimum standard of treatment obligation under Article 1105(1) extends only to the treatment of "investments of investors of another Party."

As the *Methanex* tribunal found in its examination of allegations of discriminatory measures in the context of Article 1105, "when the NAFTA Parties wished to incorporate a norm of non-discrimination, they did so" and "[w]hen the NAFTA Parties did not incorporate a non-discrimination requirement in a provision in which they might have done so, it would be wrong for a tribunal to pretend that they had."[467] The NAFTA Parties negotiated and agreed to specific legal provisions governing when discrimination on the basis of nationality would be permitted[468] and when it would not.[469] Furthermore, the NAFTA Parties have clearly stated that "[t]he concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."[470] As discussed below, the minimum standard of treatment addresses only certain types of discrimination against aliens.

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[467] *Methanex v. United States*, Final Award, pt. IV, ch. C, ¶¶ 15-16.

[468] *See, e.g.*, NAFTA art. 1111 (permitting different treatment on the basis of nationality for certain special formalities in connection with the establishment of an investment, or for informational or statistical purposes).

[469] *See, e.g.*, NAFTA art. 1102 (national treatment); *id.* art. 1103 (most-favored-nation treatment); *id.* art. 1107 (no NAFTA party may require that the senior management or boards of directors of investments of investors of another Party be "of any particular nationality"); *id.* art. 1108 & annexes I-IV (setting forth a comprehensive list of exceptions to the national treatment and most-favored-nation obligations); *id.* art. 1109(4) (providing that "a Party may prevent a transfer through the equitable, non-discriminatory and good faith application" of certain laws); *id.* art 1110(1)(b) (permitting expropriations "on a non-discriminatory basis" and under certain other conditions).

[470] NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions ¶ B(2) (July 31, 2001).

In fact, "a degree of discrimination in the treatment of aliens as compared with nationals is, generally, permissible as a matter of customary international law."[471] For example, States routinely limit or deny aliens the right to vote and the right to work without running afoul of international law.[472] Furthermore, customary international law upholds the right of governments to limit the property rights of aliens within their territories.[473] While States frequently agree to refrain from discriminating against aliens

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[471] ROBERT JENNINGS & ARTHUR WATTS, OPPENHEIM'S INTERNATIONAL LAW: PEACE 932 (9th ed. 1992). *See also* ANDREAS H. ROTH, THE MINIMUM STANDARD OF INTERNATIONAL LAW APPLIED TO ALIENS 83 (1949) ("[T]he principle of equality has not yet become a rule of positive international law, *i.e.*, there is no obligation for a State to treat the aliens like the nationals. A discrimination of treatment between aliens and nationals alone does not yet constitute a violation of international law."); *see also* J.L. BRIERLY, THE LAW OF NATIONS 278 (Sir Humphrey Waldock ed.) (6th ed. 1963) ("In general a person who voluntarily enters the territory of a state not his own must accept the institutions of that state as he finds them. He is not entitled to demand equality of treatment in all respects with the citizens of the state; for example, he is almost always debarred from the political rights of a citizen; he is commonly not allowed to engage in the coasting trade, or to fish in territorial waters; he is sometimes not allowed to hold land. These and many other discriminations against him are not forbidden by international law.").

[472] *See* ALWYN V. FREEMAN, THE INTERNATIONAL RESPONSIBILITY OF STATES FOR DENIAL OF JUSTICE 510, 513-14 (1938) ("It is universally accepted that the alien does not, in the absence of treaty or local legislation, have a right to participate in any of the State's political functions or take part with citizens in the formation of its policies. . . . [W]ith respect to the alien's right to engage in economic activity . . . in the absence of treaty, the extent of the alien's right to carry on business within a State is difficult to define. One of the reasons for this may be that general international law does not require States to base their economic legislation upon such principles as the unrestricted activity of private individuals and the free disposition of their property. . . . [O]ne [can] hardly speak of an alien's 'right' to engage in business. . . . In any event, it is well recognized that the State may exclude aliens from certain classes of occupations and professions, reserving these solely to its nationals.") (footnotes omitted); IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 502 (6th ed. 2003) ("[I]t is agreed on all hands that certain sources of inequality are admissible. Thus it is not contended that the alien should have political rights in the host state as of right. Moreover, the alien must take the local law as he finds it in regard to regulation of the economy and restriction on employment of aliens . . . ."); J.C. Thomas, *Reflections on Article 1105 of NAFTA: History, State Practice and the Influence of Commentators*, 17 ICSID REV- F.I.L.J. 21, 24 (2002) ("At customary international law, a state has considerable freedom to discriminate in the treatment that it accords to other states, to restrict aliens' entry into its territory, and to prohibit them from working or conducting business there.").

[473] *See The Law of Responsibility of States for Damage Done in their Territory to the Person or Property of Foreigners*, 23 AM. J. INT'L L. 133, 147 (Special Supp. 1929) (Comment to Article 5) (Harvard Draft Conventions and Comments on Nationality, Responsibility of States for Damages Done in Their Territory to the Person or Property of Foreigners and Territorial Waters) ("The local law does not, of course, have to be uniform as to nationals and aliens. For example, it is quite possible for aliens to be denied the privilege of owning real estate . . . ."); ROTH at 165 ("According to general international law, the alien's privilege of participation in the economic life of his State of residence does not go so far as to allow him to acquire private property. The State of residence is free to bar him from ownership of all or certain property, whether movables or realty.") (emphasis omitted); JENNINGS & WATTS at 911-12 ("Thus a state may restrict the rights of aliens to hold property; and far-reaching interference with private property, including

in economic matters by undertaking national treatment and most-favored-nation obligations in their international agreements, they are not required to do so by customary international law.[474] In fact, as one scholar has explained, if the principle of non-discrimination were reflected in customary international law, "most-favored-nation provisions in commercial and other treaties would be superfluous or, by sheer volume, merely declaratory by now," but that is decidedly not the case.[475]

Rather than providing a general prohibition against discrimination, Article 1105(1) prohibits discrimination against the investments of aliens in particular contexts, including denial of justice, full protection and security, and expropriation claims. *First*, the minimum standard of treatment obligation requires governments to grant aliens access to their courts and judicial remedies on a non-discriminatory basis.[476] *Second*, the

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that of aliens, is common in connection with such matters as taxation, measures of police, public health, the administration of public utilities and the planning of urban and rural development.").

[474] *See, e.g.*, ROBERT RENBERT WILSON, THE INTERNATIONAL LAW STANDARD IN TREATIES OF THE UNITED STATES 87 (1953) ("Traditionally . . . states have claimed the right, without infringing international law, to withhold commercial advantages to foreign nationals, vessels, and goods. The granting of trading privileges and advantages has, in general, come through treaties, principally bilateral ones."); Edwin Borchard, *The 'Minimum Standard' of the Treatment of Aliens*, 33 AM. SOC'Y INT'L L. PROC. 51, 56 (1939) ("Equality, then, grants more than the alien or his government can ordinarily ask, for in the absence of treaty there is no rule prohibiting certain discriminations against aliens.").

[475] *See* Hans W. Baade et al., *Permanent Sovereignty over Natural Wealth and Resources*, *in* ESSAYS ON EXPROPRIATIONS 3, 23-24 (Richard S. Miller & Roland J. Stanger eds., 1967) ("Non-discrimination is not a rule of customary international law. Otherwise, most-favored-nation provisions in commercial and other treaties would be superfluous or, by sheer volume, merely declaratory by now. Nobody claims that this is the case. Since states are free to decide with whom to trade, they must also be free to decide with whom to stop dealing—subject, of course, to as yet unexpired treaty obligations.") (footnote omitted).

[476] *See, e.g.*, ROTH at 185-86 (including in a list of minimum requirements that states must extend to aliens under international law, certain "procedural rights," including "freedom of access to court, the right to a fair, non-discriminatory and unbiased hearing, the right to full participation in any form in the procedure, [and] the right to a just decision rendered in full compliance with the laws of the State within a reasonable time"); C.F. AMERASINGHE, STATE RESPONSIBILITY FOR INJURIES TO ALIENS 243 (1967) ("Especially in a suit between State and alien it is imperative that there should be no discrimination between nationals and aliens in the imposition of procedural requirements. The alien cannot be expected to undertake special burdens to obtain justice in the courts of the State against which he has a complaint."); Report of the Guerraro Sub-Committee of the Committee of the League of Nations on Progressive Codification 1, *Publications of the League* C.196, M. 70, at 100 (1927) ("Denial of justice is therefore a refusal to grant foreigners free access to the courts instituted in a State for the discharge of its judicial functions, or the failure to grant free access, in a particular case, to a foreigner who seeks to defend his rights, *although in*

minimum standard of treatment obligation requires governments to "[a]ccord to foreigners to whom damage has been caused by its armed forces or authorities in the suppression of an insurrection, riot or other disturbance the same indemnities as it accords to its own nationals in similar circumstances."[477] *Third*, the minimum standard of treatment prohibits discrimination against aliens in the taking of property.[478] Because Claimants have not couched their allegations of discrimination in the context of such established rules, and none of the measures they challenge can be found to discriminate against Claimants on their face, they cannot be considered under Article 1105.

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the circumstances nationals of the State would be entitled to such access.") (emphasis added); *Ambatielos Claim* (Greece v. U.K.), 12 R. INT'L ARB. AWARDS 83, 111 (Mar. 6, 1956) ("The modern concept of 'free access to the Courts' represents a reaction against the practice of obstructing and hindering the appearance of foreigners in Court, a practice which existed in former times and in certain countries, and which constituted an unjust discrimination against foreigners. Hence, the essence of 'free access' is adherence to and effectiveness of the principle of non-discrimination against foreigners who are in need of seeking justice before the courts of the land for the protection and defence of their rights.").

[477] League of Nations, *Bases of Discussion: Responsibility of States for Damage Caused in their Territory to the Person or Property of Foreigners*, League of Nations Doc. C.75.M.69.1929.V, at 107 (1929), *reprinted in* 2 LEAGUE OF NATIONS CONFERENCE FOR THE CODIFICATION OF INTERNATIONAL LAW [1930], at 529 (Shabtai Rosenne ed., 1975) (Basis of Discussion 21(4)); *see also id.* at 538 (Basis of Discussion 22(b)) ("A State must accord to foreigners to whom damage has been caused *by persons taking part in an insurrection or riot or by mob violence* the same indemnities as it accords to its own nationals in similar circumstances.") (emphasis added). *See, e.g.*, *Elettronica Sicula S.p.A. (ELSI) Case (*U.S. v. Italy*)*, 1989 I.C.J. Rep. 15, ¶ 108 (July 20, 1989) (explaining that the "essential question" when determining whether the protection provided by a domestic authority falls below the full protection and security standard under international law is "whether the local law, either in its terms or its application, has treated [alien] nationals less well than [its own] nationals").

[478] *See, e.g.*, *Libyan Am. Oil Co. v. Libya*, Award,, 20 I.L.M. 1, 58-59 (1981) (Apr. 12, 1977) ("It is clear and undisputed that non-discrimination is a requisite for the validity of a lawful nationalization. This is a rule well established in international legal theory and practice.") (citation omitted); *Kuwait v. Am. Ind. Oil Co. (AMINOIL)*, 21 I.L.M. 976, 1019, ¶ 87 (Mar. 24, 1982) (considering the question "whether the nationalization of Aminoil was not thereby tainted with discrimination," but finding that there were legitimate reasons for nationalizing Aminoil and not the Arabian Oil Company); *see also* RESTATEMENT (THIRD) OF THE LAW OF FOREIGN RELATIONS OF THE UNITED STATES § 712(1)(b) (1987) ("A state is responsible under international law for injury resulting from . . . a taking by the state of the property of a national of another state that . . . is discriminatory . . . ."); *id.* § 712 cmt. f ("Formulations of the rules on expropriation generally include a prohibition of discrimination . . . .").

b. The International Instruments And Documents On Which Claimants Rely Do Not Reflect Customary International Law

Claimants invoke certain provisions of the UN Indigenous Declaration and ILO 169, as well as other UN documents, to support the proposition that there is a general "customary international law obligation to avoid discrimination" against indigenous tribes by requiring States to proactively consult with those tribes prior to taking legislative actions that might have a substantial impact on them.[479] As the United States has demonstrated, however, the minimum standard of treatment cannot be construed to include particular protections for certain classes of aliens and not for others.[480] Furthermore, as the NAFTA Parties have confirmed, "[a] determination that there has been a breach . . . of a separate international agreement, does not establish that there has been a breach of Article 1105(1)."[481] Finally, the international instruments on which Claimants rely do not reflect customary international law binding upon the United States, and thus cannot be relied on to supplement the existing obligations under Article 1105(1).

