

**CONFIDENTIAL INFORMATION REDACTED**

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.*

**REJOINDER OF  
RESPONDENT UNITED STATES OF AMERICA**

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UNITED STATES DEPARTMENT OF STATE  
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**REJOINDER OF  
RESPONDENT UNITED STATES OF AMERICA**

In accordance with the Minutes of the First Session of the Tribunal, dated March 31, 2005, the Tribunal's Letter to Counsel, dated June 24, 2008, and Claimants' Letter to the Tribunal, dated March 2, 2009, Respondent United States of America respectfully submits this Rejoinder to the claims of Grand River Enterprises Six Nations, Ltd. ("Grand River"), Jerry Montour, Kenneth Hill, and Arthur Montour, Jr.

**Preliminary Statement**

The U.S. Counter-Memorial addressed a series of fundamental flaws, both factual and legal, in Claimants' NAFTA Chapter Eleven claim. Rather than addressing those flaws, Claimants simply elect to put forward new arguments, which are also without merit. For the reasons set out in the Counter-Memorial and discussed below, the claim

should be dismissed and the United States should be awarded costs under Article 40 of the UNCITRAL Arbitration Rules.

As a preliminary matter, Claimants continue to assert that state regulation of the tobacco industry has violated U.S. obligations under NAFTA Chapter Eleven. In particular, Claimants continue to allege international law violations arising from measures passed by 46 state legislatures, which closed a loophole that had been exploited by certain tobacco manufacturers, including Grand River, in order to maintain relatively lower prices for their cigarettes. Those lower prices increased demand among price-sensitive consumers, including smokers under age 18, to the detriment of public health. Exploitation of the statutory loophole by tobacco manufacturers also reduced by hundreds of millions of dollars the amount of funds available to the states to meet future tobacco-related health care costs and enabled those tobacco manufacturers to avoid internalizing such costs.

In response to the closing of the loophole, Claimants have launched an attack on the core public health rationale supporting the states' regulatory framework for the tobacco industry, and continue to demand well over a quarter of a billion dollars in alleged damages from U.S. taxpayers. The claim is not supported, either in fact or in law.

The multiple factual and legal flaws in Claimants' Chapter Eleven claim, which were highlighted in the U.S. Counter-Memorial and have not been addressed in Claimants' Reply, include the following. As a factual matter, exports of Seneca cigarettes from Canada by Grand River are as strong as ever, and much of the supposed "on-reserve" market for those cigarettes exists, in reality, off-reservation. Furthermore, Claimants' allegations of a U.S. investment by Grand River, purportedly made through

an alleged Seneca-brand “venture” with Native Wholesale Supply (“NWS”), are undocumented and contradicted in fact by Grand River’s own representations, made in U.S. court proceedings, that it sells Seneca cigarettes “F.O.B. Canada” to its “third-party distributors,” NWS and Tobaccoville, and thereafter retains no control over the cigarettes.

As a legal matter, although Claimants’ case is built fundamentally on assertions that they held certain “expectations” as members of Canadian First Nations to sell an inherently dangerous product—cigarettes—in the U.S. market free from state regulation, the mere frustration of an investor’s “expectations,” like a mere breach of contract by a NAFTA Party, does not give rise to a claim under Article 1105(1). Moreover, Claimants’ alleged expectation that the 1794 Jay Treaty gave them permanent rights to sell billions of cigarettes in the United States free from state regulation is completely unsupported. The language of the treaty itself made clear that the duty exemption under Article 3 would not apply to goods imported on a large scale. And the United States has maintained for decades that Article 3 of the Jay Treaty remains in force only to the extent that it relates to the *free passage* right of Indians on either side of the border.

Claimants’ alleged “expectations” also find no support under U.S. federal Indian law, under which states have authority to regulate operations occurring partly outside of “Indian country” as that term is defined under U.S. law. As Professor Goldberg explained in her first expert report, that rule applies to NWS in this case, regardless of whether Arthur Montour, Jr. is a member of a U.S. federally recognized Indian tribe.

In addition, Claimants’ allegations of “discrimination” ultimately concern the failure to accord them *special* treatment in recognition of their status as members of Canadian First Nations, specifically the “failure” of MSA States to affirmatively consult

with Grand River prior to adopting the allocable share amendments. But as addressed in the U.S. Counter-Memorial and as confirmed below, Article 1105(1) includes no such consultation obligation. Moreover, Claimants' attempt to shift the focus of this case from NAFTA Chapter Eleven to the U.N. Declaration on the Rights of Indigenous Peoples and International Labor Organization Convention No. 169 is fruitless. Leaving aside that a breach of a separate international agreement does not establish a breach of NAFTA Chapter Eleven, those instruments do not reflect any purported customary international law special right to consultation binding on the United States.

Regarding their claims of "discrimination" under Article 1102 (national treatment) and Article 1103 (most-favored-nation treatment), Claimants again make no attempt to show any form of nationality-based discrimination in this case, and are unable to point to any aspect of the challenged measures that accords more favorable treatment to U.S. or other foreign tobacco manufacturers in like circumstances.

Rather than directly respond to the above factual or legal points, Claimants instead offer new arguments, which fare no better than the arguments put forward in their Memorial. For example, in an attempt to transform an exporter/importer relationship into a U.S. investment, Claimants now assert that Grand River and NWS are in fact a "business association" that is "constituted" under the Seneca Nation of Indians Business Code. But Claimants provide no documentary evidence of such an association, and fail to address that the Seneca Nation Business Code does not even govern the establishment of business organizations under Seneca Nation law. Moreover, in support of their argument under the Seneca Nation Business Code, Claimants rely not on their Indian law experts, Professors Clinton and Fletcher, but rather on Professor Maurice Mendelson,



who openly acknowledges that he has no expertise in “the law of Native American peoples.” As discussed below, Professor Goldberg, who has worked directly with Indian nations in drafting their constitutions and legal codes, concludes that the Seneca Nation Business Code does not support the existence of a “business association” between Grand River and NWS.

Claimants also venture even further afield than the U.N. Declaration on the Rights of Indigenous Peoples, and now seek to rely on general U.N. human rights and treaty law to establish their alleged special rights to sell a deadly product without regulation in the United States. Claimants concoct a circuitous argument allegedly finding their right to special exemptions from state regulation in the Universal Declaration of Human Rights and the U.N. Charter. Moreover, Claimants assert that the Vienna Convention on the Law of Treaties would render Article 1105(1) void unless the Tribunal finds that it has jurisdiction to sit as a type of constitutional court applying general non-discrimination law and remedying “injustice.” As discussed below, however, the Vienna Convention clearly does *not* require States to submit to dispute settlement procedures for the adjudication of “all imperative principles of international law.”

At bottom, Claimants’ case is built on deception and distraction. Claimants bring a discrimination claim under the investment chapter of the NAFTA, but the challenged measures do not distinguish between foreign and domestic cigarette manufacturers, or between indigenous and non-indigenous cigarette manufactures. Nor do Claimants allege any such distinctions in the application of those measures. With respect to their denial of justice claim under Article 1105(1), after contending in their Memorial that they had been denied equal access to U.S. courts before the imposition of escrow deposit obligations

under the escrow statutes, Claimants now acknowledge that they have no complaint “with the US justice system,” and instead seek relief for a denial of “administrative and regulatory due process.” For the reasons discussed below, the latest iteration of Claimants’ denial of justice claim, like the earlier version, is unavailing.

Claimants also now launch an attack on the public welfare objectives of the Master Settlement Agreement (“MSA”), which is not even a challenged measure in this arbitration. As addressed below by Professor Gruber, Claimants’ argument runs directly contrary to the consensus among experts that the MSA led to a large decline in cigarette smoking because cigarette consumption is price-sensitive. Claimants also attack the existence of different categories of manufacturers inside and outside the MSA, focusing in particular on one manufacturer, Liggett Group (“Liggett”), which like Grand River targets consumers of discount cigarettes. But Claimants fail to acknowledge or address the reasonable basis for the states’ decision not to take a “one size fits all” approach to regulating the tobacco market. In the case of tobacco manufacturers like Liggett, such state regulation took the form of offering, for a 90-day period in 1998, partial payment exemptions in exchange for maximizing participation in the MSA, and thereby maximizing application of the MSA’s limitations on tobacco manufacturer conduct.

Ultimately, Claimants’ case is wholly unsupported because they have failed to make available even the most basic documentary evidence in support of their claim. Regarding their alleged investment, the only support for Claimants’ allegation that Arthur Montour, Jr. holds the Seneca trademark for the benefit of all Claimants is Arthur Montour, Jr.’s bare assertion of that fact; even Claimants’ legal expert, Professor Mendelson, is unable to determine whether Mr. Montour’s assertion concerning the

Seneca trademark reflects anything more than “a moral obligation.” Similarly, the only document provided by Claimants in support of their alleged Seneca-brand legal “association” between Grand River and NWS is a “Cigarette Manufacturing Agreement” between Grand River and NWS’ predecessor, Native Tobacco Direct (“NTD”), which merely grants Grand River a license to use the Seneca brand “for the sole purpose” of manufacturing and delivering Seneca cigarettes to NTD under the agreement.

As for damages, Claimants allege their business has been damaged by the application of the allocable share amendments. But Claimants have failed to submit audited financial statements from Grand River for 2006 and 2007. As addressed below, and as confirmed in the rebuttal report of Navigant Consulting, Inc. (“Navigant”), among the most important sources of financial data for any damages expert to review is a complete set of audited financial statements, including at a minimum statements for the years in which damages are being claimed. The absence of audited financial statements for 2006 and 2007 is particularly significant here because Claimants rely on sales and cost data from those years to project future lost profits, and because Claimants’ underlying sales and cost data from those years is contradictory, uncorroborated, or otherwise unreliable.

For the reasons set out in the U.S. Counter-Memorial and discussed below, Claimants’ claim should be dismissed in its entirety, with costs awarded to the United States.

## I. Jurisdiction

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

As addressed in the U.S. Counter-Memorial, under Article 1101(1), NAFTA Chapter Eleven applies only to *investors* of another NAFTA Party or their *investments*. 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,<sup>1</sup> and the only “investors” covered by Chapter Eleven are those who seek to make, are making, or have made an investment in another Party.<sup>2</sup> Claimants Grand River, Jerry Montour, and Kenneth Hill, who have not shown that they have investments of their own in the United States, attempt to establish a U.S. investment by alleging the existence of a U.S.-based “association” between Grand River and its U.S.-based distributor, NWS, which itself is incorporated under a charter granted by the Sac and Fox Nation of Oklahoma. Those allegations, however, are unsupported, and thus Claimants Grand River, Jerry Montour, and Kenneth Hill fail to qualify as “investors” under Article 1101(1).

Article 1101(1) further requires that the measures at issue in a Chapter Eleven arbitration “relate to” the investor or investment. Neither Arthur Montour, Jr. nor his distribution companies, NTD/NWS, qualify as a “Tobacco Product Manufacturer” under the escrow statutes (either in their original or amended form), and thus neither Arthur

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<sup>1</sup> NAFTA art. 1101(1)(b); *see also* *Bayview Irrigation District v. United Mexican States*, ICSID Case No. ARB(AF)/05/1, Award ¶ 105 (June 19, 2007) (“*Bayview 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.”).

<sup>2</sup> *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 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”).

Montour, Jr. nor NTD/NWS is subject to escrow obligations under the escrow statutes.<sup>3</sup>

The escrow statutes, therefore, do not “relate to” Arthur Montour, Jr.

Accordingly, the claims of Grand River, Jerry Montour, and Kenneth Hill should be dismissed in their entirety for failure to meet Article 1101(1) requirements. The claim of Arthur Montour, Jr., to the extent that it challenges the escrow statutes in either their original or amended form, should also be dismissed for failure to meet Article 1101(1) requirements.<sup>4</sup>

As noted above, the jurisdiction of NAFTA Chapter Eleven Tribunals is limited to matters concerning investors of another NAFTA Party or their investments. As observed by the Tribunal in the *Canadian Cattle Claims* case, under Chapter Eleven, “mere money claims arising out of cross-border goods in trade or services or financing,” without more, “do not constitute an investment” and therefore cannot support jurisdiction.<sup>5</sup> As further observed by the *Canadian Cattle Claims* Tribunal, “no matter how similar or integrated the industries on each side of the border may be,” an investor still must have made, be making, or be seeking to make an investment in another NAFTA Party to bring a Chapter Eleven claim.<sup>6</sup>

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<sup>3</sup> See Model Escrow Statute, MSA Ex. T, T-3 (applying escrow deposit obligations only to “tobacco product manufacturer[s]”); U.S. Counter-Memorial at 36 [hereinafter Counter-Mem.] (stating that an importer cannot qualify as a “Tobacco Product Manufacturer” under the escrow statutes unless the manufacturer does not intend to sell the cigarettes in the United States, whether through an importer or otherwise). In this case, it is not disputed that the manufacturer of Seneca cigarettes, Grand River, intends to sell the cigarettes in the United States through an importer.

<sup>4</sup> Article 2103 provides an independent basis for dismissing Claimants’ challenge to the Michigan equity assessment statute, which is a tax measure. As discussed in the U.S. Counter-Memorial, Claimants failed to address jurisdictional requirements for tax measures under Article 2103. See Counter-Mem. at 69-71. Claimants do not address the Michigan equity assessment statute, or Article 2103, in their Reply.

<sup>5</sup> *In re Consolidated Canadian Cattle Claims*, NAFTA/UNCITRAL, Award on Jurisdiction ¶¶ 143, 147 (Jan. 28, 2008) (“*Canadian Cattle Claims Award*”).

<sup>6</sup> *Id.* ¶ 169.

In this case, Grand River and its shareholders, Jerry Montour and Kenneth Hill, seek compensation under Chapter Eleven arising from the alleged impact of the challenged measures on Grand River's exports of Seneca cigarettes to the United States. Well aware that the mere export of goods to the United States does not satisfy Chapter Eleven requirements, Claimants have alleged the existence of an "integrated business enterprise" between Grand River and NWS, and now allege, in their most recent filing, that such an enterprise is actually "constituted" under Seneca Nation law. Those claims are unsupported and should be rejected.

In their Memorial, when attempting to establish the existence of an "integrated business enterprise" between Grand River and NWS, Claimants alleged that they had "formalized" their business plan to develop the Seneca brand in the United States "by having NTD and Grand River sign formal agreements cross-licensing use of the [Seneca] brand, including exclusive manufacturing and distribution rights."<sup>7</sup> But Claimants made available only one of those "formal agreements" in this arbitration: the 1999 Cigarette Manufacturing Agreement between NTD and Grand River. Thus, when attempting to establish the existence of an alleged "integrated business enterprise" between Grand River and Native Wholesale Supply, Claimants opted to provide not the agreement with Native Wholesale Supply, but rather the agreement with the predecessor of NWS, Native Tobacco Direct. Moreover, that one agreement is the *only* document relied on by Claimants in support of their alleged "integrated business enterprise."

In their Reply, Claimants now place less emphasis on the Cigarette Manufacturing Agreement with NTD, and instead seek to establish the existence of a "business

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<sup>7</sup> First Witness Statement of Arthur Akwiraienton Montour ¶ 14 (July 10, 2008) [hereinafter Arthur Montour, Jr. First Statement].

association” between Grand River and NWS under Seneca Nation law, specifically the Seneca Nation of Indians Business Code.<sup>8</sup> But when putting forward their new argument under Seneca Nation law, Claimants turn not to their Indian law experts, Professors Clinton and Fletcher, but rather to Professor Maurice Mendelson, who openly acknowledges that he is “not an expert in . . . the law of Native American peoples.”<sup>9</sup> As discussed below, and as found by Professor Goldberg, who has “worked directly with individual Indian nations to draft their constitutions and legal codes,”<sup>10</sup> the Seneca Nation Business Code does not establish any “business association” between Grand River and NWS.

For the reasons discussed below, the claims of Grand River, Jerry Montour, and Kenneth Hill should be dismissed in their entirety for failure to meet Article 1101(1) requirements.

**1. Because Claimants Fail To Include Tobaccoville, Their Exclusive Off-Reservation Distributor, Within Their Alleged Investment In The United States, The Tribunal Lacks Jurisdiction Over Claimants’ Off-Reservation Claim**

Grand River exports Seneca cigarettes from Canada to NWS (for on-reservation distribution in the United States) and Tobaccoville (for off-reservation distribution in the United States).<sup>11</sup> As discussed above, Claimants attempt to establish an investment by

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<sup>8</sup> See Claimants’ Reply Memorial ¶¶ 80, 84, 85, 87 [hereinafter Reply]. Claimants note that the Cigarette Manufacturing Agreement states that it is governed by Seneca Nation law, *see id.* ¶ 85, but do not rely on any language in the Agreement to support their assertion that Grand River and NWS have formed a “business association” that is “constituted” under Seneca Nation law.