On September 13, 2007, at its sixty-first session, the General Assembly of the United Nations adopted the UN Indigenous Declaration by a vote of 143 – 4 (opposed) – 11 (abstained), with more than 30 countries absent. Of those voting in favor of the Declaration, numerous countries took the position that they did not have indigenous

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[479] *See* Mem. ¶¶ 192-93, 219. Article 38 of the UN Indigenous Declaration provides: "States in consultation and cooperation with indigenous peoples, shall take the appropriate measures, including legislative measures, to achieve the ends of this Declaration." *See United Nations Declaration on the Rights of Indigenous Peoples*, A/RES/61/295, art. 38 (Sept. 13, 2007). Article 19 of the UN Indigenous Declaration provides: "States shall consult and cooperate in good faith with the indigenous peoples concerned through their own representative institutions in order to obtain their free, prior and informed consent before adopting and implementing legislative or administrative measures that may affect them." *Id.* art. 19.

[480] *See* Merits-Liability Sec. II.B..

[481] NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions ¶ B(3) (July 31, 2001).

populations and, therefore, the Declaration did not apply to them.[482] Others countries with recognized indigenous populations, however, including Australia, Canada, New Zealand and the United States, voted against it or abstained, including the Russian Federation and Colombia.[483] Many countries highlighted the aspirational nature of the document.[484] Other countries, such as Mexico, were clear that either all or significant

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[482] *See, e.g.*, China Concerned with Protection of Indigenous Peoples, Chinese Embassy, *available at* http://ch.china-embassy.org/eng/ztnr/rqwt/t138829.htm (last visited Dec. 19, 2008) (The article notes that the adviser of the Chinese delegation stated at the 53rd session of the United Nations Commission on Human Rights that "[t]he indigenous issues are a product of special historical circumstances. By and large, they are the result of the colonialist policy carried out in modern history by European countries in other regions of the world, especially on the continents of America and Oceania. As in the case of other Asian countries, the Chinese people of all ethnic groups have lived on our own land for generations … . In China, there are no indigenous people and therefore no indigenous issues."); Statement of Indonesia, Transcript of the Sixty-First Session of the United Nations General Assembly, 108th Plenary Meeting, A/61/PV.108, at 4 (Sept. 13, 2007) (relying on the ILO definition of indigenous peoples, and noting that because "Indonesia is a multicultural and multi-ethnic nation that does not discriminate against its people on any grounds, the rights stipulated in this Declaration accorded exclusively to indigenous peoples are not applicable in the context of Indonesia"); Statement of Turkey, *id.* at 5 ("Turkey does not have any group within its territory that falls with the scope of indigenous peoples to which the United Nations Declaration on the Rights of Indigenous Peoples applies.").

[483] *See* Transcript of the Sixty-First Session of the United Nations General Assembly, 107th Plenary Meeting, A/61/PV.107, at 10-19 (Sept. 13, 2007). Azerbaijan, Bangladesh, Bhutan, Burundi, Colombia, Georgia, Kenya, Nigeria, Russian Federation, Samoa and Ukraine abstained.

[484] *See* Statement of Australia, *id*. at 12 ("it is the clear intention of all States that it be an aspirational declaration with political and moral force but not legal force."); Statement of Canada, *id.* ("We have sought for many years, along with others, an aspirational document …."); Statement of New Zealand, *id*. at 14 ("The Declaration is explained by its supporters as being an aspirational document intended to inspire rather than to have legal effect."); Statement of United Kingdom, *id.* at 22 ("it will be an important policy tool…."); Statement of Norway, *id*. ("The Declaration sets a standard of achievement to be pursued in a spirit of partnership and mutual respect."); Statement of Guyana, *id*. at 26 ("We also take note of the fact that the Declaration is political in character…."); Statement of Suriname, *id.* at 27 ("the Republic of Suriname recognizes this document as a political document to express and demonstrate the goodwill of the State…."); Statement of Myanmar, Transcript of the Sixty-First Session of the United Nations General Assembly, 108th Plenary Meeting, A/61/PV.108, at 2 (Sept. 13, 2007) (The nature and the scope of the measures to be taken to give effect to the Declaration will be determined in a flexible manner…."); Statement of Nepal, *id.* at 3 ("It is Nepal's understanding that the principles mentioned in this Declaration are collective reflections of the good intentions of the international community as guidelines for the protection and promotion of the rights of indigenous peoples and therefore do not create and binding legal or political obligations on the part of the States that voted in favour of it."); Statement of Turkey, *id.* at 5 ("The Declaration is not legally binding. However, it can constitute an important policy tool for those States that recognize indigenous peoples within their national territories.").

portions of the Declaration would only be interpreted in accordance with their Constitution and domestic legislation.[485]

In voting against the UN Indigenous Declaration, the United States, Australia, Canada and New Zealand (as well as the Russian Federation and Colombia when abstaining from it), expressly stated their view that its provisions are not reflective of uniform State practice and thus, do not create any customary international law obligations.[486] Each of these countries has large indigenous populations which they seek to protect.[487] For this reason, the Tribunal should give particular weight to their objections when analyzing whether the rule of consultation which Claimants propose has actually matured into a rule of customary international law.[488]

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[485] *See* Statement of Mexico, *id.* at 23 ("The right of indigenous peoples to self-determination, autonomy and self-government, as set out in articles 3, 4 and 5 of the Declaration, *shall be exercised in accordance with the constitution*, so as to ensure the national unity and territorial integrity of our State. The provisions of articles 26, 27 and 28 relating to ownership, use, development and control of territories and resources shall not be understood in a way that would undermine or diminish the forms and procedures relating to land ownership and tenancy *established in our constitution and laws* relating to third-party acquired rights. The procedures set out in article 27 and 28 *are subordinate to national legislation*.") (emphasis added). *See also* Statement of Paraguay, *id.* at 4-5 (It "will be interpreted in accordance with the relevant provisions of our national constitution and the normative framework of our national legal order."); Statement of Namibia, *id.* at 3 ("Namibia understands that the exercise of the rights set forth in this Declaration are subject to the limitations determined by the constitutional frameworks and other national laws of States.").

[486] *See* Transcript of the Sixty-First Session of the United Nations General Assembly, 107th Plenary Meeting, A/61/PV.107, at 10-19 (Sept. 13, 2007). While abstaining from voting on the Declaration, the Russian Federation stressed that the "text clearly does not enjoy consensus support" and Colombia articulated its view that it "in no way constitutes the establishment of conventional or customary provisions." *Id.* at 16-17.

[487] *See id.* at 15 ("Under United States domestic law, the United States Government recognizes Indian tribes as political entities with inherent powers of self-government as first peoples."); *id.* at 13 ("In New Zealand, indigenous rights are of profound importance. They are integral to our identity as a nation-State and as a people. . . . Today, we have one of the largest and most dynamic indigenous minorities in the world."); *id.* at 13 ("The recognition of indigenous rights to lands, territories and resources is important to Canada. Canada is proud of the fact that aboriginal and treaty rights are given strong recognition and protection in Canada's constitution."); *id.* at 11 (referencing various Australian laws designed specifically to protect indigenous property rights and cultural heritage); *id.* at 16 ("The Russian Federation attaches great importance to the protection of the rights of indigenous peoples and to the strengthening of international cooperation in that area.") .

[488] *See Fisheries Jurisdiction Case* (U.K. v. Ice.), 1974 I.C.J. 3, 26, ¶ 58 (July 25, 1974) (examining State practice "on the subject of fisheries" to determine if there was "widespread acceptance of the concept of preferential rights for coastal States" and noting that of particular relevance was the practice of maritime

The United States clearly rejected "any possibility that [the Declaration] is or can become customary international law" and emphasized that because the Declaration "does not describe current State practice or actions that States feel obliged to take as a matter of legal obligation, it cannot be cited as evidence of the evolution of customary international law."[489] The United States further emphasized that "[t]he flaws in this text run through all of its most significant provisions" and because "these provisions are fundamental to interpreting all of the provisions in [the] text, the text as a whole is rendered unworkable and unacceptable.[490] The United States specifically observed, with respect to the consultation obligation under Article 19 of the Declaration, that the obligation "could be misread to confer upon a sub-national group a power of veto over the laws of a democratic legislature by requiring indigenous peoples[’] free, prior and informed consent before passage of any law that 'may' affect them."[491]

When similarly objecting to the UN Indigenous Declaration, Canada stated its view that the Declaration was "not a legally binding instrument"; had "no legal effect in

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States, "including both Parties," with respect to the matter); *see also* Int'l Law Ass'n, Comm. on the Formation of Customary (General) Int'l Law, *Statement of Principles Applicable to the Formation of General Customary International Law (Final Report)*, 69 INT'L L. ASS'N REP. CONF. 712, 737 (2000) (discussing the ICJ's statement in the *North Sea Continental Shelf* cases that when deciding if State practice was sufficiently extensive and uniform to prove the existence of a rule of customary international law, it would look to the practice "of States whose interests are specifically affected" and noting that consequently, "if important actors do *not* accept the practice, it cannot mature into a rule of general customary law").

[489] *Observations of the United States with Respect to the Declaration on the Rights of Indigenous Peoples*, in United States Mission to the United Nations, USUN Press Release No. 204(07), *Explanation of vote by United States, Robert Hagen, U.S. Advisor, on the Declaration on the Rights of Indigenous Peoples, to the UN General Assembly, September 13, 2007, available at* http://www.un.int/usa/press_releases/20070913_204.html (last visited Dec. 20, 2008).

[490] *Id.*

[491] *Id.* Claimants' contention that "Respondent does not appear to reject or even criticize the obligations reflected in Articles 19, 20, 36 or 37 of the Declaration" is plainly incorrect, and therefore, its assumption that the United States did not "vehemently reject[]" the notion that Article 19 could be reflective of an emerging customary international law norm must be disregarded. *See* Mem. ¶ 158, n.198.

Canada"; and that its provisions did "not represent customary international law."[492] Australia emphasized in its vote against the UN Indigenous Declaration that the Declaration "does not describe current State practice or actions States consider themselves obliged to take as a matter of law" and thus, "cannot be cited as evidence of the evolution of customary international law."[493] New Zealand explained its "no" vote by contending that the UN Indigenous Declaration "does not state propositions which are reflected in State practice or which are or will be recognized as general principles of law."[494]

Claimants' reliance on the consultation provisions in Article 6 of ILO 169 to prove the existence of such a norm is equally unavailing.[495] Despite having been open for signature since 1989, only twenty of the more than 190 States in the world have

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[492] Transcript of the Sixty-First Session of the United Nations General Assembly, 107th Plenary Meeting, A/61/PV.107, at 13 (Sept. 13, 2007). Like the United States, Canada specifically objected to the Declaration's provisions "on free, prior and informed consent when used as a veto" on the grounds that they are "unduly restrictive." *Id.* at 12-13. Canada explained specifically with respect to Article 19 that, "[w]hile there are already strong consultation processes in place, and while Canadian courts have reinforced these as a matter of law, the establishment of a complete veto power over legislative and administrative action for a particular group would be fundamentally incompatible with Canada's parliamentary system." *Id.* at 13.

[493] *Id.* at 12. Like the United States, Australia emphasized that the Declaration's articles "with regard to free, prior and informed consent" are overly broad, and focused, in part, on the discriminatory nature of the provision. *Id.* at 11. Australia was concerned that these provisions "could mean that States are obliged to consult with indigenous peoples about every aspect of law that might affect them" and it "would apply a standard for indigenous peoples that does not apply to others in the population." *Id.* It emphasized that the UN Indigenous Declaration's principles of informed consent could not be reflective of state practice, because they were also "potentially inconsistent with, and go well beyond, any concept of free and informed consent that may be developing in other international forums." *Id.*

[494] *Id.* at 15. Like the United States, New Zealand observed that "the Declaration, in particular its article 19 and paragraph 2 of article 32, implies that indigenous peoples have a right of veto over a democratic legislature," which was untenable because those articles would create "different classes of citizenship, where indigenous peoples have a right of veto that other groups or individuals do not have." *Id.* at 14. New Zealand noted further that other provisions of the Declaration "are all discriminatory in the New Zealand context" because the implication of their implementation would be to grant indigenous peoples preferential status over other citizens. *Id.*

[495] *See* International Labor Organization, *Convention Concerning Indigenous and Tribal Peoples in Independent Countries* (Sept. 5, 1991), adopted by the General Conference of the ILO on June 27, 1989, in force beginning Sept. 5, 1991, *available at* http://www.ilo.org/ilolex/cgi-lex/convde.pl?C169 (last visited Dec. 20, 2008).

ratified ILO 169 and the United States is not among them.[496] Furthermore, the ILO Convention does not purport to reflect customary international law,[497] and, moreover, a convention with so few parties cannot be suggested credibly to be reflective of customary international law. None of the documents[498] or instruments relied on by Claimants by themselves reflect customary international law or provide evidence of the evolution of customary international law. Moreover, Claimants have shown neither a widespread or consistent state practice nor *opinio juris* for the contention that customary international law mandates consultations with indigenous tribes for the types of circumstances present in this case. Thus, Claimants' argument that the minimum standard of treatment obligation in Article 1105(1) includes an obligation to consult with indigenous tribes prior to taking any regulatory action that may significantly impact their interests is completely groundless.

For the above reasons, Claimants' discrimination claim under Article 1105 fails.

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[496] Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Denmark, Dominica, Ecuador, Fiji, Guatemala, Honduras, Mexico, Nepal, Netherlands, Norway, Paraguay, Peru, Spain and Venezuela have ratified the Convention. *See* International Labor Organization, *Convention Concerning Indigenous and Tribal Peoples in Independent Countries* (Sept. 5, 1991), Table of Ratifications, *available at* http://www.ilo.org/ilolex/cgi-lex/ratifce.pl?C169 (last visited Dec. 20, 2008).

[497] *See* International Labor Organization, *Convention Concerning Indigenous and Tribal Peoples in Independent Countries* (Sept. 5, 1991), Preamble, *available at* http://www.ilo.org/ilolex/cgi-lex/convde.pl?C169; (last visited Dec. 20, 2008) (noting developments in the field of international law since the ILO adopted its first standards on indigenous and tribal populations in 1975, as well as the terms of various "international instruments on the prevention of discrimination," but not claiming that the new international standards it was articulating reflected customary international law).

[498] Also unavailing is Claimants' reliance on the recommendations of the U.N. Committee on the Elimination of Racial Discrimination (encouraging States to take measures to ensure that indigenous peoples are able to participate effectively in public life), *see* Comm. on the Elimination of Racial Discrimination, *General Recommendation 23, Rights of Indigenous Peoples*, U.N. Doc. A/52/18, annex V, at 122 (Aug. 18, 1997), and the U.N. Seminar on the Effects of Racism and Racial Discrimination on the Social and Economic Relations Between Indigenous Peoples (encouraging States to address systemic problems of discrimination against indigenous peoples). *See* U.N. Econ. & Soc. Council [ECOSOC], Comm'n on Human Rights, *Report on the United Nations Seminar on the Effects of Racism and Racial Discrimination on the Social and Economic Relations between Indigenous Peoples and States*, U.N. Doc. E/CN.4/1989/22 (Feb. 8, 1989). Such recommendations and reports do not give rise to binding obligations under customary international law.

4. Claimants' Denial of Justice Claim Fails Because The Allocable Share Amendments And Complementary Legislation Do Not Deny Them Access To U.S. Courts

Grand River has brought, and continues to litigate, declaratory judgment actions in domestic U.S. courts challenging the allocable share amendments and complementary legislation. Nothing in those measures prevents Grand River from pursuing such claims. Nevertheless, Claimants contend that the allocable share amendments and complementary legislation have denied them justice under international law, in violation of Article 1105.[499] The claim should be rejected.

Subsumed within the minimum standard of treatment obligation in Article 1105(1) is the customary international law requirement that the NAFTA Parties refrain from denying justice to foreign investors.[500] The doctrine of denial of justice requires that States render justice to foreigners and grant aliens access to their courts, as well as administer their judicial systems in a manner which provides certain minimum procedural guarantees.[501]

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[499] *See* Mem. ¶¶ 193-99.

[500] *See* Andrea J. Bjorklund, *Reconciling State Sovereignty and Investor Protection in Denial of Justice Claims*, 45 VA. J. INT'L L. 809, 837 (2005) ("The international minimum standard and denial of justice are often conflated, but the requirement not to deny justice is a subset of the international minimum standard.").

[501] *See* ALWYN V. FREEMAN, INTERNATIONAL RESPONSIBILITY OF STATES FOR DENIAL OF JUSTICE 215-16 (1938). *See also* ANDREAS H. ROTH, THE MINIMUM STANDARD OF INTERNATIONAL LAW APPLIED TO ALIENS 185-86 (1949) (including in a list of minimum requirements that states must extend to aliens under international law, certain "procedural rights"; including "freedom of access to court, the right to a fair, non-discriminatory and unbiased hearing, the right to full participation in any form in the procedure, [and] the right to a just decision rendered in full compliance with the laws of the State within a reasonable time."); ROBERT JENNINGS & ARTHUR WATTS, OPPENHEIM'S INTERNATIONAL LAW: PEACE 543-44 (9th ed. 1992) ("If the courts or other appropriate tribunals of a state refuse to entertain proceedings for the redress of injury suffered by an alien, or if the proceedings are subject to undue delay, or if there are serious inadequacies in the administration of justice . . . there will be a 'denial of justice' for which the state is responsible."); *The Law of Responsibility of States for Damage Done in their Territory to the Person or Property of Foreigners*, 23 AM. J. INT'L L. 131, 173 (Special Supp. 1929) (Harvard Draft Conventions and Comments on Nationality, Responsibility of States for Damages Done in Their Territory to the Person or Property of Foreigners and Territorial Waters) (denial of justice includes "denial, unwarranted delay or

As the NAFTA Chapter Eleven Panel in *Azinian v. Mexico* stated, "A denial of justice could be pleaded if the relevant courts refuse to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way."[502] The NAFTA Chapter Eleven Panel in *Mondev v. United States* articulated the doctrine's requirements in the following manner:

> In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subject to unfair and inequitable treatment.[503]

Claimants charge that their international due process rights have been violated, and thus, that they have been denied justice, by the imposition of escrow deposit obligations on Grand River before there has been any judicial determination of liability.[504] Claimants argue that these escrow obligations, in effect, have deprived them of "access to courts for the adjudication of civil claims brought against them under domestic law"[505] in contravention of various provisions of the Universal Declaration of Human Rights,[506] the American Convention on Human Rights,[507] and the International Convention on the Elimination of All Forms of Racial Discrimination.[508]

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obstruction of access to courts, gross deficiency in the administration of judicial or remedial process, [and] failure to provide those guarantees which are generally considered indispensable to the proper administration of justice").

[502] *Azinian v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award ¶¶ 102-03 (Oct. 6, 1999) (The tribunal also indicated that there was "a fourth type of denial of justice, namely the clear and malicious misapplication of the law.").

[503] *Mondev Int'l Ltd. v. United States*, ICSID Case No. ARB(AF)/99/2, Award ¶ 127 (Oct. 11, 2002).

[504] *See* Mem. ¶¶ 233-35.

[505] Mem. at ¶ 198.

[506] *See* Universal Declaration of Human Rights, G.A. Res. 217 A(III), art. 10 (Dec. 10, 1948) ("Everyone is entitled in full equality to a fair and public hearing by an independent and impartial tribunal, in the determination of his rights and obligations and of any criminal charge against him."). The Universal Declaration of Human Rights was adopted by the United Nations General Assembly in 1948 and

But nothing in the allocable share amendments or complementary legislation denies Claimants access to U.S. courts. Grand River in fact continues to seek to enjoin those measures in U.S. courts.[509]

Furthermore, Claimants' allegation that Grand River has been forced "to satisfy judgments for tort claims that have not even been conceived, much less proved" is baseless.[510] As Claimants themselves acknowledge, deposits made under the escrow statutes are "currently the property of Claimants."[511] Unlike settlement payments made pursuant to the MSA, an NPM retains ownership over its escrowed funds.[512] Thus, the amended escrow statutes do not require Grand River and other NPMs to satisfy

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"proclaimed a series of political, civil, economic, social, and cultural rights as a universal standard." RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES, Introductory Note to Part VII - Protection of Persons (1987).

[507] *See* American Convention on Human Rights, arts. 8 & 24, 1144 U.N.T.S. 143 ("Every person has the right to a hearing . . . for the determination of his rights and obligations of a civil, labour, fiscal, or any other nature.") ("All persons . . . are entitled, without discrimination, to equal protection of the law.") (in force July 18, 1978). The United States is not a party to the American Convention. It signed the Convention on June 1, 1977, and submitted it to the U.S. Senate on February 23, 1978, but the Senate has not ratified it.

[508] *See* International Convention on the Elimination of All Forms of Racial Discrimination ("ICERD"), 7 March 1966, 5 I.L.M. 352, art. 5 (in force January 4, 1969) (obligating States Party to that Convention "to eliminate racial discrimination in all its forms and to guarantee the right of everyone, without distinction as to race, colour, or national or ethnic origin, to equality before the law, notably in the enjoyment of the following rights: (a) [t]he right to equal treatment before the tribunals and all other organs administering justice."). The United States ratified the International Convention on the Elimination of All Forms of Racial Discrimination in October 1994, and the Convention entered into force for the United States on 20 November 1994. *See* Reports Submitted by State Parties Under Article 9 of the Convention, Third Periodic Reports of States Parties due in 1999, Addendum United States of America, CERD/C/351/Add.1, Introduction at 3, ¶ 1 (Sept. 21, 2000).

[509] *See, e.g.,Grand River Enters. Six Nations, Ltd. v. Beebe*, 418 F. Supp. 2d 1082 (W.D. Ark. March 6, 2006), *injunction denied by* 2006 U.S. Dist. LEXIS 27200 (W.D. Ark. May 3, 2006), *motion granted in part, motion denied in part* 2006 WL 2942928 (W.D. Ark. Oct. 10, 2006), *aff'd and motion dismissed* 467 F.3d 698 (8th Cir. 2006); *Grand River Enters. Six Nations Ltd. v. Beebe*, 372 Ark. 384 (2008); *Grand River Enterprises Six Nations, Ltd. v. Pryor*, 425 F.3d 158 (2d Cir. 2005), *cert. denied sub nom King v. Grand River Enters. Six Nations, Ltd.*, 127 S.Ct. 379 (2006).

[510] Mem. ¶¶ 196, 234. *See* Gruber Report ¶ 14 (explaining that NPMs enjoy an advantage under the escrow statutes when compared with PM, because they do not actually make payments to the government, but rather put money in escrow, which earns interest over time that is available to NPMs on a current basis).

[511] Mem. ¶ 119.

[512] *See* Facts Sec. II.

judgments for claims not yet proven, nor do they prejudge Claimants' liabilities. Rather, they secure the availability of a source of funds in the event that potential *future* judgments may be entered against the NPM. As stated by Professor Gruber:

> [T]he NPMs enjoy an advantage because they do not actually make payments to the government, but rather put money in escrow, money that earns interest over time that is available on a current basis to the NPMs. The state escrow statutes do not impose taxes on the NPMs, but rather impose forced savings. To the extent that the NPMs would have wanted to hold some safe assets in their portfolio anyway, this is not a very costly requirement. Even if they did not want to establish such accounts and were forced to borrow to finance the escrow, such borrowing is still economically less costly than actually paying a tax.[513]

In the event that a tobacco-related claim were to be brought by a Settling State against Grand River, nothing in the allocable share amendments or complementary legislation would limit Grand River's ability to defend against that claim. And nothing in those measures limits Grand River's ability to bring, and continue to pursue, declaratory judgment actions challenging those measures in U.S. court.

In addition, Claimants have failed to exhaust their challenges to the states' allocable share amendments and complementary legislation in U.S. courts. The doctrine of denial of justice contains within it an exhaustion requirement, *i.e.*, a requirement that recourse to the domestic judicial system be made, unless such recourse is obviously futile.[514] This requirement is understandable, "[s]ince denial of justice implies the failure

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[513] Gruber Report ¶ 14.

[514] *See De Caro Case*, 10 R. INT'L ARB. AWARDS 635 (1903) (noting that claimant, M. De Caro, failed to avail himself of his right to appeal to Venezuelan courts and that "before he can appeal to an international tribunal, . . . , he should be prepared to show some actual denial of justice with relation to the subject-matter of his appeal."); *Orinoco Steamship Co. Case*, 9 R. INT'L ARB. AWARDS 180 (1903) (explaining the position of the British Government as being that a denial of justice claim could not be brought until the claimants were "in a position to show that they had exhausted their ordinary legal remedies with a result that a *prima facie* case of failure or denial of justice remained."); *see also Loewen Group v. United States*, Award ¶ 165 (explaining that "the obligation to pursue local remedies in a case in which the alleged violation of international law is founded upon a judicial act" requires "that the claimant is bound to exhaust any remedy which is adequate and effective . . . so long as the remedy is not 'obviously futile.'") (quoting

of a national legal system as a whole to satisfy minimum standards."[515] Thus, a claim cannot lie "until the self-correcting features of the national system have failed."[516] As the NAFTA Chapter Eleven Panel in *Loewen v. United States* stated, the purpose of the rule "is to ensure that the state where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own judicial system."[517] This general principle of international law obligates Chapter Eleven Claimants "to exhaust local remedies which are effective and adequate and are reasonably available to the complainant in the circumstances in which it is situated."[518] This obligation also

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The Finnish Ships Arbitration Award, 3 R. INT'L ARB. AWARDS 1480, 1495, 1503-05 (May 9, 1934) and *Nielsen v. Denmark* [1958-1959] Y.B. EUR. COMM'N H.R. 412 at 436, 438, 440, 444).