<sup>9</sup> Expert Opinion of Professor Maurice Mendelson, Q.C. ¶ 28 (Feb. 28, 2009) [hereinafter Mendelson Report].

<sup>10</sup> Expert Rebuttal Report of Professor Carole Goldberg at 5 (May 10, 2009) [hereinafter Goldberg Rebuttal Report].

<sup>11</sup> See Claimants’ Memorial ¶ 68 [hereinafter Mem.]; Arthur Montour, Jr. First Statement ¶¶ 20, 22; First Witness Statement of Larry Phillips ¶¶ 3-4 (July 10, 2008).

Grand River in the territory of the United States by alleging that Grand River has established a “business association” with NWS that is “constituted” under Seneca Nation law. But Claimants make no attempt to establish any such “association” between Grand River and its exclusive off-reservation distributor in the United States, Tobaccoville. Claimants thus fail to allege any “investment” in the United States with respect to the portion of Grand River’s cigarette exports that are intended for distribution off-reservation in the United States. Claimants’ off-reservation claim therefore should be dismissed for failure to meet jurisdictional requirements under Article 1101(1).

In their Reply, Claimants confirm that Tobaccoville is not included within their “investment enterprise in the United States.”<sup>12</sup> Claimants also characterize Tobaccoville as a mere “third-party distributor.”<sup>13</sup> Claimants nevertheless assert that Grand River’s cigarette exports to Tobaccoville are part of their U.S. investment because they represent part of the value of Claimants’ alleged “intangible property right” in the Seneca brand.<sup>14</sup>

But the trademark to the Seneca brand is owned by Arthur Montour, Jr., not Grand River.<sup>15</sup> Although Claimants allege that Arthur Montour, Jr. holds the Seneca trademark “beneficially for all Claimants,”<sup>16</sup> they provide no documentary support for

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<sup>12</sup> Reply ¶ 89.

<sup>13</sup> Mem. ¶ 206 & n.257.

<sup>14</sup> Reply ¶ 89.

<sup>15</sup> Claimants assert that the U.S. Counter-Memorial “displays some confusion” about the distinction between the Seneca trademark and the Seneca brand. Reply ¶ 90. But as discussed in the damages section below, Claimants’ entire theory of damages is premised on a misplaced understanding of “brand value.” Specifically, Claimants conflate the value of a product—which may generate millions of dollars in sales while having little to no brand value—with the value of a brand. As Claimants’ own valuation expert observes, “market shares for discount and deep discount cigarettes are three or more times as responsive to own-price changes . . . as are premium market shares.” Expert Report of Wayne R. Wilson Jr. ¶ 35 (July 10, 2008) [hereinafter Wilson Report] (quotation marks omitted). Discount cigarettes, including Seneca cigarettes, have limited brand loyalty and compete almost exclusively on price.

<sup>16</sup> Mem. ¶ 21; *see also* First Witness Statement of Jerry Montour ¶ 25 (July 9, 2008) [hereinafter Jerry Montour First Statement]; Arthur Montour, Jr. First Statement ¶ 14.



that assertion. Indeed, Claimants' assertion is directly contradicted by Grand River's consistent representations in U.S. court proceedings that it has "no control" over the distribution of Seneca cigarettes in the United States.<sup>17</sup> Moreover, Claimants' own legal expert, Professor Mendelson, is unable to determine whether Arthur Montour, Jr.'s allegation concerning the Seneca trademark is "simply a statement of moral obligation" or "something more."<sup>18</sup>

Thus, Claimants' bare allegation that Arthur Montour, Jr. holds the Seneca trademark for the benefit of Grand River cannot cure the fundamental jurisdictional gap in Claimants' off-reservation claim. Grand River's President Steve Williams, when resisting jurisdiction in separate legal proceedings, has stated in sworn testimony that Grand River has no "affiliation . . . beyond the sale of its products" with its exclusive off-reservation distributor, Tobaccoville.<sup>19</sup> Specifically, in those proceedings, Mr. Williams stated that:

Grand River produced (and continues to produce) Seneca brand cigarettes for Tobaccoville USA, Inc. ("Tobaccoville"), which has been granted a license by NWS that permits Tobaccoville to contract for the manufacture of, and to sell, Seneca cigarettes off-reservation in the United States. Grand River has no control over where Tobaccoville sells these products, nor does Grand River have any affiliation with Tobaccoville beyond the sale of its products to Tobaccoville.<sup>20</sup>

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<sup>17</sup> See, e.g., Affidavit of Steve Williams in Support of Motion for Relief from Judgment ¶¶ 7, 9, *South Dakota v. Grand River Enters., Inc.*, Civ. No. 01-465 (6th Jud. Cir. S.D. Feb. 6, 2007); Memorandum in Support of Motion for Relief from Judgment at 24, *South Dakota v. Grand River Enters., Inc.*, Civ. No. 01-465 (6th Jud. Cir. S.D. Feb. 6, 2007); Affidavit of Steve Williams in Support of Defendant's Motion to Dismiss or for a Stay ¶ 5, *Kansas v. Grand River Enters. Six Nations, Ltd.*, No. 08 C 207 (D. Kan. 9th Div. July 18, 2008); 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.*, No. 08 C 207 (D. Kan. 9th Div. July 18, 2008).

<sup>18</sup> Mendelson Report ¶ 39.

<sup>19</sup> Affidavit of Steve Williams in Support of Motion for Relief from Judgment ¶ 9, *South Dakota v. Grand River Enters., Inc.*, Civ. No. 01-465 (6th Jud. Cir. S.D. Feb. 6, 2007).

<sup>20</sup> *Id.*; see also Memorandum in Support of Motion for Relief from Judgment at 26, *South Dakota v. Grand River Enters., Inc.*, Civ. No. 01-465 (6th Jud. Cir. S.D. Feb. 6, 2007) (asserting that once Grand River ships

In this arbitration, Claimants now allege just the opposite, asserting that they “selected four principal States in which we would *permit* Tobaccoville to sell the Seneca<sup>®</sup> brand.”<sup>21</sup> In addition to being plainly inconsistent with Grand River’s earlier assertions in U.S. court proceedings, Mr. Montour’s allegation is not supported by the Cigarette Production Agreement between Grand River and Tobaccoville. That agreement grants Tobaccoville an exclusive right to import and sell Seneca brand cigarettes anywhere in the United States “off of Native Territories,” without any other geographic restrictions.<sup>22</sup>

Grand River’s representations when applying to become an SPM further illustrate the company’s lack of control over Tobaccoville’s distribution activities. In its application, Grand River could identify the states in which Tobaccoville had sold Seneca cigarettes only “[u]pon information and belief”:

Since 2003, Applicant has sold cigarettes F.O.B. Ohsweken, to Tobaccoville USA, Inc. Upon information and belief, Tobaccoville USA, Inc. has sold such cigarettes in or to wholesalers located in Oklahoma, North Carolina, South Carolina, Arkansas, Georgia and Tennessee.<sup>23</sup>

Claimants cannot exclude Tobaccoville from their alleged U.S. enterprise while at the same time including Grand River’s cigarette exports to Tobaccoville within their Chapter Eleven investment claim.<sup>24</sup> Claimants’ off-reservation claim should be dismissed for failure to meet jurisdictional requirements under Article 1101(1).

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Seneca cigarettes to its third party distributors (NTD/NWS and Tobaccoville), “the third parties have the power to do with them as they wish and send them anywhere in the world”).

<sup>21</sup> Second Witness Statement of Jerry Montour ¶ 11 (Mar. 2, 2009) [hereinafter Jerry Montour Second Statement] (emphasis added).

<sup>22</sup> See Cigarette Production Agreement ¶ 11 (June 10, 2002) (Counter-Mem., Ex. 10).

<sup>23</sup> MSA Application of Grand River Enterprises Six Nations, Ltd. ¶ 21(g) (Mar. 31, 2006) (Counter-Mem., Ex. 12).

<sup>24</sup> See, e.g., *Archer Daniels Midland Co. & Tate & Lyle Ingredients Americas Inc. v. United Mexican States*, ICSID Case. No. ARB(AF)/04/5, Award ¶¶ 272-74 (Nov. 21, 2007) (“*Archer Daniels Midland*

## **2. Claimants' Bare Allegations Of A Grand River/NWS "Business Association" Constituted Under The Seneca Nation Business Code Should Be Rejected**

As addressed in the U.S. Counter-Memorial, Grand River has represented, when resisting jurisdiction in multiple U.S. judicial proceedings, that the company merely sells Seneca cigarettes "F.O.B. Canada" to "third-party distributors" (Tobaccoville and NTD/NWS), at which point Grand River loses all control over any subsequent distribution and/or sale of the cigarettes.<sup>25</sup> Absent something more than an exporter/importer relationship between Grand River and its U.S. distributors, Grand River, which itself has shown no U.S. operations, would not qualify as an "investor" under NAFTA Article 1101. Claimants take no issue with any of the above points.

Notwithstanding their burden to meet the investment requirement under Chapter Eleven, Claimants offer only contradictory theories based on little to no documentary support. First, Claimants originally alleged that Grand River and NWS were "corporate branches,"<sup>26</sup> but now admit there is in fact no parent corporation for such branches.<sup>27</sup> Second, Claimants originally alleged there was a "formal venture"<sup>28</sup> between Grand River and NWS, but now assert that it is merely an "informal venture."<sup>29</sup> And in

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Award") (observing that the Tribunal had jurisdiction "only to award compensation for the injury caused to Claimants in their investment made in Mexico [the host state]"). Notably, alleged injury to Tobaccoville forms the primary basis of Claimants' damages claim. *See* Rebuttal Report of Wayne R. Wilson Jr. ¶ 10 (Mar. 3, 2009) [hereinafter Wilson Rebuttal Report] (observing that Navigant's report demonstrates that the impact of the challenged measures on NWS and Grand River is "relatively minor, while the impact to the Tobaccoville sales is profound," given that "Tobaccoville is much less diversified than NWS").

<sup>25</sup> Counter-Mem. at 59-60.

<sup>26</sup> Mem. ¶ 111.

<sup>27</sup> Reply ¶ 78.

<sup>28</sup> Mem. ¶ 20

<sup>29</sup> Reply ¶ 86 & n.67.

response to the U.S. Counter-Memorial, Claimants now have confirmed that the relationship between Grand River and NWS is not a joint venture.<sup>30</sup>

As addressed in the U.S. Counter-Memorial, Grand River has a clear incentive not to establish a joint venture with NWS in the United States: the continued avoidance of U.S. taxation.<sup>31</sup> Faced with that limitation, Grand River attempts to allege just enough of a corporate affiliation with NWS to claim an investment in the territory of the United States for purposes of this arbitration, while not, at the same time, exposing itself to U.S. taxation. For the reasons discussed below, Grand River fails in that attempt. Claimants have shown no investment by Grand River in the territory of the United States.

In their Reply, Claimants assert, for the first time, that the purported “venture” between Grand River and NWS is in fact a “business association” constituted under the Seneca Nation of Indians Business Code (“Business Code”).<sup>32</sup> Claimants point to several provisions of that code in support of their assertion.<sup>33</sup> But those provisions establish no such association, either individually or collectively. Specifically, Claimants set out the following list of provisions from the Business Code in support of their allegation:

- The scope of the Business Code includes “traditional custom and practice” (Art. 1-102);
- Civil matters are to be governed by “Seneca Nation laws and customs not in direct contravention of the laws of the United States” (Art. 1-105);
- Except as otherwise expressly provided, the provisions of the Business Code “apply to all persons and entities, whether Nation members or not, within the territorial jurisdiction of the Nation” (Art. 1-106);

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<sup>30</sup> *Id.* ¶¶ 13, 87.

<sup>31</sup> *See* Counter-Mem. at 33-34.

<sup>32</sup> Reply ¶¶ 12, 84, 85, 87 & n.68, 160.

<sup>33</sup> *See* Mendelson Report ¶ 29.

- For purposes of the jurisdictional provisions of the Business Code, “Person” includes “any individual, firm, partnership, association or corporation, or business entity” (Art. 1-109(a));
- The Peacemakers Court has jurisdiction over (i) “any person who transacts, conducts or performs any business or activity within the Nation, either in person, by agent or representative” (Art. 1-109(b)(2)), and (ii) real and personal property located within the territorial jurisdiction of the Nation to determine “the ownership or rights thereof” (Art. 1-111);
- Various definitions under the Business Code’s Business License System (Art. 2-104).<sup>34</sup>

As a preliminary matter, Professor Goldberg observes that no business entity can in fact be “constituted” under the Business Code:

Unlike business laws adopted by some other Indian nations, the Seneca Nation of Indians Business Code does not govern incorporation or establishment of business organizations under tribal law. Thus, no business entity can be “constituted” under its authority. All that the Business Code addresses is permission to do business within Seneca Nation territory for an entity that has already been formed under some other body of law.<sup>35</sup>

Claimants nevertheless assert that the above provisions of the Business Code establish that a Grand River/NWS “business association” is “constituted” under Seneca Nation law, apparently as a result of nothing more than the fact that Claimants are

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<sup>34</sup> The definitions under Art. 2-104 cited by Claimants are as follows: “Agreement” is defined as “a manifestation of mutual assent, between two or more legally competent persons which ordinarily leads to a contract. It is the bargain of the parties in fact as found in their language, or by implication from other circumstances, including course of dealing or usage of trade or course of performance”; “Business” is defined as “all activities engaged in, whether the object of gain, benefit or advantage to the taxpayer or another person or class, directly or indirectly . . .”; “Engaging in business” is defined as “commencing, conducting, or continuing in any business of whatever nature . . .”; “Indian” is defined as “a member of any tribe, Pueblo, band, group, village or community that is recognised by the Secretary of the Interior or the Secretary of Health and Human Services as being Indian, or any person who possesses Indian blood and who is recognised as an Indian by the Community where such person lives”; “Individual” is defined as “a natural person, a corporation, an entity, association”; “Person” is defined as “an individual, corporation, governmental subdivision or agency, partnership, association, cooperative or any other legal entity.” *See id.*

<sup>35</sup> Goldberg Rebuttal Report at 5-6 (footnote omitted).

engaged in trade with each other.<sup>36</sup> Specifically, Claimants assert that Seneca Nation law and custom permit Haudenosaunee members to “strike business associations with each other, and operate them in and from Seneca Nation territory, where one of the members of the venture is a member of the Seneca Nation.”<sup>37</sup> Claimants further assert that Article 2-107 of the Business Code exempts “participants” in such associations from having to obtain their own Seneca Nation business license, “so long as they are working in concert with a Seneca Nation Member who does have a license.”<sup>38</sup>

But the Business Code establishes clear licensing requirements for any business operating on Seneca Nation territory, with only very narrow exceptions. Any business seeking to operate on Seneca Nation territory must apply, on an annual basis, for a business license. To obtain a license under the Business Code, a business entity must have a particular name, particular address, particular telephone number, particular officers and/or directors, and particular persons who have a financial interest in the business.

Specifically, Article 2-105 of the Business Code requires every individual “engaged in or intending to engage in a trade, business, profession or commercial activity of any sort within the Nation boundaries” to file an application for a business license annually. Article 2-106 provides that a person or business entity holding a license to conduct business operations on Seneca Nation of Indians Reservations “shall have the right to conduct only such business(es) upon the Seneca Nation of Indians Reservations for such time(s) at such location(s) as is (are) listed on the application.” Article 2-111

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<sup>36</sup> Reply ¶¶ 80, 84, 85, 87.

<sup>37</sup> *Id.* ¶ 84.

<sup>38</sup> *Id.*

requires applications for a business license to include, among other information, the following:

- Name, address, and telephone number of the business;
- Location(s) of the business, “including Road, and Reservation”;
- Name, address and phone number(s) of the owner or Chief Executive Officer of the business.

Business license applicants must also indicate, under Article 2-111, “current officers and/or directors including persons having a direct or indirect financial interest in the business.” Article 2-111 further requires supplementary lists of additions and deletions to be filed quarterly.

Although Claimants allege that Article 2-107 of the Business Code exempts “participants” in business associations from having to obtain their own Seneca Nation business license so long as they are “working in concert” with a licensed Seneca Nation Member,<sup>39</sup> Article 2-107 in fact contains no such exemption. Article 2-107 states as follows:

2-107 Business License Exemptions

(a) No business license shall be required of:

- (1) any person engaged in the ministry of healing by purely spiritual means or other recognized religious activity;
- (2) any entity owned by the Seneca Nation of Indians;
- (3) any person under the age of 18 who conducts any activities which gross less than Three Thousand Dollars in any one calendar year;
- (4) any person engaged in the production and sale of the intrinsic or traditional crafts of the Seneca in the traditional manner

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<sup>39</sup> *Id.*

which grosses less than Ten Thousand Dollars in any one calendar year;

- (5) any person who engages in a business operated entirely from their place of residence which grosses less than Ten Thousand Dollars in any one calendar year;
- (6) any person whose gross receipts attributable to activities that occur within the Nation boundaries are less than Ten Thousand Dollars in any one calendar year.