[515] JAN PAULSSON, DENIAL OF JUSTICE IN INTERNATIONAL LAW 130 (2005). *See* Clyde Eagleton, *Denial of Justice in International Law*, 22 AM. JUR. INT'L. L. 538, 557-58 (1928) (describing the requirement that claimants exhaust local remedies as "unquestionably the most important element in the procedure of enforcing state responsibility. It recognizes the independent personality, the exclusive jurisdiction, the so-called sovereignty of the state; and thus aids to reconcile the conflict between sovereignty and international law.").

[516] PAULSSON at 108 ("For a foreigner's international grievance to proceed as a claim of denial of justice, the national system must have been tested. Its perceived failings cannot constitute an international wrong unless it has been given a chance to correct itself."). *See Loewen Group v. United States*, Award ¶ 156 (explaining, "[t]he purpose of the requirement that a decision of a lower court be challenged through the judicial process before the State is responsible for a breach of international law constituted by judicial decision is to afford the State the opportunity of redressing through its legal system the inchoate breach of international law occasioned by the lower court decision.").

[517] *Loewen Group v. United States*, Award ¶ 158.

[518] *Loewen Group v. United States*, Award ¶ 168. In NAFTA Article 1121, the NAFTA Parties agreed that the general requirement that claimants exhaust all local remedies before bringing a claim before a Chapter Eleven panel would be waived. *See* NAFTA art. 1121(1)(b) (stating that the investor and its enterprise must "waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1116, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party"). But Article 1121's waiver provision has no impact on the requirement under international law that claimants must exhaust challenges to judicial processes in local courts before they can bring claims before an international tribunal for denials of justice. *See Loewen Group v. United States*, Award at ¶ 161 ("One thing is, however, reasonably clear about Article 1121 and that is that it says nothing expressly about the requirement that, in the context of a judicial violation of international law, the judicial processes be continued to the highest level.").

precludes Claimants from challenging municipal judicial decisions under international law unless they are issued by courts of last resort.[519]

In *Grand River Enterprises Six Nations, Ltd. v. Pryor*, Claimants challenged the allocable share amendments adopted by 31 MSA states (including North Carolina, South Carolina and Georgia) and the complementary acts adopted by 14 of those states, as imposing unconstitutional prejudgment deprivations of property without due process of law, including the right to a hearing.[520] The Second Circuit Court of Appeals dismissed Claimants' procedural due process claim under the U.S. Constitution on the ground that the escrow statutes, which were "designed to ensure that funds are available should litigation *subsequently* begin and result in judgment against manufacturers," were not subject to the notice and hearing requirement of the due process clause.[521] Claimants did not seek review of that determination in the U.S. Court, and thus, have failed to exhaust their local remedies with respect to their procedural due process claim.[522]

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[519] *Loewen Group v. United States*, Award ¶ 154 (noting that, "[n]o instance has been drawn to our attention in which an international tribunal has held a State responsible for a breach of international law constituted by a lower court decision when there was available an effective and adequate appeal within a State's legal system."). *See also* J. Jiménez de Aréchaga, *International Law in the Past Third of a Century*, 159 RECUEIL DES COURS 281-82 (1978) (taking the view that a State cannot be held responsible under international law for its judicial decisions unless they are issued by "a Court of last resort, all remedies available having been exhausted").

[520] *See* 425 F.3d 158 (2d Cir. 2005), *cert. denied sub nom King v. Grand River Enters. Six Nations, Ltd.*, 127 S.Ct. 379 (2006). *See also* Brief of Defendants-Appellees at 1, n.1, 5, *Grand River Enters. Six Nations Ltd. v. Pryor*, 425 F.3d 158 (2d Cir. 2005) (No. 03-9179CV).

[521] 425 F.3d at 174-75 (Claimants contended in that proceeding that "the escrow funds operate as unconstitutional prejudgment deprivations of property without due process of law and that they are entitled to a hearing before the funds are placed in escrow").

[522] *See* Brief of Grand River Enterprises in Opposition to Petition for Writ of Certiorari By State Attorneys General, *King v. Grand River Enters. Six Nations, Ltd.*, 127 S. Ct. 379 (No. 05-1343) (opposing petition on question of whether United States District Court for Southern District of New York could exercise personal jurisdiction over Attorneys General from other states, but not cross-petitioning for writ on the Second Circuit's denial of their procedural due process claim).

Claimants also did not challenge the allocable share amendments and complementary legislation of Arkansas, Oklahoma or numerous other states in *Pryor*, and therefore, their allegation that those statutes have deprived them of the right to a judicial hearing can still be brought before U.S. courts. In fact, Claimants have been challenging Arkansas's allocable share amendment and complementary act on due process grounds since 2005 in both federal and state courts in Arkansas.[523] Consequently, Claimants' denial of justice claim in relation to the allocable share amendments and complementary legislation not challenged in *Pryor* also cannot lie, because Claimants have not exhausted their domestic remedies for these measures.

For the above reasons, Claimants' denial of justice claim should be dismissed.

C. Claimants' Article 1110 Claim Fails Because Claimants Have Not Demonstrated That Any "Investment" Has Been Expropriated

Claimants' expropriation claim is fundamentally flawed and should be rejected. Claimants utterly fail to demonstrate that their putative investments have been "taken" from them, or that the economic impact of the challenged measures was akin to a taking. Rather, they complain about reduced profits and alleged lost opportunities to expand their business. This falls well short of the proof required to demonstrate an expropriation under international law.

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[523] *See Grand River Enters. Six Nations, Ltd. v. Beebe*, 418 F. Supp. 2d 1082 (W.D. Ark. March 6, 2006), *injunction denied by* 2006 U.S. Dist. LEXIS 27200 (W.D. Ark. May 3, 2006), *motion granted in part, motion denied in part* 2006 WL 2942928 (W.D. Ark. Oct. 10, 2006), *aff'd and motion dismissed* 467 F.3d 698 (8th Cir. 2006); *Grand River Enters. Six Nations, Ltd. v. Beebe*, 372 Ark. 384 (2008) (finding that Grand River cannot appeal the Circuit Court of Pulaski County's dismissal of those claims until the entire case is certified for appeal).

The defects in Claimants' expropriation claim become abundantly clear upon an examination of the factors that are analyzed[524] to determine if a regulatory measure constitutes an expropriation in violation of international law, namely: (1) the economic effect of the challenged measure on the claimant's property;[525] (2) the extent to which the measure interferes with the claimant's reasonable investment-backed expectations;[526] and (3) the character of the measure.[527]

First, Claimants have failed to demonstrate that the putative economic impact on their alleged investments[528] was sufficiently severe to qualify as an expropriation under Article 1110. One fact is clear from the record of this case: Claimants continued to derive significant revenues from sales of cigarettes in United States during the years following the enactment of the allocable share amendments. Claimants have gone to great lengths to mask the true financial condition of Grand River and NWS, including by alleging the existence of a purported "integrated enterprise" that bears no resemblance to the businesses that exist in reality. Yet even if their so-called "enterprise" were to be treated as an actual business organized under applicable law, Navigant Consulting, Inc.'s ("Navigant") expert financial analysts have conducted a thorough review of Claimants'

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[524] *See, e.g.*, OECD DIRECTORATE FOR FIN. AND ENTER. AFFAIRS, WORKING PAPERS ON INTERNATIONAL INVESTMENT NO. 2004/4, "INDIRECT EXPROPRIATION" AND THE "RIGHT TO REGULATE" IN INTERNATIONAL INVESTMENT LAW at 10 (2004) ("OECD Indirect Expropriation Paper") (citing authorities); Steven Ratner, *Regulatory Takings in Institutional Context: Beyond the Fear of Fragmented International Law*, 102 AM. J. INT'L L. 475, 511-512 (2008); *see also* 2004 U.S. Model Bilateral Investment Treaty, Ann B ¶ 4 *available at* http://www.state.gov/documents/organization/38710.pdf (last visited Dec. 20, 2008); 2003 Canada Model Foreign Investment Protection Agreement, ann. B.13(1).

[525] *See e.g.*, *Pope & Talbot v. Canada*, Interim Award ¶ 102 (June 26, 2000); *Feldman v. Mexico*, Award ¶ 151.

[526] *See, e.g.*, *Oscar Chinn Case*, 1934 P.C.I.J. (Ser. A/B) No. 63, p. 88-89 (Dec. 12, 1934); *Methanex v. United States*, Final Award, pt. IV, ch. D ¶¶ 7-8; *Feldman v. Mexico*, Award ¶ 112.

[527] *See, e.g.*, *S.D. Myers v. Canada*, First Partial Award ¶ 281-82; *Tecmed v. Mexico*, Award ¶ 122.

[528] As discussed in Jurisdiction, Sec. I.A., *supra*, Claimants Grand River, Jerry Montour and Kenneth Hill have no "investment" in the United States as defined under Article 1139.

financial evidence and have concluded that there has only been an 18% decline in its value over the relevant time period. Under these circumstances, there cannot have been a violation of NAFTA Article 1110.

Second, Claimants had no reasonable investment-backed expectation that the states would retain the allocable share release mechanism in the original escrow statutes. To the contrary, as discussed in the Merits-Liability Section II.B.2.b. above, the allocable share amendments were plainly foreseeable. The overall structure and specific provisions of the MSA make it clear that NPMs were expected to be on a level playing field with PMs concerning the internalization of healthcare costs caused by their tobacco products. The unintended loophole included in the allocable share release mechanism undermined those very objectives. Claimants had every reason to know that state officials would amend the allocable share release, and it strains credulity to suggest otherwise. Moreover, Claimants' bare allegations of "commitments" by "state officials" that the allocable share release provision would remain in place in perpetuity are baseless, further undermining their claim of expropriation based on regulatory action.

Finally, the Article 1110 claim fails because the "character" of the challenged measures is in no way expropriatory. The allocable share amendments were non-discriminatory regulations of general application that were part of a coordinated plan among the 46 MSA states to address the public health consequences resulting from smoking. Such regulation does not give rise to an expropriation under international law.

Each of these issues is discussed in detail below.

1. Claimants' Alleged Business And Other Property Interests Have Not Been Expropriated Because The Impact Of The Challenged Measures Upon Them Is Insufficient To Qualify As An Expropriation

Claimants assert that their investment in the United States consists of an undocumented "integrated enterprise" (allegedly made up of NWS and a portion of Grand River's U.S. sales operations), or the goodwill and intellectual property associated with the Seneca and Opal brands.[529] As discussed in Jurisdiction Section I.A. above, neither qualifies as an "investment" under NAFTA Chapter Eleven. Moreover, even if they did qualify as investments, Claimants have failed to demonstrate that the impact of the allocable share amendments was sufficient to constitute an expropriation under NAFTA Article 1110. This is because a mere negative impact on an investment's profitability as a result of regulation is insufficient to support a finding of expropriation under international law. As noted by Professor Brownlie, "State measures, prima facie a lawful exercise of powers of government, may affect foreign interests considerably without amounting to expropriation."[530] Thus, "the general body of precedent usually does not treat regulatory action as amounting to expropriation."[531] Indeed, if States were held liable for expropriation every time a regulation had an impact on an investment,

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[529] Mem. ¶ 102. As discussed above, Claimants failed to allege any facts concerning the Opal brand at any point prior to the submission of their Memorial, and thus Claimants' allegations concerning the Opal brand should not be considered as part of Claimants' claim. *See* n. 245, *supra*. Furthermore, Claimants' expert witness presents no evidence or analysis of damages relating to the Opal brand.

[530] IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 535 (5th ed. 1998). *See also*, G.C. Christie, *What Constitutes a Taking of Property Under International Law*, 38 BRIT. Y.B. INT'L L. 307, 335 (1962) ("It would seem, on balance, that in cases of 'partial monopoly' or 'partial prohibition' the difficulties are so great that the only practicable solution is to resolve all doubts against the alien claimant."); B.A. WORTLEY, EXPROPRIATION IN PUBLIC INTERNATIONAL LAW 50 (1977) ("Whatever may be the remedy of foreigners caught by general changes in the law, if those changes do not in fact dispossess them but merely lessen the value of their holdings or expectations, in the general interest, then bona fide changes in the public interest will not be confiscations, since the owners are left in possession of their property . . . .").

[531] *S.D. Myers v. Canada*, First Partial Award ¶ 281.

governments could not afford to regulate. As one NAFTA Chapter Eleven tribunal has observed:

> [G]overnments must be free to act in the broader public interest . . . . Reasonable government regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this.[532]

For this reason:

> While it may sometimes be uncertain whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been "taken" from the owner.[533]

As discussed below, the impact of the allocable share amendments upon Claimants' putative "integrated" business enterprise, as well as the impact upon their so-called brand goodwill and intellectual property, falls well short of the level that would be necessary to meet this standard.

a. Claimants Fail To Establish A Sufficient Impact On Their Putative Integrated Business Enterprise To Prove An Expropriation

Tellingly, neither Claimants nor their expert witnesses have attempted to put a value on the so-called "integrated" business enterprise they assert constitutes their investment in the United States.[534] Indeed, Claimants have not produced annual financial statements of Grand River or NWS for 2006 and 2007, the two years in which they claim the allocable share amendments caused the most harm. Claimants have thus failed to

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[532] *Feldman v. Mexico*, ¶ 103; *see id*. at ¶ 112 ("[N]ot all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110."); *c.f. Penn Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978), *reh'g denied*, 439 U.S. 883 (1978) ("Government could hardly go on if to some extent values incident to property could not be diminished without paying for every such change in the general law.").

[533] *Pope & Talbot v. Canada*, Interim Award ¶ 102.

[534] Mem. ¶¶ 101, 108-18.

establish that the challenged measures had a sufficient economic impact on their "enterprise" to constitute an expropriation under Article 1110. In fact, the limited data Claimants did produce suggest very strongly that the challenged measures did *not* have such an impact.

As Table 1 below demonstrates, the documents Claimants have produced in this arbitration confirm that Grand River's sales revenue increased consistently from year to year—even after some MSA states began enacting the allocable share amendments. The same is true for Grand River's gross margin. Indeed, with the exception of the year 2000, the same can be said of *net income*

Table 1

FINANCIAL PERFORMANCE: GRAND RIVER ENTERPRISES (CAD$)[535]

YEAR	GROSS SALES	NET SALES	GROSS MARGIN	NET INCOME	MANAGEMENT BONUS
1998					
1999					
2000					
2001					
2002					
2003					
2004					
2005					

While Claimants have declined to provide Grand River's financial statements for 2006 and 2007, it is evident from the data they have presented that the impact of the

[535] Claimants' Document Production, Volume 5, Tabs 12(B)-12(H).

allocable share amendments on their "enterprise" was not sufficient to constitute an expropriation. Although there is in reality no actual entity that corresponds to the "enterprise" to which Claimants refer, Navigant has made an effort in its expert report to assess the impact on the fair market value of that portion of Grand River's and NWS' business that roughly corresponds to an integrated enterprise focused solely on the sale and distribution of Grand River-manufactured cigarettes in the United States.[536] (For ease of reference, Navigant refers to this concept as the "Assumed Enterprise" in its Report.).

Navigant's analysis has concluded that, by a conservative estimate, the fair market value of the Assumed Enterprise was US$89,611,204 prior to the imposition of the allocable share amendments, compared with US$73,079,014 thereafter.[537] In the face of these stark figures (showing only an 18% decrease in fair market value), Claimant's assertion that "the Allocable Share Amendments have rendered their brands useless"[538] is patently not credible. Claimants' evidence falls well short of demonstrating the sort of evisceration of economic value necessary to "support[] a conclusion that the [enterprise] has been 'taken' from its owner," as is required to establish an expropriation under Article 1110.[539] Their Article 1110 claim should be rejected for this reason alone.

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[536] Navigant Report ¶ 10.

[537] *Id.* ¶¶ 21, 201. Navigant's alternative calculation based upon an "unrestricted buyer pool" leads to a similar result. *Id.* ¶ 202.

[538] Mem. ¶ 304.

[539] *Pope & Talbot v. Canada*, Interim Award ¶ 102; *Feldman v. Mexico*, Award ¶ 151.

b. Claimants Fail To Establish A Sufficient Impact On Their Alleged Investment Of Intellectual Property And Goodwill To Constitute An Expropriation

As an alternative to their alleged "business venture," Claimants also define their investment as brand "goodwill" or "intellectual property." While Claimants use two separate terms to describe their putative investment, their expert reports make clear that the terms relate to the same concept: the estimated value of the profits Claimants say they can derive from their cigarette sales in the United States. As discussed in Jurisdiction, Section I.A. above, however, just like claimants in other NAFTA Chapter Eleven cases who have attempted to re-define their alleged future sales and profits as expropriated investments (under the guise of terms like "goodwill," "market share" or "market access"), Claimants' effort is misplaced. It is well-established that concepts such as "goodwill," "market share," and "market access" may play some part in the *valuation* of an investment, but those concepts do not themselves constitute "investments" under NAFTA Chapter Eleven that, by themselves, are capable of being expropriated.[540]

Even if such concepts could constitute "investments" under Chapter Eleven, however, Claimants have failed to demonstrate that the value of their brands has been sufficiently diminished in this case. *First*, the purported impact on Claimants' cigarette sales in this case has not been shown to be severe enough to meet the test for an expropriation. Grand River's data for its U.S. cigarette sales make this point clear. As is plain from figure 3 in paragraph 48 of the Navigant Report, Grand River's U.S. sales in 2006—the year the allocable share amendments went into effect in the five states targeted

[540] *Methanex v. United States*, Final Award, pt. IV, ch. D, ¶ 17 ("In the view of the Tribunal, items such as goodwill and market share may, as Prof. White wrote, 'constitute [ ] an element of the value of an enterprise and as such may have been covered by some of the compensation payments.' Hence in a comprehensive taking, these items may figure in valuation. But it is difficult to see how they might stand alone, in a case like the one before the Tribunal.") (internal citations omitted).

by Claimants for sales off-reservation—were *higher* than they had been in 2003, before the allocable share amendments were introduced. As the Navigant Report shows, while Grand River's sales to Tobaccoville during 2005-2007 decreased, they were not materially lower than they had been in 2003, and Grand River's on-reservation sales to NWS actually *increased* during this time period.[541]

Second, Claimants simply have failed to present a fair market valuation of their brands, or any related "goodwill" or "intellectual property." Thus, there is no basis on which the Tribunal can conclude that an expropriation has occurred. As Navigant explains in its report:

> Mr. Wilson's explanation of how one measures the impairment to an intangible asset (i.e., intellectual property or a brand) is fatally flawed and, consequently, the damages analysis he conducts does not measure any alleged impairment to the Seneca brand or Claimants' investment in it. Contrary to Mr. Wilson's reasoning, measuring a company's lost profits does not establish a measure of impairment to a company's brand. In order to measure any potential impairment to the Seneca brand, Mr. Wilson should have conducted two separate analyses, both of which are absent from his report.[542]

As Navigant goes on to explain, Claimants were required to show what economic value the Seneca brand had, and the amount (if any) of its impairment caused by the challenged measures. Claimants' experts failed to do so.[543]

Faced with these shortcomings, Claimants strain to re-cast their case. Making reference to their so-called "five state strategy," Claimants strive to give the impression of expropriatory impact by claiming that their ability to sell Seneca cigarettes in Georgia, North Carolina, South Carolina, Oklahoma and Arkansas

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[541] *See* Navigant Report ¶ 48.

[542] *Id.* ¶ 58.

[543] *Id.* ¶¶ 59-64.

are each separate "investments" entitled to individual protection under NAFTA Chapter Eleven.[544] Such an approach should not be countenanced, for at least two reasons.

First, the legal justifications Claimants present for their "regional" or "five state" focus are groundless. The cases cited in Claimants' Memorial to support their argument that the Tribunal must consider each of the "five original states" as a separate investment say nothing of the sort. Rather, they discuss whether or not laws should be interpreted to have extraterritorial effect.[545] None of them discuss expropriation claims under NAFTA Chapter Eleven, a bilateral investment treaty, customary international law, or even their domestic analogue (*i.e.*, a takings claim in the United States). The scant legal authorities cited by Claimants thus have nothing to do with the geographical scope of a market for purposes of a damages analysis, much less for purposes of a NAFTA Chapter Eleven expropriation claim.

Second, the factual basis for Claimants' argument has no evidentiary support. Nowhere in the MSA or in any state legislation is there any mention of a policy to encourage "regional" cigarette manufacturers, as Claimants suggest. According to Claimants, they *chose* to focus their sales in five states. Claimants made that choice after discovering a loophole in the escrow statutes that presented a temporary opportunity for exploitation; the regulatory scheme did not preclude them from selling elsewhere. Many other cigarette manufacturers—NPMs and PMs alike—have been more than capable of competing on a national basis.

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[544] Mem. ¶ 311 ("In order to assess what has been indirectly taken . . . the Article 1110 analysis should be focused on the territories in which Claimants intended for the Seneca brand to be established . . . .").

[545] *Id.* ¶¶ 307-08.

Indeed, it is clear that the U.S. cigarette market is a national one, and that Claimants themselves treat it this way. In addition to Claimants' own admission that "[t]o be sure, from a business perspective the market for tobacco products is nation-wide with regional differentiation,"[546] the record in this case demonstrates that in the normal course of its business Grand River itself does not consider the brands it sells in these markets as separate and distinct property interests. It is only in this arbitration that these artificial categories have come to life. This is evident from the following facts:

- Grand River has no U.S., state-level subsidiaries; and nowhere has shown that it maintains a sales force or other division dedicated to increasing market share in an individual state;
- Grand River nowhere identifies state-by-state "goodwill" in its financial statements; [547]
- Grand River itself does not know how many of its cigarettes are sold into any given state by its distributors;[548]
- Grand River's products are not just sold off-reserve in the "Five Original States" but in several other U.S. states as well.[549]

These facts undermine Grand River's claim in this case that its market share, market access and so-called goodwill in Georgia, North Carolina, South Carolina, Oklahoma and Arkansas are separate "investments" entitled to individual protection under the NAFTA.

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[546] PSOC ¶ 169.

[547] *See* Claimants' Document Production, Vol. 5, Tabs 12A-12H.

[548] *See* MSA Application of Grand River Enterprises Six Nations, Ltd. ¶ 21(d) ("[Grand River] does not have any information that would allow it to determine the total volume of cigarettes it produced that were sold in the U.S."); *id*. ¶ 21(g) ("[Grand River] has no knowledge or means of ascertaining in which states [its importers/distributors] have sold products produced by Grand River."). Indeed, Claimants can only make representations "on information and belief" that Tobaccoville sold Grand River Cigarettes in Oklahoma, North Carolina, South Carolina, Arkansas, and Georgia—the very states in which it purports to have cultivated a "market." *See id*.

[549] Navigant Report ¶¶ 66-67 & app. P.1 (showing off-reserve sales in Kansas, Tennessee, Mississippi, Missouri, Connecticut, Florida and California).

For all of these reasons, Claimants have utterly failed to demonstrate that the economic impact of the challenged measures was sufficient to qualify as an expropriation.

2. Claimants Have Failed To Establish Any Reasonable Expectation That the Favorable Regulatory Conditions They Exploited Would Continue In Perpetuity

Claimants had no reasonable expectation that the escrow statutes (and the accompanying regulatory loophole they exploited through their so-called "five state strategy") would remain unchanged. Claimants' alleged reliance on the allocable share release for their "business strategy" and their feigned surprise at the passage of the allocable share amendments simply strain credulity, and should be rejected. As the Permanent Court of International Justice explained in the *Oscar Chinn* case:

> Some industries may be able to make large profits during a period of general prosperity, or else by taking advantage of a treaty of commerce or of an alteration in customs duties; but they are also exposed to the danger of ruin or extinction if circumstances change. Where this is the case, no vested rights are violated by the State.[550]

Claimants' own filings in this case make this point abundantly clear. Their original claim makes no mention of a five state "strategy" in reliance upon the escrow statutes, much less an expectation that the temporary loophole they chose to exploit would last in perpetuity. Rather, Claimants' original Particularized Statement of Claim asserted that they had been "excluded from participating"[551] in certain states, *not* that they had been *induced* by some of the states to adopt a targeted "business plan" as they

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[550] 1934 P.C.I.J. ser. A/B, No. 63, at 88.

[551] PSOC ¶170.

now suggest.[552] As discussed in the Merits-Liability Section II.B.2.b. above, Claimants have produced no evidence supporting their bare allegations of taking "state officials . . . at their word" that the escrow statutes would not be amended.[553]

The lack of any such alleged specific commitments by the states, especially in an industry like the cigarette industry, is fatal to Claimants' Article 1110 claim. As in *Feldman*, Claimants are involved in one of the most highly regulated industries, and thus were well aware that "[g]overnments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue."[554] For this reason, NAFTA tribunals have rejected expropriation claims based upon shifting regulatory conditions unless the claimant has established a "specific commitment" from the government to refrain from such regulation. As the tribunal in *Methanex* explained:

> [A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, *inter alios*, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.[555]

That is precisely the situation here. Claimants have failed to demonstrate that they had any reasonable expectation that the loophole in the escrow statutes they exploited with their five-state "strategy" would remain unchanged. Indeed, as explained in Merits-

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[552] Statement of Claimants' Claims Arising Directly Out of the Adoption and Implementation of the Allocable Share Amendments ¶ 55 (Nov. 6, 2006) ("Allocable Share S.O.C.").

[553] Mem. ¶ 209.

[554] *Feldman v. Mexico*, Award ¶ 112.

[555] *Methanex v. United States*, Final Award, pt. IV, ch. D, ¶ 7.

Liability Section II.B.2.b. above, they had every reason to believe that the release *would* be amended.