None of the above exemptions apply to an association “participant” working “in concert with” a Seneca Nation Member who holds a business license.<sup>40</sup>

In their Reply, Claimants assert that they “clearly intended to operate their [Grand River/NWS] venture together under Seneca Nation law,”<sup>41</sup> but Claimants have not identified any Seneca Nation business license held by such a venture. Nor have Claimants alleged any name, address, telephone number, officer or director of the alleged venture. Claimants also fail to identify any applicable exemption under Article 2-107. Contrary to Claimants’ allegations, a “plain reading” of the Business Code does *not* “demonstrate[] that Claimants have formed an investment enterprise under Seneca Nation law.”<sup>42</sup>

Claimants Grand River, Jerry Montour, and Kenneth Hill fail to support their bare allegations of an “association” with NWS that is constituted under Seneca Nation law. Accordingly, Grand River, Jerry Montour, and Kenneth Hill do not qualify as “investors” that have made, or are seeking to make, an “investment” in the United States. Thus, under Article 1101(1), their claims should be dismissed in their entirety.

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<sup>40</sup> *Id.*

<sup>41</sup> *Id.* ¶ 80.

<sup>42</sup> *Id.* ¶ 87.



**3. Claimants’ Alleged Line Of Credit “With No Fixed Maturity Date” Does Not Satisfy Subparagraph (d)(ii) Of The Chapter Eleven Definition Of “Investment”**

In an alternative attempt to establish an investment in the United States, Claimants assert that Grand River made a loan to NTD/NWS which qualifies as an “investment” under subparagraph (d)(ii) of the Chapter Eleven definition of “investment.”<sup>43</sup> [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Such inconsistent allegations illustrate the critical importance of documenting business relationships and business obligations. When business relationships and business obligations are grounded in bare allegations, rather than documentation, [REDACTED]

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<sup>43</sup> See Mendelson Report ¶¶ 33-34. [REDACTED]

[REDACTED]





[REDACTED]

[REDACTED]

<sup>44</sup> *Id.*

<sup>45</sup> Jerry Montour First Statement ¶ 29.

<sup>46</sup> Jerry Montour Second Statement ¶ 3.

  
  
  
 Claimants' allegations of an investment under subparagraph (d)(ii) of the Chapter Eleven definition of "investment" should be rejected.

**4. Claimants Distance Themselves From Their Own Allegation Of An Investment Under Subparagraph (g) Of The Chapter Eleven Definition Of "Investment"**

In yet another attempt to establish an investment in the United States, Claimants assert that Arthur Montour, Jr.'s allegation that he holds the Seneca trademark beneficially for himself and the owners of Grand River may possibly satisfy the definition of "investment" under subparagraph (g) of the Chapter Eleven definition of "investment." Under subparagraph (g), the definition of "investment" includes "real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes."

But Claimants' own legal expert, Professor Mendelson, fails to commit to that argument, merely stating that Arthur Montour, Jr.'s allegation "may well be capable" of satisfying the definition of "investment" under subparagraph (g).<sup>47</sup> Professor Mendelson also is unable to determine whether Arthur Montour, Jr.'s allegation is "simply a statement of moral obligation" or "something more."<sup>48</sup> The only evidence put forward by Claimants in support of Arthur Montour, Jr.'s "holding" of the Seneca trademark for the benefit of Grand River's owners is Arthur Montour, Jr.'s own unsupported allegation.

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<sup>47</sup> Mendelson Report ¶ 39.

<sup>48</sup> *Id.*

Given such a lack of documentary support, as well as Claimants’ own failure to commit to the argument, the claim of an “investment” under subparagraph (g) should be rejected.<sup>49</sup>

**5. Claimants’ Alleged Line Of Credit Does Not Satisfy Subparagraph (h) Of The Chapter Eleven Definition Of “Investment”**

Claimants’ final attempt to establish an investment in the United States, under subparagraph (h) of the Chapter Eleven definition of investment, likewise fails.

Subparagraph (h) states, in relevant part, as follows:

[“Investment” means] interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under

- (i) contracts involving the presence of an investor’s property in the territory of the Party, including turnkey or construction contracts, or concessions . . . .

Claimants assert that Grand River, Jerry Montour, and Kenneth Hill “have contractually committed **capital** in the USA,” [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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<sup>49</sup> As addressed in the Counter-Memorial, *see* Counter-Mem. at 63 n.245, Claimants did not attempt to include the Opal brand within their Chapter Eleven claim until the filing of their Memorial. Claimants thus failed to provide sufficient notice of the Opal-related claim under UNCITRAL Article 18. The Opal-related portion of Claimants’ Chapter Eleven claim therefore should not be considered.

<sup>50</sup> Mendelson Report ¶ 45. Claimants do not assert that Grand River, Jerry Montour, and Kenneth Hill have an “investment” in the United States under subparagraph h(ii). *See id.* ¶ 43 (“So far as concerns sub-subparagraph (ii) above, I do not have sufficient factual information to determine whether the Claimants can bring themselves within it.”).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

But it is the inventory, not the line of credit, that is located in the territory of the United States, and Claimants have provided no documentation to the contrary. Furthermore, the inventory located in the United States is owned by NTD/NWS, not Grand River. As Grand River has made clear when resisting jurisdiction in U.S. court proceedings, all of its cigarette sales to NTD/NWS are made “F.O.B. Ontario,” meaning that NTD/NWS takes ownership of the inventory in Canada.<sup>53</sup> Inventory in the possession of NTD/NWS in the United States is not Grand River’s property. As Grand River itself maintains, once NTD/NWS takes ownership of Seneca cigarettes in Ontario, Grand River loses “all control over the cigarettes.”<sup>54</sup>

When Grand River provided NTD/NWS with “access to an inventory loan,” it did not commit capital in the territory of the United States. Not only have Claimants failed to provide documentation to the contrary, they in fact have provided no documentary evidence in any form in connection with their alleged “inventory loan.” For the above reasons, Claimants’ allegation of an “investment” under subparagraph (h) of the Chapter Eleven definition of “investment” should be rejected.<sup>55</sup>

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<sup>51</sup> Jerry Montour First Statement ¶ 29.

<sup>52</sup> Jerry Montour Second Statement ¶ 3.

<sup>53</sup> See, e.g., Memorandum in Support of Motion for Relief from Judgment at 24, *South Dakota v. Grand River Enters., Inc.*, Civ. No. 01-465 (6th Jud. Cir. S.D. Feb. 6, 2007).

<sup>54</sup> *Id.*

<sup>55</sup> [REDACTED]

Furthermore, the only document produced by Claimants in support of Grand River's alleged U.S. investment, the Cigarette Manufacturing Agreement between Grand River and NTD, falls squarely within subparagraph (i) of the Chapter Eleven definition of "investment," which provides that "investment" does *not* mean claims to money arising 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 Cigarette Manufacturing Agreement provides for the sale of goods (cigarettes) by a Canadian enterprise (Grand River) to an enterprise in the territory of the United States (NTD). Therefore, the Cigarette Manufacturing Agreement between Grand River and NTD does not support the existence of an "investment" by Grand River in the United States.

Notably, Claimants have not presented a single document demonstrating any corporate relationship between Grand River and NWS. Instead, Claimants offer only the *allegation* that such a document exists, and that it is "almost identical" to the Cigarette Manufacturing Agreement between Grand River and NTD.<sup>56</sup> But Claimants have elected not to make that document available in support of their claim. Claimants cannot base a Chapter Eleven claim on bare allegations and innuendo—evidentiary support is required. Ultimately, Claimants' allegation of a "business association" existing between Grand River and NWS that is "constituted" under Seneca Nation law is wholly unsupported.

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allege, was intended to contribute to the development of the Seneca brand in the United States. *See* Wilson Report ¶ 48. But Claimants do not even attempt to include that Canada-based equipment within their U.S. investment, which is understandable, given that damages under Chapter Eleven must flow from an investment located in the territory of the host State. *See, e.g., Archer Daniels Midland Award* ¶¶ 272-74. Grand River's Canada-based equipment cannot support a claim for damages under Chapter Eleven.

<sup>56</sup> Arthur Montour, Jr. First Statement ¶ 14.

The claims of Grand River, Jerry Montour, and Kenneth Hill should be dismissed in their entirety.

**6. NWS Is Not Subject To Deposit Obligations Under The Escrow Statutes, And Thus Those Measures Do Not “Relate To” Arthur Montour, Jr., As Required By Article 1101(1)**

In their Reply, Claimants refer to “Respondent’s objection to Arthur Montour continuing as a Claimant” in this arbitration.<sup>57</sup> That characterization is inaccurate. As stated in the U.S. Counter-Memorial, “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.”<sup>58</sup> 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.<sup>59</sup> Here, it is not disputed that the Seneca cigarettes manufactured by Grand River are intended for sale in the United States. Thus, the deposit obligations under the escrow statutes run to the manufacturer, Grand River, and not the importer, NWS.

Claimants assert that Arthur Montour, Jr. is subject to the escrow statutes because both he and NWS “are personally facing three active lawsuits, under the Escrow Statutes of Idaho, New Mexico and California.”<sup>60</sup> To the contrary, the lawsuits against NWS in Idaho, New Mexico, and California have been brought under state complementary legislation, not state escrow statutes.<sup>61</sup>

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<sup>57</sup> Reply ¶ 104.

<sup>58</sup> Counter-Mem. at 53 (emphasis added).

<sup>59</sup> *See id.* at 18, 37.

<sup>60</sup> Reply ¶ 103.

<sup>61</sup> *See* Verified Complaint ¶ 44, *Idaho v. Native Wholesale Supply Co.*, No. CV 0C 0815228 (4th Jud. Dist. Idaho Aug. 14, 2008); Complaint for Injunctive Relief, Civil Penalties, Contempt and Other Relief at 1-2, *New Mexico v. Native Wholesale Supply Co.*, No. D-101-CV-2008-02236 (1st Jud. Dist. N.M. Aug. 12,

Unlike deposit obligations under the escrow statutes, which apply only to “Tobacco Product Manufacturers” as defined under those statutes, 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.<sup>62</sup> As an owner, transporter, and importer of cigarettes, NWS is subject to the complementary legislation. But NWS is not a manufacturer of cigarettes, and thus is not subject to deposit obligations under the escrow statutes. The escrow statutes, therefore, do not “relate to” NWS or its owner, Arthur Montour, Jr.<sup>63</sup> Accordingly, the claim of Arthur Montour, Jr., to the extent that it challenges the escrow statutes, should be dismissed for failing to meet Article 1101(1) requirements.

## **II. Merits—Liability**

### **A. Claimants Fail To Show Any Basis For Their Expropriation Claim**

In 2005, Claimants alleged in this arbitration that the “effect of compliance” with the escrow statutes “is the complete destruction of the Investors’ business and their investments.”<sup>64</sup> Claimants’ most recent iteration of their expropriation claim is considerably more modest: “There are only a small number of regional markets where individual state Measures resulted in full expropriation of the brand. In fact the primary

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2008); Complaint for Injunction, Civil Penalties, Contempt and Other Relief at 1-2, *California v. Native Wholesale Supply Co.*, No. 2:08-CV-01827-LKK-KJM (Cal. Super. Ct. June 30, 2008); *see also* Counter-Mem. at 40-47.

<sup>62</sup> *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).

<sup>63</sup> *See, e.g., Methanex Corp. v. United States*, NAFTA/UNCITRAL, First Partial Award ¶ 150 (Aug. 7, 2002) (finding that a ban on the gasoline oxygenate MTBE, which did not extend to the MTBE component methanol, did not “relate to” a methanol manufacturer under Article 1101(1)).

<sup>64</sup> Claimants’ Particularized Statement of Claim ¶ 67.

claim in this arbitration is for treatment no less favorable than that enjoyed by U.S. corporations.”<sup>65</sup>

As addressed in the U.S. Counter-Memorial,<sup>66</sup> the factors that are analyzed by international tribunals when determining whether a regulatory measure constitutes an expropriation do not support Claimants’ expropriation claim. Specifically, Claimants have failed to demonstrate: (i) sufficient economic impact on their alleged investment, (ii) interference with reasonable investment-backed expectations, and (iii) the discriminatory nature of the challenged measures and/or their lack of legitimate public welfare objectives.

*First*, with respect to the economic impact factor, Claimants’ expropriation claim must confront the simple fact that the Seneca brand continues to thrive in the United States. As stated in their most recent filing, “Claimants still own the Seneca brand. They are able to fully use the brand in other markets outside of the specifically identified, strategic regional markets”<sup>67</sup> addressed in Mr. Wilson’s first report.<sup>68</sup> Claimants fail to demonstrate sufficient economic impact on their alleged U.S. investment to support an expropriation claim; indeed, sales of Seneca cigarettes by NWS are stronger than ever in many states, including New York and California.

*Second*, Claimants’ alleged “expectations”—that their on-reservation sales would be exempt from state regulation and that their off-reservation sales would enjoy large releases of escrow deposits in perpetuity—are unsupported. For on-reservation sales, as a

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<sup>65</sup> Wilson Rebuttal Report ¶ 3(b).

<sup>66</sup> See Counter-Mem. at 147-48.

<sup>67</sup> Wilson Rebuttal Report ¶ 21.

<sup>68</sup> Wilson Report ¶ 51 (discussing Grand River’s investment in off-reservation sales in “five specific States – Georgia, North Carolina, South Carolina, Oklahoma, and Arkansas”).



factual matter, Claimants fail to acknowledge that a large, if not overwhelming, portion of their “on-reserve” sales ultimately serve an off-reservation market. As a legal matter, Claimants fail to respond to the federal Indian law arguments set out in Professor Goldberg’s expert report, as well as the Jay Treaty arguments set out in the U.S. Counter-Memorial. Claimants simply provide no support for any “legitimate expectation” that their “on-reserve” operations would be exempt from state regulation. For off-reservation sales, Claimants similarly provide no support for their bare assertion of a “legitimate expectation” that large releases of escrow payments under the escrow statutes would remain available in perpetuity.

*Third*, Claimants cast no doubt on the generally applicable and non-discriminatory nature of the challenged measures. Nor do Claimants cast any doubt on the strong public interest driving the adoption of those measures. Furthermore, Claimants’ wide-ranging attacks on the public welfare objectives of the MSA, which is not even a challenged measure in this arbitration, are baseless.

For the above reasons, Claimants’ expropriation claim should be dismissed.

**1. Claimants Fail To Show Sufficient Economic Impact On Their Alleged U.S. Investment To Support A Claim Of Expropriation**

The first factor considered by international tribunals when determining whether a regulatory measure constitutes an expropriation, the economic impact of the challenged measure, does not support Claimants’ expropriation claim. In their previous filing, Claimants asserted that the challenged measures impaired their investment in the Seneca brand on-reservation in the states of Arizona, California, Idaho, and Nevada,<sup>69</sup> and off-reservation in the states of North Carolina, South Carolina, Oklahoma, Arkansas, and

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<sup>69</sup> See *id.* ¶ 77.

Georgia.<sup>70</sup> Claimants no longer include the state of California within their on-reservation claim,<sup>71</sup> and now include only “three states” within their off-reservation claim.<sup>72</sup>

Claimants’ decision to remove California from their on-reservation claim is quite understandable, given that sales of Grand River-manufactured cigarettes in California have increased annually from 2004 through 2008:

CA Revised On-Reservation Sales<sup>73</sup>  
(in Sticks)

	2004	2005	2006	2007	2008
Sales <sup>1</sup>	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Growth	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

1) Sticks sold are sourced to revised NWS sales data.

Indeed, as observed by Mr. Wilson, [REDACTED]

[REDACTED],<sup>74</sup>

Sales of Grand River-manufactured cigarettes also continue to increase annually in the state of New York, [REDACTED]

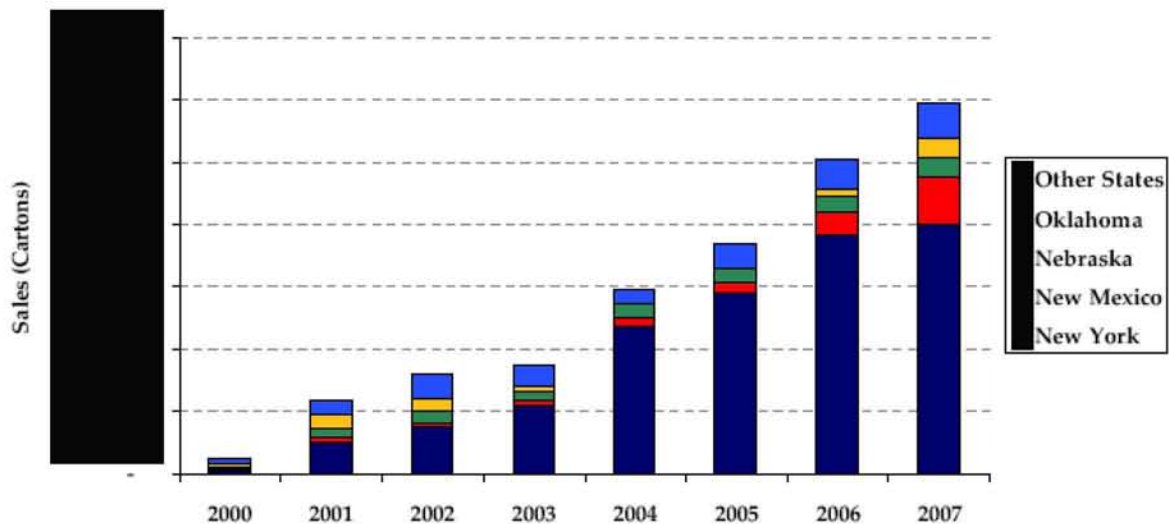
<sup>70</sup> See *id.* ¶¶ 51, 70.

<sup>71</sup> See Wilson Rebuttal Report ¶ 43.

<sup>72</sup> Reply ¶ 198.

<sup>73</sup> Wilson Rebuttal Report at 20.

<sup>74</sup> *Id.* ¶ 44 (emphasis added).

NWS Annual Geographic Sales Distribution, 2000-2007<sup>75</sup>

Claimants nevertheless assert that consideration of the performance of the Seneca brand in the state of New York, or in any state other than the “small number” of MSA States that have been identified by Claimants for purposes of their expropriation claim, would be not only “irrelevant,” but in fact *barred* by the Tribunal’s Decision on Jurisdiction in this matter.<sup>76</sup>

But the Tribunal’s Decision on Jurisdiction imposed no limitations on the consideration of the Seneca brand’s performance in the United States. The Tribunal granted the Claimants’ oral motion to add a claim based on the allocable share amendments “as specified in” the Claimants’ motion.<sup>77</sup> That oral motion, which was

<sup>75</sup> Expert Report of Navigant Consulting, Inc. at 21 (Dec. 22, 2008) [hereinafter Navigant Report].

<sup>76</sup> See Wilson Rebuttal Report ¶ 8 (stating that Navigant’s valuation approach “would value the [Seneca] brand beyond the areas allowed by the tribunal” in its Decision on Jurisdiction); *id.* ¶ 23 (stating that Navigant’s proposed valuation “ignores the terms of this arbitration as determined by the tribunal”); *id.* ¶ 27 (stating that it is not appropriate to perform Navigant’s “proposed tests of value of the Seneca brand . . . due to the rulings of the tribunal because it would result in the inclusion of irrelevant markets”).

<sup>77</sup> Decision on Objections to Jurisdiction ¶ 102 (July 20, 2006).

made, as characterized by Claimants, “in the third-alternative on the last day”<sup>78</sup> of the jurisdictional hearing in this case, stated as follows:

[S]hould the Tribunal believe that it has no jurisdiction to hear the claim in respect of the allocable share amendments, the Claimants hereby seek leave to amend the claim to add them as separate and distinct measures that did not breach the NAFTA, nor cause loss or damage until they came into force.<sup>79</sup>

Neither Claimants nor the Tribunal imposed any geographic limitations on the consideration of the Seneca brand’s U.S. performance in this case.

Furthermore, NWS’ sales of Seneca cigarettes throughout the United States, including the state of New York, fall squarely within the Claimants’ alleged “investment” in the United States. As stated by Jerry Montour, “early in 1999 we entered into a relationship with Arthur Montour [REDACTED] to develop a line of cigarettes under the Seneca brand, which would be distributed on Native American land throughout the United States.”<sup>80</sup> Given Claimants’ characterization of their U.S. investment as including the development of the Seneca brand on-reservation throughout the United States, the performance of the Seneca brand on-reservation throughout the United States is plainly relevant when analyzing Claimants’ expropriation claim.

Claimants also attempt to bar consideration of the Seneca brand’s performance throughout the United States by relying on the *Pope & Talbot* decision, which, according to Claimants, supports the proposition that “effectively depriving an investor of its access to a regional market may constitute an indirect expropriation of the economic value of the

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<sup>78</sup> April 18, 2006 Letter from Claimants to Tribunal at 1.

<sup>79</sup> Decision on Objections to Jurisdiction ¶ 95 (quoting Transcript vol. 3, at 1161:9-18).

<sup>80</sup> Jerry Montour First Statement ¶ 21; *see also* Mem. ¶ 24 (“In connection with their U.S. business enterprise, Grand River also initially loaned equipment to NTD, including a truck that NTD used to make deliveries to its Native American customers throughout the United States.”).

enterprise that depends upon such access.”<sup>81</sup> But the “regional market” at issue in *Pope & Talbot* was the entire United States.<sup>82</sup>

Claimants’ incentive for attempting to bar consideration of the Seneca brand’s performance throughout the United States is clear: apart from Tobaccoville’s off-reservation sales of Seneca cigarettes in the “five original states,”<sup>83</sup> Seneca sales in the United States are stronger than ever. As recently reported by the *Buffalo News*, the Seneca brand “has surged in sales in the past couple of years both in New York and around the country.”<sup>84</sup> [REDACTED]

[REDACTED] More recently, as reported by the *Buffalo News*, “[s]ales of Seneca cigarettes by Indian retailers have grown more than 200 percent from 2007 to 2008 in upstate New York.”<sup>85</sup> [REDACTED]

<sup>81</sup> Mem. ¶ 298.

<sup>82</sup> See *Pope & Talbot, Inc. v. Canada*, NAFTA/UNCITRAL, Interim Award ¶ 96 (June 26, 2000) (“[A]ccess to the U.S. market is a property interest subject to protection under Article 1110.”).

<sup>83</sup> See, e.g., Wilson Rebuttal Report, Ex. 8 (table calculating Seneca Brand exemptions in “Five Original States”).

<sup>84</sup> Tom Precious, *Snyder Vows Probe of Seneca Cigarettes*, BUFFALO NEWS, Mar. 10, 2009, available at <http://www.buffalonews.com/cityregion/story/602680.html> (last visited Apr. 28, 2009).

<sup>85</sup> Tom Precious, *Indian-Made Cigarettes Seen as Cheap, Toxic, and Tax-Free*, BUFFALO NEWS, Mar. 9, 2009, available at <http://www.buffalonews.com/home/story/600776.html> (last visited Apr. 28, 2009).

<sup>86</sup> Navigant Report at 20-21, Figures 4 & 5.

<sup>87</sup> Navigant Report, App. N.

[REDACTED]

[REDACTED]

[REDACTED]

For the above reasons, the first factor considered by international tribunals when resolving regulatory expropriation claims—the extent of the economic impact of the challenged measure on the claimant’s investment—does not support Claimants’ claim here.

**2. Claimants’ Alleged Reasonable Investment-Backed Expectations, With Respect To Both Their On-Reservation And Off-Reservation Sales, Are Baseless**

Claimants’ expropriation claim also finds no support under a second factor considered by international tribunals when determining if a regulatory measure has caused an expropriation: the extent to which the challenged measure interferes with the claimant’s reasonable investment-backed expectations. With respect to their on-reservation sales, Claimants allege expectations of exemption from state regulation. With respect to their off-reservation sales, Claimants allege expectations of continued releases of escrow deposits in perpetuity. Neither claim is supported by the facts or the law.

**a. Claimants Fail To Show Any Reasonable Investment-Backed Expectation That Their On-Reservation Sales Would Be Exempt From State Regulation**

Claimants assert that they “held, and were fully entitled to hold, expectation[s] that on-reserve sales of their brands would never be disturbed by state regulation of the kinds at issue this case.”<sup>89</sup> As a factual matter, however, Claimants’ “on-reserve” sales are largely serving an off-reservation population. And as a legal matter, Claimants were

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[REDACTED]

<sup>89</sup> Reply ¶ 166.

not “entitled” to hold any expectation, under U.S. or international law, that their “on-reserve” operations would be exempt from state regulation.

*First*, as a factual matter, Claimants’ allegations of “on-reserve sales” made on a “nation-to-nation”<sup>90</sup> basis fail to acknowledge that a large, if not overwhelming, portion of their “on-reserve” sales ultimately serve an off-reservation market. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Similarly, with respect to the “on-reserve” cigarette market in New York, as reported by the *New York Times* in October 2008:

[F]ewer than 20,000 Indians live on reservations in New York. And last year more than 30 million cartons – six billion cigarettes with a retail value of nearly \$2 billion – were sold on the Indian lands.

According to the State Department of Taxation and Finance, those cigarettes amounted to nearly one-third of all the cigarettes sold in the state of New York, where cigarette excise taxes are the highest in the nation.

The bulk of wholesale shipments to New York reservations last year went to two tribes – the Poospatucks, on Long Island, and the Senecas of western New York.<sup>93</sup>

Furthermore, as reported by the *Buffalo News* in March 2009, Seneca cigarettes are available on “hundreds” of Internet websites, and on one such website:

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<sup>90</sup> *Id.*

<sup>91</sup> Counter-Mem. at 5.

<sup>92</sup> Wilson Rebuttal Report at 20.

<sup>93</sup> Stephanie Saul, *Suits Claim Wide Reach of Cigarettes from Tribes*, N.Y. TIMES, Oct. 1, 2008, available at [http://www.nytimes.com/2008/10/02/nyregion/02smoke.html?\\_r=2](http://www.nytimes.com/2008/10/02/nyregion/02smoke.html?_r=2) (last visited Apr. 30, 2009).

a carton of 200 Seneca cigarettes was priced at \$13, compared with \$37 to \$50 for well-known cigarettes. Not surprisingly, the cheap cigarettes are selling well, especially in Western New York. . . . Some industry executives believe the Seneca brand alone could push 10 billion cigarettes a year in volume.<sup>94</sup>

Indeed, as illustrated by the Internet websites cited below, Seneca cigarettes are consistently advertised at prices well below not only the \$37-\$50 price range for premium-tier cigarettes, but also well below the prices advertised for the discount Liggett brand, Grand Prix.<sup>95</sup> Specifically, on average Seneca cigarettes are advertised on those

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<sup>94</sup> Tom Precious, *Indian-Made Cigarettes Seen as Cheap, Toxic, and Tax-Free*, BUFFALO NEWS, Mar. 9, 2009, available at <http://www.buffalonews.com/home/story/600776.html> (last visited Apr. 28, 2009).

<sup>95</sup> See, e.g., AJ Smokes, [www.ajsmokes.com](http://www.ajsmokes.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$22.00 per carton and Liggett's Grand Prix cigarettes for \$30.00 per carton); Allegany Trail Enterprises, [www.alleganytrail.com](http://www.alleganytrail.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$20.75 per carton and Liggett's Grand Prix cigarettes for \$32.25 per carton); All of Our Butts, [www.allofourbutts.com](http://www.allofourbutts.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$21.00 per carton and Liggett's Grand Prix cigarettes for \$31.05 per carton); Best Deal Smokes, [www.bestdealsmokes.com](http://www.bestdealsmokes.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$22.50 per carton and Liggett's Grand Prix cigarettes for \$31.99 per carton); Big Buffalo Smokes, [www.bigbuffaloesmokes.com](http://www.bigbuffaloesmokes.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$20.99 per carton and Liggett's Grand Prix cigarettes for \$31.40 per carton); Carolina Cartons, [www.carolinacartons.com](http://www.carolinacartons.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$30.75 per carton and Liggett's Grand Prix cigarettes for \$36.75 per carton); Cartons 4 Free, [www.cartons4free.com](http://www.cartons4free.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$30.75 per carton and Liggett's Grand Prix cigarettes for \$36.75 per carton); CigarettesAmerica.com, [www.cigarettesamerica.com](http://www.cigarettesamerica.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$21.00 per carton and Liggett's Grand Prix cigarettes for \$31.05 per carton); Crazy Wolf Smokes, [www.crazywolfsmokes.com](http://www.crazywolfsmokes.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$21.50 per carton and Liggett's Grand Prix cigarettes for \$33.50 per carton); Deer Path Cigarettes, [www.deerpathcigs.com](http://www.deerpathcigs.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$22.70 per carton and Liggett's Grand Prix cigarettes for \$33.00 per carton); EZ Smokes, [www.ezsmokes.biz](http://www.ezsmokes.biz) (last visited May 5, 2009) (advertising Seneca cigarettes for \$22.80 per carton and Liggett's Grand Prix cigarettes for \$30.90 per carton); Internet Smokes, [www.internetsmokes.com](http://www.internetsmokes.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$21.10 per carton and Liggett's Grand Prix cigarettes for \$31.40 per carton); Oklahoma Outlet, [www.oklahoma-outlet.com](http://www.oklahoma-outlet.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$19.99 per carton and Liggett's Grand Prix cigarettes for \$30.95 per carton); Salamanca Cigarette Outlet, [www.salamancaoutlet.com](http://www.salamancaoutlet.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$24.00 per carton and Liggett's Grand Prix cigarettes for \$36.00 per carton); Seneca Stars Cigarettes, [www.senecastarscigs.com](http://www.senecastarscigs.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$22.42 per carton and Liggett's Grand Prix cigarettes for \$36.37 per carton); Seneca Valley Enterprises, [www.lowcostcigarettes.com](http://www.lowcostcigarettes.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$21.80 per carton and Liggett's Grand Prix cigarettes for \$29.90 per carton); Smoke-It-Up.com, [www.smoke-it-up.com](http://www.smoke-it-up.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$19.00 per carton and Liggett's Grand Prix cigarettes for \$24.95 per carton); Smokes-Spirits.com, [www.smokes-spirits.com](http://www.smokes-spirits.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$19.99 per carton and Liggett's Grand Prix cigarettes for \$30.95 per carton); Three Feathers Tobacco, [www.threefeatherstobacco.com](http://www.threefeatherstobacco.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$21.10 per carton and Liggett's Grand Prix cigarettes for \$31.40 per carton); Tobacco



websites for about \$22.50 per carton, while Grand Prix cigarettes are advertised for about \$32 per carton.<sup>96</sup> As reported by the *Buffalo News* in March 2009, much of the market for Seneca cigarettes “exists in cyberspace.”<sup>97</sup>

*Second*, as a legal matter, Claimants provide no support for their alleged “expectations” that they would be exempt from state regulation of their tobacco-related operations under federal Indian law and international law.

With respect to federal Indian law, Claimants alleged in their Memorial that “under United States Federal Indian Law and under the *Jay Treaty*, Claimants were entitled to expect that none of their business activities would ever be subjected to” the challenged measures.<sup>98</sup> Professor Goldberg squarely addressed the federal Indian law portion of that argument, concluding that Claimants were *not* entitled to any such expectation under federal Indian law.<sup>99</sup> Opting not to respond directly to Professor Goldberg’s arguments under federal Indian law, Claimants instead assert that “unless and until” Professor Goldberg addresses their alleged Jay Treaty obligations as part of her federal Indian law analysis, the United States “will have completely failed to even raise a doubt” in response to Claimants’ “*prima facie* showing of their detrimental reliance [on] protections offered under Respondent’s own legal system for First Nations investors.”<sup>100</sup>

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Max, [www.tobaccomax.com](http://www.tobaccomax.com) (last visited May 5, 2009) (advertising Seneca cigarettes for \$21.80 per carton and Liggett’s Grand Prix cigarettes for \$31.90 per carton).

<sup>96</sup> See *supra*, note 95.

<sup>97</sup> Tom Precious, *Indian-Made Cigarettes Seen as Cheap, Toxic, and Tax-Free*, BUFFALO NEWS, Mar. 9, 2009, available at <http://www.buffalonews.com/home/story/600776.html> (last visited Apr. 28, 2009).

<sup>98</sup> Mem. ¶ 331.

<sup>99</sup> Expert Report of Professor Carole Goldberg at 23 (Dec. 18, 2008) [hereinafter Goldberg Report].

<sup>100</sup> Reply ¶ 165.

That response is flawed on a number of levels. *First*, the United States addressed Claimants’ alleged Jay Treaty obligations at length in its Counter-Memorial,<sup>101</sup> and Claimants offer no response to those arguments in their Reply.<sup>102</sup> *Second*, as stated by Professor Goldberg in her rebuttal report:

[I]t is quite possible to analyze separately the general principles of U.S. Indian law and any exceptions to those principles under other laws. In my Expert Opinion, I made it clear that I was leaving analysis of the Jay Treaty to others. At this point, however, I can state that I have seen nothing in Claimants’ submissions that convinces me that the Jay Treaty or any other law creates an exception to general principles of federal Indian law that would override the conclusions I have reached based on those principles.<sup>103</sup>

*Third*, Claimants also fail to address Professor Goldberg’s arguments under federal Indian law. Indeed, neither Professor Clinton nor Professor Fletcher submitted a rebuttal report in response to Professor Goldberg. *Fourth*, Claimants cite no legal authority for any burden-shifting framework under Chapter Eleven that may be triggered upon a “*prima facie*” showing of detrimental reliance,<sup>104</sup> and in any event, Claimants have made *no* showing of detrimental reliance in this case.