3. The Regulatory Nature Of The Allocable Share Amendments And The Escrow Statutes They Amended Do Not Support A Finding Of Expropriation

The character of the government's action is the third factor international tribunals consider when determining whether an indirect expropriation has occurred.[556] The character factor concerns, *inter alia*, whether the government action was akin to a physical invasion, or whether the action merely impacted property interests through "some public program adjusting the benefits and burdens of economic life to promote the common good," for example, by regulation.[557]

Where, as here, the action has not been in the nature of a physical invasion or taking, tribunals have looked to whether or not the action is a non-discriminatory measure of general applicability.[558] Under international law, where the action is a non-discriminatory regulation to promote legitimate public welfare objectives, it will not be deemed expropriatory except in rare circumstances.[559] As the *S.D. Myers* tribunal

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[556] *See Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 488 (1987); *Methanex Corp. v. United States*, Final Award,, pt. IV, ch. D, ¶ 7.

[557] *Penn Cent Transp. v. New York City*, 438 U.S. 104, 124 (1978).

[558] *Methanex Corp. v. United States*, Final Award, pt. IV, ch. D, ¶ 7. Although it is true that application of the complementary legislation enacted in certain states could result in the seizure of cigarettes manufactured by companies that refuse to make their escrow payments, Claimants here do not challenge such measures as expropriatory. They do not seek recovery for the value of any seized cigarettes – nor could they, since by the time the cigarettes would be taken, Claimants would already have sold them and realized a profit.

[559] *See, e.g.* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 385 (2d ed., 2004) ("The starting point must always be that the regulatory interference is presumptively non-compensable."); *Methanex Corp. v. United States*, Final Award, pt. IV, ch. D, ¶ 7.

observed, "The general body of precedent usually does not treat regulatory action as amounting to expropriation."[560]

Similarly in accord are respected secondary authorities, such as the *Harvard Convention on the International Responsibility of States for Injuries to Aliens*, drafted in 1961 by Professors Sohn and Baxter, which provides:

> An uncompensated taking of property of an alien or a deprivation of the use or enjoyment of property of an alien which results . . . from the action of competent authorities of the State in the maintenance of public order, health, or morality; . . . or is otherwise incidental to the normal operation of the laws of the State shall not be considered wrongful, provided . . . it is not a clear and discriminatory violation of the law of the State concerned, [and] it is not an unreasonable departure from the principles of justice recognized by the principal legal systems of the world . . . .[561]

The Third Restatement of the Law of Foreign Relations likewise provides that *bona fide* regulations that are not discriminatory are non-compensable,[562] as does the 1967 OECD Draft Convention on the Protection of Foreign Property, which provides that measures taken in the pursuit of a State's "political, social or economic ends" do not constitute a compensable expropriation.[563]

As discussed above, the allocable share amendments and the escrow statutes they amended were not discriminatory, and acted to promote the general welfare by ensuring

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[560] *S .D. Myers v. Canada*, First Partial Award ¶ 281 (2001); *see also Too v. Greater Modesto Insur. Assoc.*, 23 Iran-U.S. Cl. Trib. Rep. 378 ¶ 26 (1989) ("[A] State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price.").

[561] LOUIS B. SOHN & R.R. BAXTER, CONVENTION ON THE INTERNATIONAL RESPONSIBILITY OF STATES FOR INJURIES TO ALIENS, FINAL DRAFT WITH EXPLANATORY NOTES, ART. 10(5) (1961), REPRINTED IN F.V. GARCÍA-AMADOR ET AL., RECENT CODIFICATION OF THE LAW OF STATE RESPONSIBILITY FOR INJURIES TO ALIENS 204-05 (1974).

[562] RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. g (1987) ("A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory.").

[563] OECD Draft Convention on the Protection of Foreign Property, Oct. 12, 1967, *reprinted in* 7 I.L.M. 117, 125 (1968).

that tobacco manufacturers internalized the health care costs caused by their cigarettes. Claimants, like all NPMs, remain free to use their trademarks and sell their products lawfully in the United States. All that is required of Grand River is what is required of every other NPM: to make escrow deposits based on the number of its cigarettes that are sold in a particular Settling State. Like any other NPM, if Grand River would prefer to sign on to the MSA as an SPM, rather than making escrow deposits under the escrow statutes, it is free to do so. The challenged measures are non-discriminatory, apply to tobacco manufacturers generally, and arise from serious public health concerns. For these reasons, and the reasons discussed above, Claimants' Article 1110 claim should be rejected.

III. MERITS – DAMAGES

Even if the Tribunal were to find a violation of a Chapter Eleven obligation in this case, Claimants should be awarded no compensation. Their Memorial and expert reports utterly fail to meet their burden to present evidence of damages.

First, Claimants rely upon an expert valuation analysis that does not match the theories of liability on which they base their case. In support of their Article 1110 claim, Claimants' expert presents no analysis of the fair market value of what Claimants assert is their "investment" in the United States (a so-called "integrated" U.S. business enterprise or, alternatively, the "goodwill" and "trademarks" relating to the Seneca and Opal Brands). Similarly, notwithstanding Claimants' legal theory under Articles 1102, 1103 and 1105 that they have received unfair treatment in comparison to grandfathered SPMs, Claimants' valuation expert makes no effort to value the difference between their current financial state under the escrow statutes as amended, and the financial situation

they might enjoy under the so-called "volumetric exemption"[564] from the allocable share amendments to which Claimants say they were entitled. Rather than present a valuation that comports with Claimants' legal theories of liability, Claimants' valuation expert instead discusses alleged future streams of income that do not fairly reflect Claimants' actual business.

Second, Claimants and their experts make the classic error of equating correlation with causation by assuming (rather than demonstrating) that the complementary legislation and allocable share amendments caused the putative decline in Claimants' sales in certain jurisdictions.

Third, Claimants fail to submit audited annual financial statements for 2006-2007, base their damages claims on questionable sales and cost data for which they have submitted no affidavit or other source attesting to its authenticity, and rely upon an expert report that is riddled with errors and inconsistencies that drastically inflate Claimants' putative compensation figures.

Fourth and finally, Claimants provide no reasonable justification to support their claims for alleged compliance costs, professional fees, and an extraordinary US$38 million in undocumented equipment costs.

In sum, Claimants' valuation arguments fall well short of the mark and should be rejected. In contrast, the United States presents a proper valuation analysis demonstrating

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[564] Claimants assert that they should have been given a "volumetric exemption" *from the allocable share amendments* that was similar to that afforded to grandfathered SPMs under the original MSA. Specifically, Claimants argue that they should be exempted from the allocable share amendments for all of their cigarette sales that do not exceed the "cap" of the higher of two measures: 100% of their market share in that state during the year prior to the enactment of the allocable share amendments in that state, or 125% of their market share two years before their enactment. *See* Mem. ¶ 326; Expert Report of Wayne R. Wilson Jr., Gordius Consulting LLC ¶ 74 (July 10, 2008) ("Wilson Report").

that Claimants have failed to prove a compensable loss. As addressed in the Navigant Report, Grand River and NWS have grown significantly since the MSA came into effect, and the maximum possible impact of the allocable share amendments and the complementary legislation on their overall financial performance is nowhere near what Claimants assert it has been.

Each of these matters is discussed in detail below.

A. Claimants Wrongly Rely Upon Expert Valuation Analyses That Do Not Meet The Legal Standard Or Match The Theories of Liability On Which They Base Their Case

NAFTA Articles 1116 and 1117 require a claimant to prove that an investment in the United States suffered "loss or damage by reason of, or arising out of" a specific breach of NAFTA Chapter Eleven.[565] The burden is on the claimant to "prove the quantum of the losses in respect of which it puts forward its claims" and that the compensation the claimant seeks "is proved to have a sufficient causal link with the specific NAFTA provision that has been breached" rather than "other causes."[566]

The measure of compensation may differ depending upon the specific provision of Chapter Eleven that has been breached. As to expropriation claims, a claimant must show that its putative compensation figures meet the fair market value formula set forth in NAFTA Article 1110. For breaches of other NAFTA Chapter Eleven provisions, a claimant must demonstrate that the compensation it seeks is "appropriate to the specific

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[565] NAFTA arts. 1116-17; *see also*, *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas Inc. v. United Mexican States*, ICSID Case. No. ARB(AF)/04//05, Award ¶¶ 272-73 (Nov. 21, 2007) ("*ADM v. Mexico*, Award").

[566] *S.D. Myers, Inc. v. Canada*, NAFTA/UNCITRAL, First Partial Award ¶ 316 (Nov. 13, 2000) ("*S.D. Myers v. Canada*, First Partial Award").

circumstances of the case, taking into account the principles of both international law and the provisions of the NAFTA."[567]

Arbitral tribunals assessing compensation for violations of NAFTA Articles 1102, 1103 or 1105 (as well as those assessing similar provisions under other international agreements), have looked to the principles of compensation articulated in the *Chorzów Factory*[568] case for guidance. The application of the *Chorzów* principles, however, differs depending upon the facts in the case under consideration. In some cases, arbitral tribunals have determined that the fair market value formula is an appropriate measure of compensation for non-expropriation claims,[569] but in other instances, tribunals have concluded that it is not.[570]

Those arbitral tribunals that have awarded fair market value for violations other than expropriation have done so only where the breaching measure has eliminated nearly all economic value of the investment in the host state.[571] In cases where the economic

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[567] *Id.* ¶ 309; *Feldman v. United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award ¶¶ 195-98 (Dec. 16, 2002) ("*Feldman v. Mexico*, Award").

[568] *Case Concerning the Factory At Chorzów (Indemnity)*, P.C.I.J. Ser. A. No. 17, at 47 (Sept. 13, 1928). ("The essential principle contained in the actual notion of an illegal act is that reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed.").

[569] *See, e.g.*, *Metalclad v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award ¶¶ 118-22 (Aug. 30, 2000) (concluding that it was appropriate to apply FMV standard to expropriation and Article 1105 claims because the entire economic value of claimant's investment had been destroyed) ("*Metalclad v. Mexico*, Award"); *Técnicas Medioambientales Tecmed, S.A v. United Mexican States*, ICSID No. ARB(AF)/00/2, Award ¶ 188 (May, 29 2003) (same); *CMS v. Argentine Republic*, ICSID Case No. ARB/01/8, Award ¶ 410 (Apr. 25, 2005) (applying FMV standard to non-expropriation claims under bilateral investment treaty where claimant agreed to transfer ownership of investment back to host state government at conclusion of arbitration).

[570] *See, e.g.*, *Feldman v. Mexico*, Award ¶ 194 (concluding that FMV standard was inappropriate measure of compensation for non-expropriation claim); *Pope & Talbot, Inc. v. Canada*, NAFTA/UNCITRAL, Damages Award (May 31, 2002) ("*Pope & Talbot v. Canada*, Damages Award") (awarding, *inter alia*, lost profits rather than FMV); *S.D. Myers v. Canada*, First Partial Award (same).

[571] *See, e.g.*, *Metalclad v. Mexico*, Award ¶ 113 (stating that "the damages arising under NAFTA, Article 1105 and the compensation due under NAFTA, Article 1110 would be the same since both situations

damage caused by the breaching measure did not rise to such a level, the fair market value analysis was often abandoned in favor of other measures of compensation[572] so that compensation was awarded only for harm that was proximately caused by the breach.[573]

As demonstrated below, although Claimants purport to accept these general principles of compensation, they fail to apply them properly in this case.

1. Claimants' Damages Arguments Under Article 1110 Should Be Rejected Because They Fail To Present The Fair Market Value Of Their Alleged "Investment"

As discussed in the Merits-Liability, Section II.C above, the allegations put forward by Claimants concerning their purported "investment" in the United States do not withstand scrutiny. This is fatal to Claimants' damages arguments in this case, given that Claimants' expert valuation witness presents calculations based only upon losses suffered by Grand River, a Canadian corporation operating in Canada. Under NAFTA Chapter Eleven, a tribunal lacks jurisdiction to award damages incurred by investments that are not located in the host State. As the tribunal in the *ADM* case explained:

> [Chapter Eleven] protection does not apply to investments located in the territory of the investor, nor investments located outside the territory of the State that violated the rights afforded to investors under the NAFTA. . .
> . . .
> The Tribunal has jurisdiction only to award compensation for the injury caused to Claimants in their investment made in Mexico (through ALMEX). Therefore, the Claimants are not entitled to recover the lost profits on [high fructose corn syrup] they would have produced in the

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involve the complete frustration of the operation of the landfill and negate the possibility of any meaningful return on Metalclad's investment").

[572] *See, e.g.*, *Feldman v. Mexico*, Award ¶¶ 194-198; *Pope & Talbot v. Canada*, Damages Award ¶¶ 81-85; *S.D. Myers v. Canada*, First Partial Award ¶ 309.

[573] *S.D. Myers v. Canada*, First Partial Award ¶ 316; *S.D. Myers, Inc. v. Canada*, NAFTA/UNCITRAL, Second Partial Award ¶¶ 94-100 (Oct. 21, 2002) ("*S.D. Myers v. Canada*, Second Partial Award").

> United States and exported to Mexico 'but for' the Tax, as these losses were not suffered in their capacity as investors in Mexico.[574]

In addition to this fatal jurisdictional flaw, Claimants' valuation expert makes no attempt to value any of the putative "investments" on which Claimants say they base their expropriation claims. As discussed above, Claimants assert that the investment that has been harmed in this case is the goodwill or intellectual property associated with their brands, or alternatively, the so-called "enterprise" that Claimants say is engaged in selling those brands in the United States. Yet, nowhere in Claimants' Memorial or in the Wilson Report is there a proper valuation of these alleged investments. Instead, the Wilson Report analyzes: (1) (incorrectly), the so-called "volumetric exemption" from the allocable share amendments[575]; (2) a hypothetical stream of income that Claimants say they can earn from off-reserve Seneca sales in five U.S. states[576]; and (3) a different hypothetical stream of income that Claimants say can be earned from on-reserve Seneca sales in four other U.S. states.[577]

As discussed in the Merits-Liability Section II.C. above, and as the Navigant Report explains, Mr. Wilson's analysis is not a fair representation of the diminution in fair market value of the Seneca or Opal brands. As Navigant explained, "Contrary to Mr. Wilson's reasoning, measuring a company's lost profits does not establish a measure of impairment to a company's brand."[578]

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[574] *AMDC v. Mexico*, Award ¶¶ 272, 274.

[575] Wilson Report ¶¶ 73-76.

[576] *Id.* ¶¶ 70-72.

[577] *Id.* ¶¶ 77-79.

[578] Expert Report of Navigant Consulting, Inc. ¶ 58 (Dec. 22, 2008) ("Navigant Report").

Nor is there a proper valuation of the so-called "integrated enterprise" that, according to Claimants, constitutes "Claimants' tobacco business in the United States." Rather, the Wilson Report purports to present only a snapshot of Claimants' putative sales in a few U.S. states, leaving the more profitable aspects of their business operations unaddressed.

As the Navigant Report explains, this is improper:

> First, Mr. Wilson's analysis does not correctly assess the impairment to the Assumed Enterprise because he restricts his analysis to sales and profits allegedly lost (and that will allegedly continue to be lost) in nine specific US states rather than all US states where Seneca cigarettes are sold . . . . This approach ignores sales of GRE-manufactured cigarettes in other states. This is a significant omission that masks the true condition of NWS and GRE.
>
> A similar trend can be seen in other markets, such as On-Reservation sales in New Mexico.
>
> If an analysis of impairment to the Assumed Enterprise were the correct analysis to conduct, Mr. Wilson should not have measured the net decrease in sales and profits in only nine states. Rather, Mr. Wilson should have measured the net decrease in sales and profits resulting from the ASA Measures in all relevant US states. In other words, Mr. Wilson should have considered the activities of the entire Assumed Enterprise rather than the activities of the Assumed Enterprise in just nine states. If the entire Assumed Enterprise is considered, then growth in sales and profits in other states reduces the lost sales and profits allegedly incurred in the nine selective states. Thus, Mr. Wilson's analysis necessarily overstates the alleged impairment to the Assumed Enterprise.[579]

In contrast, the Navigant Report attempts to assess the fair market value of the "Assumed Enterprise" by analyzing sales in the entire U.S. market. As Navigant explains, Claimants' decision not to provide financial statements for 2006-2007 has required Navigant to present a conservative fair market value analysis that, in all

[579] *Id.* ¶¶ 66-67.

likelihood, inures to Claimants' benefit in this case.[580] Nonetheless, even Navigant's conservative analysis makes plain that Claimants have drastically overstated the degree to which their businesses have been impacted by the challenged measures. While the Wilson Report asserts that the harm to the "enterprise" ranges from US$135,640,503 to US$210,724,976,[581] Navigant concludes that the diminution in value of the entire Assumed Enterprise in the period after the implementation of the allocable share amendments ranges, at most, from US$15,139,406 to US$16,532,190.[582]

2. Claimants' Valuation Analysis For Off-Reservation Damages Is Fundamentally Flawed And Does Not Fit The Theory Of Liability Underlying Their Non-Expropriation Claims

In addition to presenting a valuation that does not comport with their definition of "investment," Claimants rely on an off-reservation damages analysis that is inconsistent with their theory of liability. In support of their valuation of claims under Articles 1102, 1103 and 1105 for off-reservation damages, Claimants assert that the allocable share amendments have accorded better treatment to grandfathered SPMs and that as a result they should be awarded compensation "equivalent to an exemption from the allocable share amendments, which is effectively what they would have been entitled to enjoy had those measures never been imposed upon them."[583] Yet neither of the two putative off-reservation compensation figures presented by Claimants' valuation expert—namely, the

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[580] Navigant would be prepared to supplement its Report if additional financial information on Grand River and NWS were to become available.

[581] US$70,291,867 to US$ 87,649,335 for off-reservation sales and US$65,348,636 to US$123,075,641 for on-reservation sales.

[582] Navigant Report ¶¶ 201-02.

[583] Mem. ¶ 325.

"cash benefit from exemption" and "lost sales" figures—compares Claimants' financial position today as an NPM with what Claimants' financial position would have been had Grand River been afforded the so-called "volumetric exemption" treatment to which they believe they should have been entitled. This is fatal to their off-reservation damages claim.

a. The "Cash Benefit From Exemption" Approach Is Fundamentally Flawed

The "Cash Benefit From Exemption" analysis in the Wilson Report purports to estimate how much the Claimants would have paid in escrow obligations to the five "original states" had they been afforded the special "volumetric exemption" from the allocable share amendments that they say they were entitled to. The analysis then calculates the escrow obligations that, according to Mr. Wilson, Claimants will incur under the allocable share amendments in the future if the present regulatory regime remains unchanged in those five states. Claimants ask the Tribunal to award them the difference between these two figures as compensation—or as Claimants describe it, "the value of a volumetric exemption from the Allocable Share Amendments (but not the original escrow statutes)."[584]

Leaving aside the flawed manner in which the Wilson Report calculates these figures,[585] the more fundamental problem is that the entire exercise is conceptually misguided. This is because the Wilson Report ignores that the escrow obligations are deposits, not payments. Although it may be true that, under their theory, the Claimants

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[584] *Id.* ¶ 326.

[585] *See* Navigant Report ¶ 143.

will be required to place additional funds into escrow in the future if they continue to sell in the so-called "five original states," it is equally true that they would be entitled to a release of those funds twenty-five years later, and would receive the interest on those funds as it is earned. In other words, Claimants demand that the United States fund their future escrow payments, the interest on which would be distributed to Claimants as it is earned, along with the original principal later being distributed to the Claimants—not to the United States—twenty-five years later. The result is that Claimants are asking this Tribunal to award them an incredible windfall.

Claimants' own expert report demonstrates this point. Exhibit 6.3 to the Wilson Report estimates that under Mr. Wilson's "no growth" scenario, beginning in 2007, Claimants will be required to place approximately 1.88 cents in escrow for each cigarette sold in North Carolina, as opposed to approximately 0.2 cents per cigarette if Claimants were given their so-called "exemption" from the allocable share amendments.[586] Claimants seek the difference between these two amounts as damages: approximately 1.64 cents per cigarette or, in aggregate, over 8 million dollars for each year from 2008 into the future. All told, Claimants calculate over 282 million dollars in this fashion for the value of the so-called exemption in the "five original states."[587]

Claimants choose not to mention that these amounts would be *in addition* to the profits that, according to Claimants, Grand River would receive on each cigarette sold—sales that they speculatively say will revert back to pre-allocable share amendment levels

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[586] Claimants say that they are able to know this figure now because they will limit their sales precisely to their market share "cap" levels, which will permit them to maximize the marginal value of the escrow exemption. Wilson Report ¶ 75.

[587] *Id.* ¶¶ 76, 80 and exh. 6.

if they are again able to lower their wholesale prices to those that existed prior to the adoption of the allocable share amendments. In other words:

- Claimants effectively want the United States to fund their future additional escrow deposits, amounting to approximately US$282 million;
- Claimants want to keep the interest earned on those additional escrow deposits;
- Claimants want to keep the additional escrow deposits themselves when the twenty-five-year escrow period expires; and
- Claimants want to keep the profits from the alleged new sales that they say they will be able to make by lowering their prices to alleged pre-allocable share amendment levels.

This would *not* return Claimants to the financial position that they would have been in had they been given a "volumetric exemption" from the allocable share amendments, or even to the position that they would have been in had the allocable share amendments never been enacted in the first place. To the contrary, the damages sought by Claimants would represent a windfall of hundreds of millions of dollars. After all, had the Claimants been permitted the so-called "volumetric exemption" from the allocable share amendments, they would have received only the profits on their cigarette sales. They would not have received hundreds of millions of dollars *in addition* to those profits, as they now demand. Demands for such a windfall cannot be countenanced.

b. The "Lost Sales" Approach Does Not Fit With Claimants' Liability Theory

The Wilson Report also presents an analysis which is labeled the "Lost Sales" theory.[588] Claimants barely mention this analysis in their Memorial, and it is unclear the extent to which they rely upon it.[589] This is not surprising. The Lost Sales approach

[588] *Id.* ¶¶ 70-72.

[589] Mem. ¶ 326.

purports to estimate how much profit the Claimants allegedly would have received on their cigarette sales in the five original states had the allocable share amendments never been enacted, and compares that profit to the profits that Claimants say they will receive if the current regulatory regime remains unchanged. Yet in their Memorial, Claimants only assert that they should have been given the so-called "volumetric exemption" from the allocable share amendments—an exemption on sales up to a certain specified "cap" amount—not that all of their sales be exempted from the allocable share amendments.[590] The Wilson Report makes no attempt to estimate the level of sales that Claimants say they would have enjoyed if the so-called "volumetric exemption" had been granted to them.

For this reason, the entire lost sales valuation is irrelevant to this case because it does not fit the liability theory on which Claimants now rely for their non-expropriation claims (and, as discussed in the Merits-Liability Section II.C above, the lost sales analysis fails to establish a sufficient impact upon Claimants to support an expropriation claim under Article 1110). Moreover, and as discussed in the Merits-Damages Section III.C below, even if the lost sales valuation were somehow relevant to this case, it is replete with errors and overstatements, which make it entirely unreliable.

3. Claimants' On-Reservation Valuation Analysis Should Be Rejected Because It Is Based Upon Demonstrably False Assumptions And Erroneous Calculations

The theoretical flaws in Claimants' valuation theory are not limited to their off-reservation claim. The putative on-reservation loss calculations are equally infirm. With respect to on-reservation activity, Claimants assert that they are "entitled to compensation

[590] *Id.*

for the manner in which performance of their brands marketed exclusively on First Nations territory has been impaired."[591] According to Claimants, "Tribes and First Nations wholesalers on territories located in various states have either suffered unlawful seizures by state officials . . . or have chosen to refrain from dealing with Claimants' brands to avoid such misfortune."[592] In this regard, the Wilson Report presents calculations purporting to estimate the monetary effect of those alleged actions on Claimants' business in four states: Arizona, California, Idaho and Nevada.[593] As the Navigant Report explains in detail, these calculations are fundamentally flawed.

First, the Wilson Report is based on the false assumption that Claimants have not been selling Grand River-manufactured cigarettes in Arizona, California, Idaho, or Nevada. Yet, throughout the entire time period for which Mr. Wilson assumes that no sales have been made in those four states, Claimants *were* selling cigarettes into those markets.[594] As Navigant explains,

> The second major element of the lost profits calculation – actual GRE and NWS On-Reservation sales – is ignored by Mr. Wilson in his analysis. Unlike the Off-Reservation analysis, where GRE's actual sales from Tobaccoville were deducted from "but for" sales in order to calculate lost sales, GRE and NWS's actual sales are simply not considered or addressed by Wilson in the On-Reservation analysis. *Implicitly, Mr. Wilson has assumed that GRE and NWS did not sell any cigarettes in the various states that form the On-Reservation claim.*
>
> This, however, is not the case. GRE and NWS did in fact sell cigarettes on reservation following the states' ASA measures.

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[591] *Id.* ¶ 328.

[592] *Id.* ¶ 329.

[593] *See* Wilson Report ¶¶ 77-79 & exhs. 7, 8.

[594] Navigant Report ¶¶ 122-25.