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<sup>101</sup> See Counter-Mem. at 109-16.

<sup>102</sup> See Reply ¶ 165 (“With respect to Respondent’s arguments on the applicability of the Jay Treaty . . . Claimants will stand on the expert opinion of Professor Clinton, which they submit is dispositive of the issue.”).

<sup>103</sup> Goldberg Rebuttal Report at 3. Indeed, Professor Clinton had no difficulty analyzing general principles of U.S. Indian law separately from the Jay Treaty: “[T]he only conceivable conclusion anyone familiar with domestic American Indian law could draw during the period between 1994 and 2006 is that [the challenged measures] could not lawfully be applied to the on-reserve business activities of the Haudenosaunee [sic] Claimants/Investors.” Expert Report of Robert N. Clinton at 46 (July 10, 2008) [hereinafter Clinton Report].

<sup>104</sup> See Reply ¶ 165. Indeed, throughout their Reply, Claimants maintain that various burdens purportedly apply to the United States in this matter, without ever citing any legal authority in support of those assertions. See, e.g., *id.* ¶ 40 (alleging that “[u]ntil Respondent can produce clear and convincing evidence that state governments can actually obtain a judgment against Claimants for specific conduct attributable to them and the sale of their brands in any given state, there is simply no basis for imposing any Escrow obligations upon them”); *id.* at 21 (stating, in a section heading for their brief, that “Respondent Fails to Demonstrate Necessity of Its Measures”); *id.* ¶ 54 (asserting that the United States must “justify its *prima facie* breaches of international law”).

As addressed by Professor Goldberg in her expert report, Claimants had no legitimate expectation, under U.S. federal Indian law, that states lacked regulatory authority to (i) impose escrow deposit obligations on Grand River arising from the sale of Grand River-manufactured cigarettes to on-reservation dealers, or (ii) enforce complementary legislation against NWS for the importation, transport, possession, ownership, and sale of Grand River-manufactured cigarettes, where Grand River does not appear on the applicable state directories of compliant manufacturers.<sup>105</sup>

Regarding the imposition of escrow deposit obligations on Grand River, because Grand River “operates *only* on land that is outside of the United States,” under federal Indian law “the activities of Grand River in Canada are [to be considered] off-reservation activities . . . .”<sup>106</sup> Furthermore, because the Canadian company Grand River, and Canadian citizens Jerry Montour and Kenneth Hill, have failed to establish that they are “Indians” for purposes of U.S. federal Indian law, “federal Indian law affords [them] very limited protection from state regulation, even for activity within Indian country.”<sup>107</sup>

Rather than responding directly to Professor Goldberg’s arguments, Claimants simply offer new ones. Specifically, Claimants now allege that they are “operating in association together, in Indian Country (i.e. from Seneca Nation land),”<sup>108</sup> and that Grand River, Jerry Montour, and Kenneth Hill generally qualify as “Indians” under U.S. federal Indian law because the right to enter the United States has been accorded to them as

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<sup>105</sup> Goldberg Report at 23-24.

<sup>106</sup> *Id.* at 13 (quoting *Grand River Enters. Six Nations, Ltd. v. Pryor*, 425 F.3d 158, 174 (2d Cir. 2005)).

<sup>107</sup> *Id.* at 21.

<sup>108</sup> Reply ¶ 162.

“American Indians born in Canada” under section 289 of the Immigration and Nationality Act (“INA”).<sup>109</sup> But as addressed by Professor Goldberg, each of those arguments fails.

Regarding the application of complementary legislation to NWS, such regulation is consistent with federal Indian law because states have authority to regulate “wholly or partly off-reservation” activities,<sup>110</sup> and NWS’ distribution activities occur “partly outside Indian country.”<sup>111</sup> Specifically, NWS’ importation of Seneca cigarettes “first occurs as soon as the cigarettes enter the regulating state and before the cigarettes have reached a reservation,”<sup>112</sup> and cigarettes distributed by NWS “traverse territory outside of Indian country en route to their on-reservation dealers.”<sup>113</sup> Because NWS’ distribution operations occur partly outside of Indian country, states have authority to regulate those activities, regardless of “whether Arthur Montour, Jr. is a member of a United States federally recognized Indian nation or tribe.”<sup>114</sup> Claimants do not respond to any of the points above.

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<sup>109</sup> *Id.* ¶¶ 159-60. Claimants also assert that it is “difficult to reconcile the positivist approach to determining ‘Indian identity’” purportedly taken in Professor Goldberg’s “*confidential*” report with an earlier law review article written by Professor Goldberg. Reply ¶ 157. But as Professor Goldberg responds, that article maintained, for purposes of establishing “Indian” status in the context of constitutional questions that arise when U.S. law singles out “Indians” for special treatment, that such status could be established by showing descent from members of a federally recognized tribe, without the necessity of formal enrollment. *See* Goldberg Rebuttal Report at 8. Even that broader definition in that particular context, however, requires “descen[t] from someone belonging to a federally recognized tribe.” *Id.*

With respect to Claimants’ reference to the “*confidential*” report of Professor Goldberg, that designation was a direct result of Claimants’ decision to designate as confidential nearly all of their witness statements and expert reports in this matter. Specifically, Professor Goldberg’s report was designated confidential only because the report quoted from the “confidential” witness statement of Arthur Montour, Jr.; Professor Goldberg’s findings were set out at length in the public version of the U.S. Counter-Memorial, and with Claimants’ consent the United States would lift the confidential designation from the report.

<sup>110</sup> Goldberg Report at 22.

<sup>111</sup> *Id.* at 23.

<sup>112</sup> *Id.* at 22.

<sup>113</sup> *Id.* at 23.

<sup>114</sup> *Id.* at 21 n.7.

With respect to Claimants' new argument under the Seneca Nation Business Code, that Code expressly identifies when a corporate entity should be considered a tribal member, and Claimants offer no evidence that Grand River meets that test. Under Article 2-124 of the Business Code, a corporate entity shall be considered a tribal member "only if 51 percent or more of the entity is owned by tribal members."<sup>115</sup> Grand River is not owned by members of the Seneca Nation, and Claimants do not address any ownership structure of the alleged "business association" between Grand River and NWS.<sup>116</sup> In addition, as observed by Professor Goldberg, even assuming the Seneca Nation has the power to confer "Indian" status under U.S. federal Indian law to unenrolled individuals, Claimants have provided no evidence that the Seneca Nation actually has accorded such status to Jerry Montour and Kenneth Hill.<sup>117</sup> Moreover, despite Claimants' frequent appeals to tribal "custom" in support of their claim,<sup>118</sup> Claimants make no attempt to comply with the mechanism expressly set out in Article 1-102 of the Business Code for identifying tribal custom, namely a request for the advice of tribal elders familiar with tribal custom. Professor Goldberg observes:

Claimants have provided no evidence that the Seneca Nation of Indians has ever asked tribal elders to opine on the question whether entities and individuals from Haudenosaunee Nations in Canada are tribal members for any purpose. Neither have Claimants provided any evidence that the

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<sup>115</sup> Goldberg Rebuttal Report at 6 (quoting the Business Code).

<sup>116</sup> *See id.*

<sup>117</sup> *See id.* at 8-9. Indeed, the Seneca Nation has expressly distanced itself from Grand River. As stated by Seneca Nation President Barry E. Snyder Sr., "[Seneca] cigarettes are manufactured in Ontario, not on our territories. The Nation is in no way responsible for them or their contents." Tom Precious, *Indian-Made Cigarettes Seen as Cheap, Toxic, and Tax-Free*, BUFFALO NEWS, Mar. 9, 2009, available at <http://www.buffalonews.com/home/story/600776.html> (last visited Apr. 28, 2009).

<sup>118</sup> *See Reply* ¶ 14 (stating that "Claimants have long since defined their own relationship within the context of their own custom and law"); *id.* ¶¶ 83-84 (relying on Seneca tribal custom of "welcom[ing] and encourag[ing] non-resident members of the confederacy to conduct business with each other on their respective territories"); *id.* ¶ 87 (asserting that "Haudenosaunee cultural practice and custom affirm" that "Claimants have formed an investment enterprise under Seneca Nation Law").

Seneca Nation of Indians Peacemaker Court has rendered an opinion on tribal custom to that effect.<sup>119</sup>

With respect to Claimants’ argument under section 289 of the INA,<sup>120</sup> Professor Goldberg concludes that the provision “does not confer general Indian law status upon Claimants, and therefore does not enable them to claim exemption from state regulation.”<sup>121</sup> Specifically, as determined by Professor Goldberg, section 289:

guarantees “the right of American Indians born in Canada to pass the borders of the United States . . . .” But that provision identifies only one particular right, namely the right of free passage into the United States, and does not provide Canadian Indians with any other benefits of federal Indian law – such as those limiting state jurisdiction. The existence of this one relatively narrow statutory provision favoring “American Indians born in Canada” does not alter the general principles of federal Indian law applicable to this dispute.<sup>122</sup>

For the above reasons, and despite their new arguments under the Business Code and section 289 of the INA, Claimants ultimately offer no support for their alleged “expectation” of exemption from state regulation under U.S. federal Indian law for their on-reservation sales.

With respect to Claimants’ alleged expectations under international law, as addressed in the U.S. Counter-Memorial, Claimants’ reliance on the Jay Treaty and the Treaty of Ghent is unavailing. *First*, those treaties provide no basis for the commercial distribution and sale of billions of cigarettes throughout the United States free from state regulation. *Second*, the duty exemption under Article 3 of the Jay Treaty cannot support any “legitimate expectation” of exemption from state regulation because the United

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<sup>119</sup> Goldberg Rebuttal Report at 11.

<sup>120</sup> In the Counter-Memorial, the United States acknowledged that section 289 of the INA replaced section 226(a) of the 1928 Immigration Act, which codified the Jay Treaty’s free passage provision for Native Americans. *See* Counter-Mem. at 114 n.415.

<sup>121</sup> Goldberg Rebuttal Report at 12.

<sup>122</sup> *Id.* at 12.

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*, even if provisions of the Jay Treaty and the Treaty of Ghent did give rise to an expectation of exemption from state regulation, the three NAFTA Parties agree that a breach of a separate international agreement does not establish a breach of Article 1105.<sup>123</sup> Claimants do not respond to any of the above points. Claimants’ alleged “expectations” that they would be exempt from state regulation should be rejected.

**b. Claimants Fail To Show Any Reasonable Investment-Backed Expectation That Their Off-Reservation Sales Would Continue To Benefit From Large Releases Of Escrow Deposits In Perpetuity**

Claimants’ alleged “expectations” with respect to their off-reservation sales are equally unsupported. Claimants assert that the allocable share release provision was “obviously intended” to provide large releases of escrow deposits to “regional” NPMs, in order to maintain a level playing field between those NPMs and grandfathered SPMs.<sup>124</sup> Indeed, Claimants allege that such refunds had been *promised* to them by state officials.<sup>125</sup> As asserted in their Reply, when Claimants “established their brands off-reserve,” they “took the best deal on offer under the original Escrow Statutes, which was: the promise of annual releases of escrow payments for companies that restricted their ambitions to maintaining a regional brand.”<sup>126</sup> But Claimants provide no support for those assertions.

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<sup>123</sup> Counter-Mem. at 110-11.

<sup>124</sup> Mem. ¶ 209.

<sup>125</sup> *See id.* ¶ 209 (asserting that Claimants were “entitled” to take state officials “at their word” that the allocable share release had been included in the escrow statutes to provide a level playing field between regional NPMs and grandfathered SPMs).

<sup>126</sup> Reply ¶ 113.

As addressed in the U.S. Counter-Memorial, the purpose of the original allocable share 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.<sup>127</sup> As stated in the *American Law Report* on the MSA and its related measures, when an NPM sold cigarettes nationally, the escrow statutes "functioned as intended, permitting the NPM to obtain a refund of excess amounts placed in escrow in each state."<sup>128</sup> But when an NPM concentrated its sales only in some MSA States, "the original escrow statutes allowed the NPM to obtain a refund that was much larger than intended."<sup>129</sup> Claimants offer no evidence that the MSA States had even a *concept* of a "regional" NPM when adopting the original escrow statutes; indeed, as noted above, the original escrow statutes "functioned as intended" only when NPMs operated on a *national* basis.<sup>130</sup>

Claimants even call into question whether the exploitation of the allocable share release provision—through NPM concentration of sales in particular states—in fact constituted a loophole in the original escrow statutes. Specifically, Claimants assert that given "the magnitude of the work performed on structuring the MSA," the notion of an allocable share release loophole "of this magnitude seems a bit incredible."<sup>131</sup> But the

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<sup>127</sup> See Counter-Mem. at 24.

<sup>128</sup> 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, 469 (2007).

<sup>129</sup> *Id.*

<sup>130</sup> Equally unsupported is Claimants' assertion that "[j]ust like the Grandfathered SPMs in 1998, NPMs deserved recognition for the value of their brand investment achieved under the status quo ante regulatory regime." Reply ¶ 179. Leaving aside that SPMs were granted partial exemptions in 1998 as an *inducement* for them to sign the MSA (and not as "deserved recognition for the value of their brand investment," *id.*), a foreign investor holds no vested rights in, as characterized by Claimants, a State's "status quo ante regulatory regime." See Counter-Mem. at 98 & n.351.

<sup>131</sup> Reply ¶ 32.



Tribunal *in this arbitration* already has found that MSA States “came to regard [the allocable share release] provisions . . . as a ‘loophole,’ and the evidence indicated that 38 states had adopted amendments to ‘plug the loophole’ by September 2004.”<sup>132</sup>

Furthermore, given that the original escrow statutes “were based on an assumption that a nonparticipating manufacturer sold cigarettes nationally,”<sup>133</sup> NPMs that chose to exploit that assumption by concentrating sales in only a few MSA States could indeed achieve results of great magnitude. And it was precisely the magnitude of the releases obtained by such NPMs—which ultimately reached a level of 58 percent<sup>134</sup> of all escrowed funds for 2003 sales—that prompted 46 states and the District of Columbia to adopt allocable share amendments.

For the above reasons, Claimants could not have had any reasonable expectation that large releases of Grand River’s escrow payments would remain available in perpetuity, which further weakens Claimants’ expropriation claim.

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<sup>132</sup> Decision on Objections to Jurisdiction ¶ 16. Remarkably, Claimants further assert that given the “decision” by the United States “to withhold documents demonstrating the *bona fides* of its claim of a loophole,” a negative inference should be drawn “that the parties to the MSA intended to create precisely the regional exemption found in the Allocable Share Release.” Reply ¶ 32. Claimants simply ignore the American Law Report on the MSA, which, as discussed above, clearly indicates that the original escrow statutes “functioned as intended” only when NPMs operated on a national basis, and that those statutes “were based on an assumption that a nonparticipating manufacturer sold cigarettes nationally.” 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, 469 (2007). Moreover, the United States is not “withholding” any documents addressing the original escrow statutes or any of the other challenged measures.

<sup>133</sup> 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, 469 (2007).

<sup>134</sup> See Declaration of Michael Hering, Deputy Chief Counsel, Nat’l Ass’n of Attorneys General ¶ 3 (Dec. 19, 2008) (stating that for NPM sales in 2003, out of \$236 million in escrowed funds, \$137 million in funds were released back to NPMs through the operation of the allocable share release).

### 3. The Allocable Share Amendments Are Generally Applicable Regulatory Measures That Were Enacted To Promote Legitimate Public Welfare Objectives

A third factor considered by international tribunals when determining whether a regulatory measure constitutes an expropriation, the character of the challenged measure, also weighs against Claimants' expropriation claim. Under international law, when a challenged measure is a non-discriminatory regulation intended to promote legitimate public welfare objectives, the measure will not be deemed expropriatory except in rare circumstances.<sup>135</sup> Rather than challenging the policy objectives of the allocable share amendments as illegitimate, Claimants attempt to shift the burden on the issue, asserting that the United States "has not shown" that the allocable share amendments "either contributed to the reduction in overall smoking or youth smoking."<sup>136</sup>

To the contrary, it is a *claimant's* burden to demonstrate that a challenged measure lacks a legitimate public purpose.<sup>137</sup> In any event, the public purpose of the allocable share amendments plainly was legitimate: through NPM exploitation of the allocable share release provision, (i) MSA States were denied access to funds that would 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

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<sup>135</sup> See Counter-Mem. at 159 (citing 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.") and *Methanex Corp. v. United States*, NAFTA/UNCITRAL, Final Award on Jurisdiction and Merits, pt. IV, ch. D ¶ 7 (Aug. 3, 2005) ("*Methanex* Final Award").

<sup>136</sup> Reply ¶ 76.

<sup>137</sup> See, e.g., Burns H. Weston, "Constructive Takings" Under International Law: A Modest Foray into the Problem of "Creeping Expropriation," 16 VA. J. INT'L L. 103, 121 (1975) (observing that under international law there is a "necessary presumption that States are 'regulating' when they say they are 'regulating,'" and that "[i]nternational law traditionally has granted States broad competence in the definition and management of their economies").

vis-à-vis PMs, which resulted in a reduction in PM payments to the MSA States; and (iii) lower prices for NPM cigarettes increased demand among price-sensitive consumers, including smokers under age 18, to the detriment of public health. These legitimate policy concerns are reflected throughout the respective state legislative records for the allocable share amendments.<sup>138</sup> Claimants do not address those legitimate policy concerns; rather, as noted above, Claimants only attempt to shift the burden onto the United States to show that the amendments caused a “reduction in overall smoking or youth smoking.”<sup>139</sup> But as addressed by Professor Gruber:

[T]he Claimants make a confusing argument about the lack of public health merit of the MSA. This argument is completely at odds with a vast literature in health economics. This literature shows convincingly that the price increases that were part of the MSA were a major driver of the steep decline in both adult and youth smoking since 1997. While there is some room for dispute as to the share of the decline in smoking that is due to the MSA, there is a consensus among experts that the MSA was responsible for a large decline in smoking because cigarette consumption is price sensitive. It is for this very reason that the allocable share amendments are so critical to the public health goals of the MSA. With the allocable share loophole in place, NPMs were able to keep prices low and therefore induce more smoking, undercutting the very health goals of the MSA. The allocable share amendments were a critical measure to protect the public health by ensuring that *all* cigarettes are priced at a higher level that reflects their social costs.<sup>140</sup>

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<sup>138</sup> See, e.g., *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 Apr. 28, 2009) (“The second part of the bill [re]peals the allocable share cap, which has proved to be a windfall for nonparticipating manufacturers that concentrate their sale[s] in one or a few states.”); *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 Apr. 28, 2009) (noting that “[c]losing this loophole” had several favorable implications: removing the unintended economic advantage to NPMs that allowed them to keep their cigarette prices artificially low; preserving escrow deposits as a source of funding for potential future judgments or settlements; and reducing demand for cigarettes by minors by means of higher cigarette prices).

<sup>139</sup> Reply ¶ 76.

<sup>140</sup> Expert Rebuttal Report of Jonathan Gruber ¶ 16 (May 11, 2009) [hereinafter Gruber Rebuttal Report]. See also Frank A. Sloan & Justin G. Trogdon, *The Impact of the Master Settlement Agreement on Cigarette Consumption*, 23 J. POL’Y ANALYSIS & MGMT. 843, 852 (2004) (“The MSA and the separate state settlements have led to a significant decrease in smoking since their implementation. The effect of the settlements was larger for younger adults: through 2002, the settlements reduced smoking rates by 3.5

Claimants also fail to address the generally applicable nature of the allocable share amendments. Each escrow statute, both as originally enacted and as amended, provides that *any* cigarette manufacturer doing business in the state must either join the MSA or make escrow payments pursuant to the statute.<sup>141</sup> “In that regard, the escrow statutes treat all cigarette manufacturers equally.”<sup>142</sup> Under the character factor for an indirect expropriation analysis, the legitimate public purpose and generally applicable nature of the allocable share amendments further weakens Claimants’ expropriation claim.<sup>143</sup>

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Not one of the factors that are considered by international tribunals when determining whether a regulatory measure constitutes an expropriation supports Claimants’ expropriation claim. The Seneca brand continues to thrive in the United States, undermining any claim of expropriatory economic impact. Claimants have

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percentage points for 18- to 20-year-olds and by 1 to 2 percentage points for individuals ages 21 and older. At the mean smoking rates in our sample, these figures correspond to a 13 percent decrease for ages 18 to 20 and 65 and older and a 5 percent decrease for other age groups. Most of the effect of settlements came through the associated retail price increases for cigarettes.”).

<sup>141</sup> See, e.g., OKLA. STAT. tit. 37, § 600.23(A) (“Any tobacco product manufacturer selling cigarettes to consumers within the state, whether directly or through a distributor, retailer or similar intermediary or intermediaries . . . shall do one of the following: 1. Become a participating manufacturer . . . ; or 2. Place into a qualified escrow fund [defined amounts per unit sold] . . . .”); GA. CODE ANN. § 10-13-3 (same); N.Y. PUB. HEALTH LAW § 1399-pp (same); CAL. HEALTH & SAFETY CODE § 104557(a) (same); IDAHO CODE ANN. § 39-7803 (same).

<sup>142</sup> *KT&G Corp. v. Att’y Gen. of Okla.*, 535 F.3d 1114, 1139 (10th Cir. 2008) (dismissing challenge to allocable share amendments brought under the U.S. Constitution and Sherman Act). A report cited in paragraph 33 of Claimants’ Reply states that under the allocable share amendments, an NPM will be required to pay more on a per unit basis than OPMs and SPMs. Reply ¶ 33 (citing E-mail from Merrill Lynch Global Securities Research, *Tobacco Reseller Trial in California Imminent* (June 13, 2003) (Reply Evidentiary Submissions, Ex. 21, at 55050-8946). That assertion is incorrect. As addressed by Professor Gruber, under the amended escrow statutes, “an NPM’s escrow payments for 2007 sales were about 5.2% less per cigarette than the MSA payments made by OPMs, and about 1% less per cigarette than the MSA payments of SPMs.” Expert Report of Jonathan Gruber (Dec. 19, 2008) ¶ 12 [hereinafter Gruber Report].

<sup>143</sup> See Counter-Mem. at 160 n.562 (citing RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt.g (1987)).

established no reasonable investment-backed expectation that their on-reservation operations would be exempt from state regulation or that their off-reservation sales would enjoy the benefit of large releases of escrow deposits in perpetuity. And the allocable share amendments were enacted in the public interest and apply to tobacco manufacturers generally. Claimants' expropriation claim should be dismissed.

**4. Claimants' Attacks On The Public Welfare Objectives Of The MSA, Which Is Not A Challenged Measure In This Arbitration, Are Without Basis**

The MSA is not a challenged measure in this arbitration.<sup>144</sup> Nevertheless, Claimants expend considerable effort in their Reply attempting to cast doubt on the public welfare objectives of the MSA. But as discussed below, Claimants' attacks on the MSA rely only on mischaracterizations of facts.

As a preliminary matter, the relevant character inquiry for purposes of the Claimants' expropriation claim concerns the public welfare objectives of the allocable share amendments, which are the challenged measures in this arbitration, and not the MSA, which is not a challenged measure. As discussed above, rather than offering a critique of the public welfare objectives of the allocable share amendments, Claimants merely attempt to shift the burden to the United States.<sup>145</sup> But with respect to the MSA, Claimants put forward several arguments challenging the public welfare goals of that settlement. Ultimately, however, Claimants offer no factual support for their arguments.

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<sup>144</sup> See, e.g., Claimants' Rejoinder to Respondent's Reply on Jurisdiction at 9 (Feb. 27, 2006) (stating that Claimants "could not have been clearer in describing [in prior briefing] 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" (citing Claimants' Reply to Respondent's Objection to Jurisdiction at 22-24) (Jan. 16, 2006)).

<sup>145</sup> See Reply ¶ 76.

Notably, notwithstanding their attacks on the public welfare objectives of the MSA, Claimants openly acknowledge that the MSA has reduced tobacco use by minors.

As stated in Claimants' Reply:

[I]ndependent studies attribute almost one quarter of [reductions over the past decade in youth tobacco use] to a successful public information campaign executed by the American Legacy Foundation, [which was] funded by the OPMs for only a limited time under the MSA.<sup>146</sup>

Notwithstanding their admission that the MSA has successfully reduced youth tobacco use, Claimants attack the public welfare objectives of the MSA on multiple grounds, none of which have merit.

**a. The Partial Payment Exemptions That Were Accorded To Grandfathered SPMs In 1998 Do Not Undermine The Public Welfare Goals Of The MSA**

As one example of their attacks on the MSA, Claimants assert that “there is no economic or health policy rationale to support establishing a regime under which every tobacco brand attracts a significant payment obligation except for those of a select group of favored companies [*i.e.*, the grandfathered SPMs].”<sup>147</sup>

Claimants fail to acknowledge, however, that the MSA States had a strong interest in including as many tobacco manufacturers as possible within the MSA, in order to maximize application of the MSA's limitations on tobacco manufacturer conduct.<sup>148</sup> As

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<sup>146</sup> *Id.* ¶ 68. Notwithstanding their admission that the MSA has successfully reduced youth tobacco use, Claimants question whether any “direct causal connection” exists between the challenged measures and overall reductions in tobacco use. *Id.* ¶ 54. As stated by Professor Gruber in response, a “vast literature in health economics . . . shows convincingly that the price increases that were part of the MSA were a major driver of the steep decline in both adult and youth smoking since 1997.” Gruber Rebuttal Report ¶ 16. Specifically with respect to youth smoking, Professor Gruber states that “youth smoking had been rising rapidly before the MSA, rising by one-third from 1992 through 1997. Since its peak in 1997, however, youth smoking has fallen almost by half.” *Id.* ¶ 12.

<sup>147</sup> Reply ¶ 2.

<sup>148</sup> *See, e.g., Star Scientific v. Beales*, 278 F.3d 339, 353-54 (4th Cir. 2002) (observing, in response to a challenge to Virginia's escrow statute, that “[w]hile the Master Settlement Agreement resolved the litigation between Virginia and the major tobacco manufacturers – those determined by the Commonwealth

summarized by one U.S. court, the conduct restrictions agreed to by *all* participating manufacturers under the MSA include the following:

(1) to refrain from targeting youth in the advertising and marketing of tobacco products; (2) to refrain from using cartoon characters to promote cigarette sales; (3) to limit tobacco brand-name sponsorships of athletic and other events; (4) to refrain from lobbying Congress to preempt or diminish the States' rights under the Master Settlement Agreement or to advocate that settlement proceeds under the Master Settlement Agreement be used for programs other than those related to tobacco or health; (5) to dissolve the Tobacco Institute, the Council for Tobacco Research, and the Center for Indoor Air Research; and (6) to refrain from suppressing research relating to smoking and health and misrepresenting the dangers of using tobacco products.<sup>149</sup>

Moreover, U.S. courts have observed that the MSA “‘painstakingly accommodates the public interest,’”<sup>150</sup> and that “‘litigation, or even legislation, could not have achieved some aspects of the MSA.’”<sup>151</sup> For example, all participating manufacturers, including grandfathered SPMs, must waive certain advertising and lobbying rights under the MSA.

As an NPM, Grand River, unlike grandfathered SPMs, such as Liggett, has not waived advertising or lobbying rights under the MSA. It is therefore not surprising that Grand River’s on-reservation distributor for its Seneca exports to the United States, NWS, has engaged in the following promotional activities in support of the Seneca brand:

Since 2000 NWS has spent [REDACTED] on all kinds of promotional activities, from prizes such as snowmobiles and cars to promotional items such as bingo dabbers and ball caps. We spent this money on banners, posters, billboards, donations, hockey tickets, dinner events, vacations,

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to be principally responsible for its losses – *it also provided an incentive to other manufacturers to participate in the limitations on conduct that the Commonwealth felt were beneficial to it and the citizens of Virginia*”) (emphasis added).

<sup>149</sup> *Star Scientific*, 278 F.3d at 345.

<sup>150</sup> *Freedom Holdings, Inc. v. Cuomo*, 592 F. Supp. 2d 684, 687 (S.D.N.Y. 2009) (quoting *New York v. Philip Morris, Inc.*, 686 N.Y.S.2d 564, 569 (Super. Ct. 1998), *aff’d*, 693 N.Y.S.2d 36 (App. Div. 1999)).

<sup>151</sup> *Freedom Holdings*, 592 F. Supp. 2d at 689 n.2 (quoting *Philip Morris*, 686 N.Y.S.2d at 568 & 569 n.6).

inserts, cash prizes, gift cards, decals and all kinds of promotional clothing. We also funded appearances by promotional personalities, including one of our salesmen who also served as a spokesperson known as “Seneca Sam” and a team of professional models known as the “Seneca Girls” – all of whom were of Haudensosaunee blood.<sup>152</sup>

While the above promotional activities in support of the Seneca brand are freely available to an NPM like Grand River, such activities, if undertaken by manufacturers that are subject to the MSA’s limitations on conduct, including grandfathered SPMs like Liggett, would almost certainly violate the MSA. Such conduct restrictions include, for example, a ban on “Outdoor Advertising,”<sup>153</sup> which expressly includes “billboards.”<sup>154</sup> In addition, the MSA includes a “Ban on Tobacco Brand Name Merchandise,” under which no PM is permitted, within any Settling State, to:

market, distribute, offer, sell, license or cause to be marketed, distributed, offered, sold or licensed (including, without limitation, by catalogue or direct mail), any apparel or other merchandise . . . which bears a Brand Name.<sup>155</sup>

The MSA also limits PMs to one “Brand Name Sponsorship” annually, which is defined as:

an athletic, musical, artistic, or other social or cultural event as to which payment is made (or other consideration is provided) in exchange for use of a Brand Name or Names (1) as part of the name of the event or (2) to identify, advertise, or promote such event or an entrant, participant or team in such event in any other way.<sup>156</sup>

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<sup>152</sup> Second Witness Statement of Arthur Akwiraienton Montour ¶ 21 (Feb. 26, 2009) [hereinafter Arthur Montour, Jr. Second Statement]; *see also* Tom Precious, *Indian-Made Cigarettes Seen as Cheap, Toxic, and Tax-Free*, BUFFALO NEWS, Mar. 9, 2009, available at <http://www.buffalonews.com/home/story/600776.html> (last visited Apr. 28, 2009) (noting the Seneca brand’s “explosive growth and aggressive marketing”).

<sup>153</sup> MSA III(d).

<sup>154</sup> *Id.* II(ii).

<sup>155</sup> *Id.* III(f).

<sup>156</sup> *Id.* II(j), III(c)(2).



As signatories to the MSA, grandfathered SPMs are subject to the above limitations on promotional activities. As an NPM, Grand River is not.

The partial payment exemption that was made available to grandfathered SPMs successfully persuaded those tobacco manufacturers to sign the MSA, and thus to voluntarily waive advertising and lobbying rights that otherwise could not have been taken from them through “litigation, or even legislation.”<sup>157</sup> The partial payment exemption accorded to grandfathered SPMs in no way undermines the “economic or health policy rationale”<sup>158</sup> of the MSA.

Claimants also attack the partial exemption accorded to grandfathered SPMs as anticompetitive. But as Professor Gruber addressed in his expert report, pricing decisions by tobacco manufacturers are based not on average cost, but on the marginal cost of the next unit sold.<sup>159</sup> Accordingly, because virtually all SPM cigarettes are sold by grandfathered SPMs that exceed their grandfather share, the “next unit sold” for virtually all SPM sales will be subject to full payment obligations under the MSA, and thus grandfathered SPMs enjoy no pricing advantage vis-à-vis NPMs.<sup>160</sup>

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<sup>157</sup> *Freedom Holdings*, 592 F. Supp. 2d at 689 n.2 (quoting *Philip Morris*, 686 N.Y.S.2d at 568 & 569 n.6). This is because the grandfathered SPMs otherwise would have been able to assert rights to advertise and lobby under the First Amendment of the U.S. Constitution.

<sup>158</sup> Reply ¶ 2.

<sup>159</sup> Gruber Report ¶ 22.

<sup>160</sup> *Id.* Claimants also attribute the following statement to National Association of Attorneys General Counsel Mark Greenwold and allege that the statement contradicts Professor Gruber’s testimony in this matter: “States’ allocable share objective is to impose escrow obligations on NPMs equal to that imposed on an SPM without grandfathered market share.” Reply ¶ 35 (citing Reply Evidentiary Submissions Ex. 22). Claimants in fact misquote Exhibit 22 and attribute to Mr. Greenwold what is actually an excerpt from a document authored by another person (a Philip Morris employee). In any event, as addressed by Professor Gruber, the statement attributed to Mr. Greenwold, even if accurate, would not contradict Professor Gruber’s testimony in this matter, because escrow obligations on NPMs are also roughly equal to the obligations imposed on *grandfathered* SPMs for sales above their grandfather share, which is the relevant marginal cost for those SPMs. *See* Gruber Rebuttal Report ¶ 14.