> *following those states' implementation of the ASA measures.* In our view, these sales must be considered in the lost profits analysis.[595]

Navigant has concluded that this one error alone inflated Mr. Wilson's damages figure by over US$57 million.[596]

Second, as discussed in the Navigant Report and in the Merits-Damages Section III.C below, in addition to understating actual sales, both the "No Growth" and "15% Growth" calculations presented in the Wilson Report are replete with other errors that drastically inflate the putative damage claim. As Navigant explains:

- "[T]he annual growth rate in Wilson's On-Reservation analysis is divorced from market reality and produces an inflated estimate of the lost profits allegedly suffered by GRE and NWS."[597]
- The Wilson report drastically overstates profit margins because it "completely ignores all costs borne by NWS,"[598] and "does not incorporate the indirect costs incurred by GRE."[599]
- "[D]ue to the use of an overly-simplistic method Mr. Wilson underestimates the GRE and NWS discount rate . . . ."[600]

Had Wilson simply corrected all of the errors in his on-reservation analysis, his own flawed estimate of lost sales would drop by approximately 98% from US$123,075,641 to just US$1,912,226.[601]

B. Claimants Assume, Rather Than Demonstrate, That Grand River's Drop In Market Share Was Caused By The Challenged Measures

It is well-settled that NAFTA Chapter Eleven requires Claimants to demonstrate that they suffered "loss or damage by reason of, or arising out of" a specific breach.[602]

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[595] *Id.* ¶¶ 122-23 (emphasis added).

[596] *Id.* ¶ 125. Or, approximately US$49 million in the "no growth" scenario. *Id.* n.118.

[597] *Id.* ¶ 118.

[598] *Id.* ¶ 127.

[599] *Id.* ¶ 128.

[600] *Id.* ¶ 130.

[601] *Id.* ¶¶ 135-36.

[602] NAFTA arts. 1116-17.

Claimants must show that the compensation they seek "is proved to have a sufficient causal link with the specific NAFTA provision that has been breached" and "not from other causes."[603] "[T]he harm must not be too remote" and "the breach of the specific NAFTA provision must be the *proximate* cause of the harm."[604] Here, Claimants have made virtually no effort to meet this legal requirement.

As Professor Gruber observes, Claimants' expert reports simply assume causation without demonstrating it.[605] Because the cigarette market in the United States is highly complex and dynamic, a brand-by-brand analysis must be conducted in order to examine the true causes of a decline of a given firm's market share.[606] The fact that NPMs' market share may have declined during the same time period that grandfathered SPMs' share increased does not demonstrate cause and effect; nor do Claimants' references to anecdotes from Tobaccoville's customers.[607]

Nor is causation demonstrated by the fact that after the allocable share amendments, NPM market share declined and grandfathered SPM share increased. As

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[603] *S.D. Myers v. Canada*, First Partial Award ¶ 316.

[604] *S.D. Myers v. Canada*, Second Partial Award ¶ 140.

[605] Expert Report of Prof. Jonathan Gruber ¶ 32 ("Gruber Report") ("[T]he evidence that these amendments consequently impacted the sales of the Claimants is far from clear. The figures presented in Tables 6 and 7 [of the Eisenstadt Report] show that the market shares of Claimants fell over time. This proves nothing about the amendment of the release provisions or any other policy. Simply showing that sales fell does not in any way assign a causal role to the allocable share amendments.").

[606] *Id.* ¶ 32 (explaining that "[s]everal other factors apart from the allocable share amendments could have been the cause (in whole or in part) of the loss" in Claimants' market share).

[607] *Id.* ¶ 24 ("[A] preference for MSA brands does not imply a large competitive advantage for MSA manufacturers, so long as customers have a choice of outlets that sell both OPM/SPM and NPM products. So long as individuals can shop across dealers, there is competition. Moreover, nothing in economic theory would say that giving NPMs a marginal cost advantage (such as through the original allocable share release) would be an appropriate offset to limited outlet availability.").

Professor Gruber explains, "This does not prove any competitive disadvantage or show anything other than time trends which may have many explanations."[608]

Finally, it is notable that Grand River's market performance during this same time period was poorer than that of the average NPM, suggesting that factors may have been impacting the performance of the Seneca brand that did not affect sales of other NPM brands. When coupled with the steep decline in Claimants' performance in the Canadian market, this strongly suggests that Claimants' inability to compete was due at least in part to factors specific to Grand River that were completely separate from allocable share amendments.[609] Claimants' experts have made no attempt to rule out the impact of those other factors on their losses, as they must to meet their burden of demonstrating causation in this case.

C. Claimants' Valuation Analysis Is Riddled With Errors That Drastically Inflate Their Claim For Compensation

Even if the methodological shortcomings of the Wilson Report were to be overlooked, the application of those methods by Claimants' expert is so replete with overstatements and errors that the analysis is rendered fundamentally unreliable. As the Navigant Report explains in detail, Claimants' Lost Sales analyses (1) overestimate the number of sales that would be lost, (2) overestimate the profit per carton that would be earned on those sales, and (3) employ a discount rate that is drastically understated.[610]

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[608] *Id.* ¶ 35.

[609] *Id.* ¶ 33.

[610] Navigant Report ¶¶ 80-114.

When these simple errors are corrected, the range of alleged "lost sales"—even using Claimant's flawed methodological approach—drops by approximately 77%.[611]

Finally, the Wilson Report suffers from a host of data integrity shortcomings that seriously call into question the reliability of the report's conclusions.[612] For example, the Wilson Report fails to justify its sales calculations with adequate source data. The supporting materials that Claimants provided to the United States appear to be spreadsheets summarizing Tobaccoville's sales to certain of its customers. No affidavit or other document is submitted from Tobaccoville, however, attesting to the authenticity of such records. Moreover, the records do not match the sales figures on which the Wilson Report relies.[613] The Wilson Report provides no explanation of why it is reasonable to rely upon such records.

Similarly, the Wilson Report fails to justify its profit assumptions with verified data. The Wilson Report appears to rely upon a set of spreadsheets which, presumably, are meant to be the source of the Grand River cost assumptions. Yet no citations are provided to those spreadsheets, nor is any affidavit or declaration submitted to attest to those documents' authenticity or accuracy. Under such circumstances, it is not reasonable to assume that Wilson's profit calculations are accurate.[614]

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Navigant Report ¶¶ 15, 114 & n.108. As discussed above, the same fundamental flaws also contribute to Wilson's drastic overstatement on on-reservation lost sales as well. *See* Merits-Damages Sec. III.A.3, *supra*.

612 Navigant Report ¶¶ 78-79.

613 *Id.* ¶ 78.

614 *Id.* ¶78-79.

These are not idle criticisms. During the *Pryor* preliminary injunction hearing in New York federal court in April and May of 2006, it was revealed that Grand River had submitted into evidence documents that over-allocated manufacturing overhead costs to its "Canadian" sales in order to make Grand River's U.S. sales appear more profitable. Jerry Montour explained that:

> "We try to put most of the overhead for manufacturing of products onto our Canada accounts because it was the most profitable part of our company. Sometimes if we were to put the true overhead on the cost of the U.S. sales, it would have taken where it was a nonprofitable business."[615]

Additional details on Grand River's allocation of overhead costs surfaced on cross-examination:

> "Q. Mr. Montour, we were discussing last week the fact that the factory wages listed for the production of Canadian cigarettes are twice -- exactly twice the cost listed per factory wages for the U.S. cigarettes even though there were far more U.S. cigarettes produced?
> A. Yes.
> Q. Isn't it true if you flip the numbers, if you apply the $2,824,000 cost of factory wages to the U.S. cigarettes then for the year you would have a loss on U.S. cigarettes?
> A. Yes."[616]

Upon further cross-examination, it was revealed that the documentation submitted to the Court did not reflect the true performance of Grand River's business, but rather had overstated Grand River's profits on its U.S. sales:

> "Q. The reality is the labor costs for factory wages cost that you allocated to the U.S. cigarettes in this income statement did not reflect the actual cost; is that correct?
> A. Yes.
> Q. If the actual cost were the amount allocated in the Canadian cigarettes, you would show a loss for 2004 to U.S. manufacturing; is that correct?

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[615] Testimony of Jerry Montour, p. 149, ln. 5-9, *Grand River Enters. Six Nations Ltd. v. Pryor* (S.D.N.Y., Apr. 26, 2006) (No. 02 Civ. 05068).

[616] Testimony of Jerry Montour, p. 205, ln. 16-25, *Grand River Enters. Six Nations, Ltd. v. Pryor*, (S.D.N.Y., May 1, 2006) (No. 02 Civ. 05068).

> A. If you put it your way -- if you want to cho[o]se to look at it through that view, yes."[617]

Such a tactic is unacceptable, and, as the Navigant Report explains, it unfortunately appears to have been repeated in this Arbitration.[618] Although for purposes of its opening report Navigant has relied upon Claimants' questionable data, the United States reserves the right to submit an updated report if Claimants present new data, or are unable to justify or explain the discrepancies in what is presently before the Tribunal.[619]

D. Claimants Have Failed To Demonstrate That They Are Entitled To Recover Their Alleged Compliance Costs, Professional Fees Or Equipment Purchase Costs

Claimants assert that they are entitled to recover "all of their compliance costs, save and except for those incurred with respect to Claimants' off-reserve sales [in the five original states],"[620] over US$2 million in professional fees for "contesting the wrongful application of the measures to their Investment,"[621] and an alleged in costs for equipment and other upgrades to Grand River's manufacturing facility in Ohsweken, Ontario.[622] Claimants have made no effort to justify or even explain these claims, and they should be rejected for this reason.

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[617] *Id.* at p. 207, ln. 8.

[618] Navigant Report ¶¶ 74-77.

[619] *Id.* ¶ 204 ("In summary, it is important to note that our fair market valuations have necessarily relied upon the data provided to us by the Claimants. As discussed in Section V.D, there are several reasons why this data may not be accurate or reliable, and the net effect of this is a significant overstatement of the value of the Assumed Enterprise. We reserve the right to update our Baseline and Post-ASA fair market valuations to address these data issues pending production of additional clarifying information by the Claimants (or, as the case may be, an inability on the part of Claimants to justify the accuracy of the data they have submitted thus far).").

[620] Mem. ¶ 334.

[621] *Id.* ¶ 336.

[622] Wilson Report, exh. 1 (revised).

This is particularly so with regard to the alleged equipment costs. The Wilson Report asserts that:

> GRE has invested in excess of $38 million in the plant at Ohsweken, Ontario for the sole purpose of meeting what they believed were the requirements of the U.S. market. These investments include the installation of equipment used solely for the U.S. market in production, packaging, testing and blending.[623]

Even if the alleged US$38 million in equipment costs had been adequately documented (and it has not), the claim still should be rejected, for at least three reasons. *First*, the Wilson Report's supporting citation for the assertion that the equipment was used solely for U.S. production is a footnote reference to "[i]nterviews and discussions with GRE personnel."[624] Such unverifiable evidence cannot possibly justify a US$38 million claim. *Second*, the 2007 video that Claimants submitted with their Memorial includes a tour of Grand River's facility and a discussion of the equipment upgrades at the Grand River manufacturing plant. There is no mention anywhere in the video that these upgrades were undertaken "solely for the U.S. market." To the contrary, the commentary strongly suggests that the same equipment is used for all of Grand River's North American operations, and that the equipment was necessary to meet *Canadian* health standards. *Finally*, as the Navigant Report explains, the US$38 million claim represents an attempted double recovery, since as a matter of valuation theory the value of the equipment already is incorporated into the lost profits analysis itself.[625]

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[623] *Id.* ¶ 48.

[624] *Id.* at n.23.

[625] Navigant Report ¶ 133 ("As a pure matter of economics, the amount of capital expenditures GRE may have spent in order to serve the US market should not be additive to damages based on lost profits. Rather, the cost of any investment is simply a different method of estimating damages, commonly referred to in international arbitration as the Amounts Invested approach. The two approaches – lost profits and amounts invested – should not be combined, but rather are two distinct methods with which to estimate the total damages suffered by Claimants. Thus, while a US$ 38 million investment in the US market could, as a

> A. If you put it your way -- if you want to cho[o]se to look at it through that view, yes."[617]

Such a tactic is unacceptable, and, as the Navigant Report explains, it unfortunately appears to have been repeated in this Arbitration.[618] Although for purposes of its opening report Navigant has relied upon Claimants' questionable data, the United States reserves the right to submit an updated report if Claimants present new data, or are unable to justify or explain the discrepancies in what is presently before the Tribunal.[619]

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[620] Mem. ¶ 334.

[621] *Id.* ¶ 336.

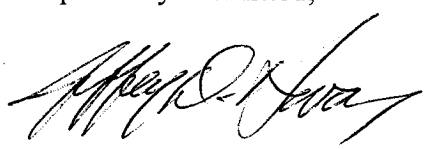
[622] Wilson Report, exh. 1 (revised).

RELIEF SOUGHT

The United States respectfully requests that this Tribunal render an award in favor of the United States and against Claimants, dismissing Claimants' claims in their entirety and with prejudice. The United States further requests that, pursuant to Article 40 of the UNCITRAL Arbitration Rules, Claimants be required to bear all costs of the arbitration, including costs of legal representation and assistance borne by the United States.

Dated: December 22, 2008

Respectfully submitted,



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