Furthermore, as stated by Professor Gruber, “[i]n a number of state cases, and most recently in the *Freedom Holdings* case in New York, the courts have uniformly agreed with the assessment that the MSA does not raise the marginal costs of the NPMs above the level of the SPMs, including grandfathered SPMs.”<sup>161</sup> Indeed, in the *Freedom Holdings* case, the U.S. District Court for the Southern District of New York expressly adopted Professor Gruber’s views on this issue:

It is true that grandfathered SPMs pay the least per carton of all manufacturers, but . . . they pay more than NPMs pay for each successive cigarette they produce, and it is that marginal cost, not the average cost, that drives manufacturers’ pricing decisions. . . . In his testimony, Professor Jonathan Gruber explained the basic microeconomics principle of marginal cost pricing to maximize a firm’s profits, and stated that, in the competitive cigarette industry, a manufacturer will price its products at or above its marginal cost, not its average cost, for each unit produced. . . . [W]hatever benefit an SPM such as Liggett Group or Commonwealth Brands enjoys due to the grandfathering provision is not reflected in its pricing decisions, and so has no bearing on marketplace competition. Grandfathered SPMs make the same per-carton payment on marginal sales above their grandfathered thresholds as non-grandfathered SPMs make on every carton they sell, and that payment exceeds the escrow payment required of NPMs.<sup>162</sup>

Claimants respond to the above analysis by asserting that it is “empirically contradicted” by facts set out in Dr. Eisenstadt’s report as well as the rebuttal witness statements of Larry Phillips and Marvin Wesley.<sup>163</sup> In response, Professor Gruber states:

Claimants . . . argue that evidence of actual pricing behavior trumps my theoretical model of marginal cost pricing. I have yet to see in this or any other proceeding convincing evidence that grandfathered SPMs were systematically pricing below marginal cost. Moreover, as I argued in my earlier report, even if the SPMs decided to raise their prices by less than the full marginal cost of the MSA payments, this does not in any way imply that the new payment obligation has imposed a competitive

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<sup>161</sup> Gruber Rebuttal Report ¶ 11.

<sup>162</sup> *Freedom Holdings*, 592 F. Supp. 2d at 697-98.

<sup>163</sup> Reply ¶ 37.

disadvantage – it simply reflects the decision of one private party to deploy its resources differently in the new post-MSA environment.<sup>164</sup>

For the above reasons, the partial payment exemptions accorded to grandfathered SPMs do not undermine the public welfare goals of the MSA.

**b. The 1997 Federal Tobacco Settlement Did Not Contain “More Concessions From OPMs” Than The MSA**

In a separate attack on the MSA, Claimants assert, without basis, that the 1997 federal tobacco settlement, which did not take effect due to the failure to adopt implementing legislation, contained “more concessions from OPMs” than the MSA.<sup>165</sup>

As an initial matter, whether the 1997 federal settlement contained more concessions from OPMs than the 1998 MSA is simply not relevant to the issue of whether the MSA, which is not even a challenged measure in this arbitration, reflects legitimate public welfare objectives. In any event, Claimants’ factual assertion on this issue is wrong and warrants correction.

The federal settlement, if implemented, would in fact have been more favorable to OPMs than the MSA. One key distinction between the two settlements was the inclusion of a broad antitrust exemption under the federal settlement,<sup>166</sup> which was not included in the MSA. As provided in the Federal Trade Commission (“FTC”) report submitted by Claimants, such antitrust immunity was at the heart of the FTC’s concerns regarding the federal settlement:

One critical aspect of the proposed settlement is a provision that confers on the tobacco companies a broad degree of immunity from the antitrust

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<sup>164</sup> Gruber Rebuttal Report ¶ 5.

<sup>165</sup> Reply ¶ 49.

<sup>166</sup> Robert Pitofsky, Statement to the Committee on the Judiciary’s Subcommittee on Antitrust, Business Rights and Competition, Oct. 29, 1997 (no pagination), *available at* <http://www.ftc.gov/os/1997/10/tobacco.tes.HTM> (last visited May 11, 2009).

laws. . . . [A]s currently drafted, the antitrust exemption would permit these firms to “jointly confer, coordinate, or act in concert” to achieve all the goals of the settlement. Such sweeping antitrust immunity appears to be unnecessary for implementation of the settlement. Moreover, broadly drafted immunity might permit a variety of activities that would enable the firms to raise prices of cigarettes beyond the level needed to satisfy industry payments under the settlement.<sup>167</sup>

The OPMs enjoy no such antitrust immunity under the MSA.

In addition, the federal settlement would not only have settled all current and future claims by state Attorneys General, but also would have eliminated punitive damages for past actions by the tobacco industry, barred all private class actions against the tobacco industry, and capped the total amount of damages for which the tobacco industry would be liable in any given year as a result of losses in suits brought by individuals.<sup>168</sup> As observed in the *American Journal of Public Health* in 2004:

Since the MSA and other settlements did not amend federal or state law, these settlements could not grant the tobacco industry the kind of immunity granted by the [federal] settlement. . . . As a result of legal verdicts, settlements, and the MSA—and in addition to the other 4 state settlements—the amount awarded in the years following the [federal] settlement has totaled \$184 billion, \$72 billion greater than the amount originally proposed under the [federal] settlement for a 25-year period. . . . [T]he total damages assessed against the tobacco industry are unknown

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<sup>167</sup> FTC, COMPETITION AND THE FINANCIAL IMPACT OF THE PROPOSED TOBACCO SETTLEMENT ii (1997), available at <http://www.ftc.gov/reports/tobacco/ndoc95.pdf> (last visited May 11, 2009). Furthermore, Claimants seize on concerns of FTC officials that the federal settlement would have led “to substantial windfall profits for the cigarette industry,” Reply ¶ 49, but those anticipated “windfall profits” were directly related to the availability of a broad antitrust exemption which, again, is not available under the MSA. Specifically, the FTC noted that increased manufacturer profits were a possible indirect result of the federal agreement, but made clear that such increased profits would result from greater industry coordination made possible by the broad antitrust exemption. See FTC, COMPETITION AND THE FINANCIAL IMPACT OF THE PROPOSED TOBACCO INDUSTRY SETTLEMENT ii (1997) (“[C]ertain features of the proposed settlement, particularly the antitrust exemption, have the potential to reduce competition and enhance the ability of the cigarette companies to ‘coordinate’ price increases. If so, the industry may be able to increase prices and generate substantial profits.”). Claimants also allege that MSA States are dependent on the financial performance of PMs, and that “[t]his result was foreseen by FTC officials,” Reply ¶ 48, but Claimants cite no authority for that assertion.

<sup>168</sup> Michael Givel & Stanton A. Glantz, *The “Global Settlement” with the Tobacco Industry: Six Years Later*, 94 AM. J. PUB. HEALTH 218, 221-22 (2004).

but growing. For these reasons the MSA, in terms of increased liability against the tobacco industry, is stronger than the [federal] settlement.<sup>169</sup>

In addition, as stated in the same study, “[t]he policies that have been developed since 1997 have advanced tobacco control substantially, often beyond the provisions of the [federal] settlement.”<sup>170</sup>

Similarly, as observed by Professor Gruber:

The 1997 [federal] agreement, which I helped evaluate as part of a Clinton Administration team, was a major windfall to the OPMs because it settled not just their state lawsuits, but their private lawsuits as well. The MSA more appropriately focused on the settlement of the state lawsuits only, and was as a result much less beneficial to OPMs than was the 1997 agreement.<sup>171</sup>

The MSA also includes more restrictive provisions regarding industry lobbying than the 1997 Agreement, prohibiting manufacturers from lobbying against certain kinds of state anti-tobacco legislation and regulation.<sup>172</sup>

For the above reasons, the federal settlement plainly did *not* contain “more concessions from OPMs” than the MSA,<sup>173</sup> and thus in no way calls into question the legitimate public health goals of the MSA.

### **c. State Expenditures Of MSA Revenues Have Not Undermined The Public Health Goals Of The MSA**

Claimants also attempt to challenge the public health goals of the MSA by asserting that the MSA States “have not spent their MSA revenues in a manner consistent

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<sup>169</sup> *Id.* at 222.

<sup>170</sup> *Id.* at 218.

<sup>171</sup> Gruber Rebuttal Report ¶ 15. As recently observed by one U.S. court, when dismissing a challenge to the allocable share amendments, the MSA ““goes well beyond what could have been achieved in the plaintiffs’ fondest dreams for the result after a protracted and risky trial.”” *Freedom Holdings*, 592 F. Supp. 2d at 689 (quoting *Philip Morris*, 686 N.Y.S.2d at 569).

<sup>172</sup> See C. STEPHEN REDHEAD, CONG. RESEARCH SERV., TOBACCO MASTER SETTLEMENT AGREEMENT (1998): OVERVIEW, IMPLEMENTATION BY STATES, AND CONGRESSIONAL ISSUES 12 (1999).

<sup>173</sup> Reply ¶ 49.

with the stated goals of the lawsuits” filed against the OPMs, because they have failed “to devote enough of their MSA revenues to tobacco reduction activities.”<sup>174</sup> But Claimants’ own evidence confirms that MSA funds have been critically important for tobacco prevention and cessation programs: “[The MSA] was a major revenue source for tobacco-control programs. In aggregate, settlement dollars represented about 55 percent of all funds that were spent on tobacco control in 2001.”<sup>175</sup> Furthermore, as the United States addressed in its Counter-Memorial, another goal of the state lawsuits against the OPMs was to recover costs incurred by the states in treating tobacco-related illnesses,<sup>176</sup> and MSA States have been using MSA funds to cover such health care costs.

Indeed, as provided in a 2006 Government Accountability Office report (“GAO 2006 MSA Report”), four out of the five states in which Claimants concentrated their off-reservation sales, North Carolina, Oklahoma, Arkansas and Georgia, allocated the largest portion of their MSA payments to health care programs, including those focusing on smoking prevention and cessation.<sup>177</sup> The GAO 2006 MSA Report further provides that “[s]tates reported that they used the largest portion of the fiscal year 2005 payments and proceeds” to fund health-related programs, and projected that they would do the same

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<sup>174</sup> *Id.* ¶ 60.

<sup>175</sup> Cary P. Gross et al., *State Expenditures for Tobacco-Control Programs and the Tobacco Settlement*, 347 N. ENG. J. MED. 1080, 1083 (2002).

<sup>176</sup> Counter-Mem. at 7.

<sup>177</sup> See GOV’T ACCOUNTABILITY OFFICE, TOBACCO SETTLEMENT: STATE’S ALLOCATIONS OF FISCAL YEAR 2005 AND EXPECTED FISCAL YEAR 2006 PAYMENTS 33, 36, 50, 52 (2006) [hereinafter GAO 2006 MSA Report] (stating that Arkansas allocated \$27,230,395 of its \$49,500,000 in expected 2006 MSA funds to health care programs, including prevention and cessation, biomedical research, Medicaid and minority health; Georgia allocated \$99,148,370 of its expected \$156,626,752 in 2006 MSA funds to Medicaid, public health and Georgia Cancer Coalition programs; North Carolina allocated \$40,245,278 of its expected \$100,262,684 in 2006 MSA funds to health care programs; and Oklahoma allocated \$32,649,026 of its expected \$53,694,091 in 2006 MSA funds to cover Medicaid costs and its Tobacco Settlement Endowment Trust Fund).

with their 2006 amounts.<sup>178</sup> While a larger percentage of MSA payments and proceeds was used to cover budget shortfalls in fiscal years 2003 and 2004, those budget shortfalls were in large measure attributable to soaring Medicaid, and thus health-care, costs.<sup>179</sup>

For the above reasons, Claimants' attacks on the public welfare objectives of the MSA, which is not a challenged measure in this arbitration, are without basis. With respect to the measures that have been challenged in this arbitration, Claimants' expropriation claim is not supported by any of the factors that are considered by international tribunals when addressing whether a regulatory measure has caused an expropriation. Accordingly, Claimants' expropriation claim should be dismissed.

**B. 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**

The challenged escrow statutes in this matter, in their original form and as amended, present *all* tobacco manufacturers with the same choice, regardless of nationality: either join the MSA or make escrow payments under the statute. For NPMs that opt not to join the MSA, the escrow statutes, in their original form and as amended,

<sup>178</sup> *Id.* inside cover; *see also id.* at 4, 28-29 (indicating that the Settling States allocated the largest portion of their combined MSA payments and securitized proceeds to cover health care costs in all of the fiscal years the GAO reported on such allocations except 2003 and 2004); *State Use of Tobacco Funds: Hearing Before the S. Comm. on Commerce, Sci., & Transp.*, 108th Cong. (2003) (statement of Ray Scheppach, Executive Dir., Nat'l Governors Ass'n), available at <http://www.nga.org/portal/site/nga/menuitem.0f8c660ba7cf98d18a278110501010a0/?vgnextoid=32ae9e2f1b091010VgnVCM1000001a01010aRCRD> (last visited May 6, 2009) (stating that from 2000 to 2003 "states have received \$37.5 billion from the Master Settlement Agreement" and approximately "36 percent went to health services and long-term care").

<sup>179</sup> *State Use of Tobacco Funds: Hearing Before the S. Comm. on Commerce, Sci., & Transp.*, 108th Cong. (2003) (statement of Ray Scheppach, Executive Dir., Nat'l Governors Ass'n), available at <http://www.nga.org/portal/site/nga/menuitem.0f8c660ba7cf98d18a278110501010a0/?vgnextoid=32ae9e2f1b091010VgnVCM1000001a01010aRCRD> (last visited May 6, 2009) (noting that "the program that has been responsible for the deteriorating fiscal condition [of the states] is Medicaid, the state-federal health care entitlement for the poor, the elderly, and the disabled. . . . Medicaid[] . . . now represents 21 percent of the average state budget"). Moreover, short-term fiscal conditions experienced by New York and New Jersey accounted for about 92 percent of all MSA funds allocated to budget shortfalls in fiscal year 2004, and neither state was projected to allocate any MSA funds to cover budget shortfalls by 2006. *See* GAO 2006 MSA Report at 8-9.

apply equally to *all* NPMs, regardless of nationality. And any NPM that does not want to be subject to the challenged measures, regardless of nationality, is free to join the MSA as an SPM.

Faced with such facts, Claimants are forced to focus their discrimination claims under Article 1102 and Article 1103 on a narrow group of tobacco manufacturers: the grandfathered SPMs, which were granted, in 1998, a partial exemption from MSA payment obligations in exchange for joining the MSA.

At the same time, however, Claimants consider themselves to be in “like circumstances” with much of the tobacco industry, specifically *all* OPMs, SPMs, and NPMs “whose brands directly compete” with the Seneca brand “in the same tier of the market.”<sup>180</sup>

Ultimately, Claimants’ Article 1102 and Article 1103 claims demand *more* favorable treatment than that accorded to *any* OPM, SPM, or NPM, including grandfathered SPMs. Specifically, Claimants demand a partial exemption from escrow obligations while, at the same time, not agreeing to be subject to any of the MSA’s limitations on tobacco manufacturer conduct. Moreover, Claimants do not even attempt to demonstrate any form of nationality-based discrimination. As discussed below, 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. The “discrimination” claims are baseless and should be rejected.

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<sup>180</sup> Reply ¶ 115 (stating that the “appropriate comparators” are “the enterprises whose brands directly compete in the same tier of the market and who participate in the MSA regime, either through making escrow payments or through joining the MSA”).



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

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.<sup>181</sup> Claimants fail to satisfy any of the above elements, and thus their claim under Article 1102 should be dismissed.

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

Under Article 1102, a Claimant must first 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.”<sup>182</sup>

In their Reply, Claimants allege that they have been accorded treatment under the allocable share amendments.<sup>183</sup> But in this case, the escrow deposit obligations under the escrow statutes, either as originally adopted or as amended, apply only to Grand River.<sup>184</sup> 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 is not accorded with respect to any investment held by Grand River in the United States because Grand River has failed to demonstrate any investment

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<sup>181</sup> See Counter-Mem. at 73.

<sup>182</sup> See NAFTA art. 1102; *United Parcel Service of Am., Inc. v. Canada*, NAFTA/UNCITRAL, Award on the Merits ¶¶ 82-83 (May 24, 2007) (“UPS Award”); Counter-Mem. at 73-75.

<sup>183</sup> See Reply at 58 (“Treatment Accorded Under the Allocable Share Amendments”) (heading).

<sup>184</sup> Counter-Mem. at 87.

in the United States. The allocable share amendments accord “treatment” to Grand River only with respect to its exports of cigarettes to the U.S. market. Furthermore, the allocable share amendments do not accord any “treatment” to Arthur Montour, Jr., because NWS is not subject to escrow deposit obligations under those measures. For this reason alone, Claimants’ Article 1102 claim should be dismissed.

**b. Like Circumstances: Claimants Have Failed To Demonstrate That They Are In Like Circumstances With Tobacco Manufacturers That Have Opted To Sign The MSA**

For an Article 1102 claim to succeed, a claimant must show that the foreign investor or investment is in “like circumstances” with “local investors or investments.”<sup>185</sup> According to Claimants, the “appropriate comparators” in this case “are the enterprises whose brands directly compete in the same tier of the market and who participate in the MSA regime, either through making escrow payments or through joining the MSA.”<sup>186</sup>

But as addressed in the U.S. Counter-Memorial, simply being in the same economic sector or selling the same product is not sufficient to demonstrate “like circumstances” under Article 1102. Particularly in a highly regulated industry, a simple comparison between investments in the same business or economic sector, without additional analysis, may sweep in enterprises that are not in fact appropriate comparators under a like circumstances analysis.<sup>187</sup> Such analysis should also consider regulatory distinctions drawn within the industry, including distinctions drawn by the challenged measures at issue. In this case, foreign and domestic tobacco manufacturers that have

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<sup>185</sup> *UPS Award* ¶ 83.

<sup>186</sup> *Reply* ¶ 115.

<sup>187</sup> *See Counter-Mem.* at 75-76.

opted to sign the MSA have made very different economic, litigation-risk, and marketing choices than those that have opted to remain NPMs.

It is other NPMs—which, like Grand River, have opted not to sign the MSA—that are the appropriate comparator in this case. Like all NPMs, Grand River has chosen to be subject to deposit obligations under the escrow statutes, rather than being subject to payment obligations (and receiving a broad release from the MSA States of tobacco-related claims) under the MSA.

For their part, Claimants fail to demonstrate how Grand River, as a tobacco product manufacturer that has opted not to sign the MSA, is in like circumstances with tobacco product manufacturers that *have* opted to sign the MSA. In particular, Claimants make no attempt to demonstrate how Grand River is in like circumstances with grandfathered SPMs, which unlike Grand River were active in the U.S. market when the MSA was executed in 1998.

Rather than addressing the complexities of the highly regulated U.S. tobacco market, Claimants simply assert that “it makes no sense to use the measure [at issue] as the basis of deciding whom to compare,” and that it is a “tautological argument” to maintain that PMs are not in like circumstances with NPMs.<sup>188</sup> In Claimants’ view, the fact that a measure is challenged means that it cannot be the basis for analyzing the appropriate comparators within a given industry under Article 1102. But it certainly does “make sense” to consider such distinctions when a challenged measure is reasonably related to a rational government policy.<sup>189</sup> Notably, a distinction made by a challenged

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<sup>188</sup> Reply ¶ 109.

<sup>189</sup> See *Pope & Talbot, Inc. v. Canada*, NAFTA/UNCITRAL, Award on the Merits of Phase 2, ¶ 87 (Apr. 10, 2001) (“*Pope & Talbot* Phase 2 Merits Award”) (finding that softwood lumber producers subject to the export fees at issue were not in like circumstances with softwood lumber producers that were not subject to

measure between members of a given industry is particularly supportable when both foreign and domestic members of that industry are subject to the measure.<sup>190</sup>

In this case, both domestic and foreign manufacturers have opted to sign the MSA as SPMs, and both domestic and foreign manufacturers have opted not to sign the MSA and remain NPMs.<sup>191</sup> Moreover, as observed by the U.S. Court of Appeals for the Tenth Circuit, the escrow statutes “treat *all* cigarette manufacturers equally” in the sense that those measures present *any* cigarette manufacturer that does business in the applicable MSA State with the same choice: either join the MSA or make escrow payments under the applicable statute.<sup>192</sup> Finally, and as expressly found by multiple U.S. courts, the distinctions made under the escrow statutes—in which tobacco manufacturers are offered a choice between signing the MSA as an SPM or not signing the MSA and remaining subject to the escrow statutes as an NPM—are reasonably related to rational state policy.<sup>193</sup>

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the export fees because the distinction drawn by the challenged measure—applying export fees only to producers in “covered provinces”—was “reasonably related” to a “rational” government policy).

<sup>190</sup> See *Pope & Talbot Phase 2 Merits Award* ¶ 87 (noting, when declining to find that all softwood lumber producers in Canada were in like circumstances, that the challenged Canadian export fee regime “affects over 500 Canadian owned producers precisely as it affects the [U.S.] Investor”); *Methanex Final Award*, pt. IV, ch. B ¶ 19 (noting the *Pope & Talbot* Tribunal’s reliance on the application of the challenged measure to domestic producers when denying a national treatment claim under Article 1102).

<sup>191</sup> See Counter-Mem. at 6, 10-11.

<sup>192</sup> See *KT&G Corp.*, 535 F.3d at 1139 (emphasis added).

<sup>193</sup> See *Star Scientific*, 278 F.3d at 351 (finding that the distinctions created among tobacco manufacturers by the Virginia escrow statute—based on whether the manufacturer signs the MSA—“are rationally related to Virginia’s legitimate purpose of ensuring a source of recovery from *all* manufacturers for Virginia’s future costs related to cigarette smoking”); *Int’l Tobacco Partners, Ltd. v. Beebe*, 420 F. Supp. 2d 989, 998-99 (W.D. Ark. 2006) (rejecting the claim that “an improper distinction is being made between PMs and NPMs” by Arkansas’ allocable share amendment because the state had found that “tobacco use poses a threat to the health and welfare of those citizens, *i.e.*, ‘smoking poses a serious health risk to Arkansans,’ and that the Allocable Share Amendment was necessary for the effective administration of the MSA, which ‘is a critical component in reducing the rate of smoking in Arkansas’”); *S&M Brands, Inc. v. Summers*, 393 F. Supp. 2d 604, 636-37 (M.D. Tenn. 2005) (“While it is true that the Escrow Act distinguishes among tobacco product manufacturers on the basis of whether they have or have not chosen to enter into the MSA, that distinction is rationally related to Tennessee’s legitimate purpose of . . . assuring a future source for

Grand River—which is not subject to conduct limitations under the MSA and maintains ownership of the payments it makes under the escrow statutes—is not in like circumstances with PMs. In particular, Grand River is not in like circumstances with grandfathered SPMs, which were active in the U.S. market when the MSA was executed in 1998. At that time, Grand River was not exporting Seneca cigarettes to the U.S. market. Unlike the grandfathered SPMs, Grand River was not in a position to receive the partial payment exemption that was offered to tobacco manufacturers for 90 days in 1998 to increase participation in the MSA. In any event, because each grandfather share is limited to an SPM’s 1998 market share (or 125 percent of an SPM’s 1997 market share), a grandfather share would not reduce Grand River’s payment obligations and thus would be worthless to Grand River.

As stated by the Chapter Eleven Tribunal in the *Methanex* case, “[i]t 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.”<sup>194</sup> Addressing the NAFTA Chapter Eleven decision in the *Pope & Talbot* case, the *Methanex* Tribunal observed that when considering the claimant’s Article 1102 claim, the *Pope & Talbot* Tribunal selected the entities that were in the “most ‘like circumstances,’” (softwood lumber producers that were subject to export fees under the applicable Export Control Regime), and not comparators that were in “less ‘like circumstances’” (softwood lumber producers that were not subject to the export fees).<sup>195</sup>

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covering the social costs of cigarette smoking within the state from *all* manufacturers who might be held liable for such costs.”); *see also* Counter-Mem. at 15-16 (observing that the state escrow statutes addressed the potential, created by the MSA, “for NPMs to exploit their ability to operate outside the restrictions of the MSA while imposing unrecoverable health care costs on the states”).

<sup>194</sup> *Methanex* Final Award, pt. IV, ch. B ¶ 19.

<sup>195</sup> *Id.*

For the reasons discussed above, Grand River is in the most like circumstances with other tobacco manufacturers that have opted *not* to sign the MSA, *i.e.* NPMs, rather than tobacco manufacturers that have opted to sign the MSA, *i.e.* PMs. Indeed, for the reasons discussed above, grandfathered SPMs would be a particularly inappropriate comparator in this case. Because Claimants fail to identify the appropriate comparator, the Article 1102 claim should be dismissed.

**c. Less Favorable: Claimants Do Not Even Attempt To Show That The Challenged Measures Have Accorded Foreign Tobacco Manufacturers Less Favorable Treatment Than Domestic Tobacco Manufacturers**

Under Article 1102, a claimant must also show that the host State has treated “the foreign investor or investment less favorably than it treats the local investor or investments.”<sup>196</sup> As stated by the three NAFTA Parties, that showing must include a showing of discrimination on the basis of nationality. Specifically, as stated by Canada, Article 1102 “prohibits treatment which discriminates on the basis of the foreign investment’s nationality.”<sup>197</sup> As stated by Mexico, an Article 1102 violation “relies upon proof of discriminatory treatment of investors based upon nationality.”<sup>198</sup> And as stated by the United States, Article 1102 was “intended only to ensure that Parties do not treat entities that are ‘in like circumstances’ differently based on their NAFTA Party nationality.”<sup>199</sup>

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<sup>196</sup> *UPS Award* ¶ 83.

<sup>197</sup> Canada’s Fourth *Methanex* Art. 1128 Submission ¶ 5.

<sup>198</sup> Mexico’s Supplemental Art. 1128 Submission, Section A.2, at 3, *Pope & Talbot, Inc. v. Canada*, NAFTA/UNCITRAL (May 25, 2000).

<sup>199</sup> United States’ First Art. 1128 Submission ¶ 3, *Pope & Talbot, Inc. v. Canada*, NAFTA/UNCITRAL (Apr. 7, 2000).

Claimants assert that Article 1102 does not require a showing of discrimination on the basis of nationality because that would in turn require a showing of discriminatory intent.<sup>200</sup> To the contrary, the requirement to show discrimination on the basis of nationality under Article 1102 does *not* require a showing of discriminatory intent. Rather, a Claimant must establish that a measure either on its face, or as applied, favors nationals over non-nationals.<sup>201</sup> But Claimants do not even attempt to make that showing here. Such an attempt would in any event fail, given the plain facts of this case. As stated by Brett DeLange, in the context of Idaho’s “Tobacco Acts” (Idaho’s escrow statute and complementary legislation):

Idaho’s Tobacco Acts . . . apply equally to foreign and domestic tobacco companies. For example, at present on the Idaho Tobacco Directory are foreign NPM tobacco companies located in Canada (Choice Tobacco, Inc.), Korea (KT&G Corporation), Armenia (International Masis Tabac, LLC), and Indonesia (PT. Gudang Garam Tbk). There are also a number of domestic NPM tobacco companies presently on the Idaho Tobacco Directory, including Dosal Tobacco Company, National Tobacco Company, and Carolina Tobacco Company. The Idaho Tobacco Directory also has tobacco companies that are members of the MSA, including foreign PM companies such as Japan Tobacco (Japan), Monte Paz (Uruguay), and Peter Stokkebye Tobaksfabrik A/S (Denmark) and domestic PM companies such as Commonwealth Brands, Inc., Santa Fe Natural Tobacco Company, Inc., and Top Tobacco L.P. These companies range from large PMs, such as Philip Morris, to very small PMs, such as NASCO Products, Inc. Each of these companies is in compliance with Idaho’s Tobacco Acts and can sell their cigarettes in Idaho legally. The certifications and duties these companies comply with are the same, regardless of whether the company is a domestic company or a foreign company, a Native-owned company or a company that is not Native-owned.<sup>202</sup>

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<sup>200</sup> See Reply ¶¶ 106-08.

<sup>201</sup> See, e.g., *S.D. Myers, Inc. v. Canada*, NAFTA/UNCITRAL, Partial Award ¶ 252 (Nov. 13, 2000) (“*S.D. Myers* Partial Award”) (considering, under Article 1102, whether the challenged measure “on its face” appears to favor nationals over non-nationals and whether the “practical effect” of the challenged measure was to create a “disproportionate benefit” for nationals over non-nationals).

<sup>202</sup> Second Declaration of Brett T. DeLange, Esq. ¶ 18 (May 8, 2009) [hereinafter DeLange Second Declaration].

Precisely because Article 1102 requires showing that a measure benefits nationals over non-nationals, NAFTA Chapter Eleven tribunals consistently reject claims under Article 1102 when domestic and foreign entities have been accorded identical treatment under the challenged measure. For example, the *Pope & Talbot* Tribunal rejected the claimant’s Article 1102 claim because there was “no convincing evidence that [implementation of the softwood lumber settlement at issue] was based on any distinction between foreign-owned and Canadian owned companies.”<sup>203</sup> In *Methanex Corp. v. United States*, the Tribunal found that “[t]he California ban [on the gasoline additive MTBE] does not differentiate between foreign investors or investments and various MTBE producers in California or, if it is relevant, methanol feedstock producers in the United States,” and, as a result, Methanex’s claim under Article 1102 failed.<sup>204</sup> The Tribunal in *ADF Group Inc. v. United States* determined that the Canadian claimant’s Article 1102 claim failed because the claimant had presented “no evidence at all” to show that “a U.S. steel manufacturer or fabricator . . . by virtue of its nationality, had been exempted from the requirements of the ‘Buy America’ provisions” at issue and therefore was accorded treatment more favorable than that accorded to the Canadian claimant.<sup>205</sup>

In this case, the challenged measures apply equally to domestic and foreign tobacco manufacturers. Claimants do not dispute that plain fact. The claim under Article 1102 should be dismissed.

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<sup>203</sup> *Pope & Talbot* Phase 2 Merits Award ¶ 103.

<sup>204</sup> *Methanex* Final Award, pt. IV, ch. B ¶¶ 21-22.

<sup>205</sup> *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1, Award ¶ 156 (Jan. 9, 2003) (emphasis added).



## **2. Claimants Fail To Meet Any Of The Required Elements For A Most-Favored-Nation Treatment Claim Under Article 1103**

Claimants similarly fail to meet the three requisite elements of a most-favored-nation treatment claim under Article 1103. Under Article 1103, a claimant must demonstrate (i) *treatment* with respect to a 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 investor or investment as compared to the investor or investment of “any other Party or of a non-Party.”<sup>206</sup>

For the reasons set forth above, (i) the allocable share amendments have not accorded Grand River any “treatment” with respect to a U.S. investment; (ii) grandfathered SPMs that “directly compete” with the Seneca brand are not the appropriate comparator in this case; Grand River in fact is in most like circumstances with other NPMs; and (iii) Claimants do not even attempt to show that the allocable share amendments have accorded tobacco manufacturers of “any other Party or of a non-Party,” including grandfathered SPMs, more favorable treatment on account of nationality. For the above reasons, the Article 1103 claim should be denied.

### **C. Claimants Fail To Establish That Their Alleged Investments Have Not Been Accorded The Minimum Standard Of Treatment Under Article 1105(1)**

As addressed in the U.S. Counter-Memorial, the customary international law minimum standard of treatment obligation under Article 1105(1) is not a general non-discrimination obligation, as might be found under separate international agreements such as Article 26 of the International Covenant on Civil and Political Rights or under

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<sup>206</sup> See Counter-Mem. at 81.

constitutional provisions such as the 14th Amendment to the U.S. Constitution. Rather, by its express terms, Article 1105(1) guarantees only that NAFTA Parties will accord the minimum standard of treatment to *investments* of investors of another Party.<sup>207</sup> That obligation includes prohibitions against denying such investments (i) a fair and efficient judicial system for the resolution of claims, (ii) the full protection and security of the host State's laws, and (iii) prompt, adequate, and effective compensation in the event of an expropriation.<sup>208</sup>

Although an investor or investment may have other rights under local and international law, Article 1105(1) incorporates only those international law obligations that are contained within the minimum standard of treatment.<sup>209</sup> Indeed, the NAFTA Free Trade Commission has specifically clarified that a breach of a separate international agreement does not establish a breach of Article 1105(1).<sup>210</sup>

Because NAFTA Chapter Eleven applies the minimum standard of treatment obligation under Article 1105(1) only to the *investments* of investors, and not to investors as individuals, Article 1105(1) cannot be a vehicle for advancing arguments about

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<sup>207</sup> When the NAFTA Parties intended to extend Chapter Eleven obligations to investors as individuals, separate and apart from their investments, they did so expressly, as illustrated by the obligations set out in Article 1102(1), Article 1103(1), and Article 1104. Compare NAFTA art. 1105(1) (“Each Party shall accord to *investments* of investors of another Party . . . .”) with NAFTA arts. 1102(1), 1103(1), and 1104 (“Each Party shall accord to *investors* of another Party . . . .”) (emphasis added).

<sup>208</sup> See Counter-Mem. at 90-91.

<sup>209</sup> Claimants assert that the minimum standard of treatment obligation has converged with autonomous fair and equitable treatment provisions found in separate investment agreements, which include, according to Claimants, an obligation not to frustrate an investor's expectations. See Reply ¶¶ 135-38. But as demonstrated by the United States, even a breach of an investment contract, without some additional showing such as complete contract repudiation, cannot establish a breach of the minimum standard of treatment. See Counter-Mem. at 96-97. The minimum standard of treatment has not “converged” with any obligation that would make an investor's expectations actionable under an investment agreement.

<sup>210</sup> See Counter-Mem. at 88; NAFTA Free Trade Comm'n, Notes of Interpretation of Certain Chapter 11 Provisions ¶ B (July 31, 2001).

general compliance with the full range of international law principles that might apply to individuals.

Furthermore, the NAFTA Parties consented to international arbitration under Chapter Eleven to resolve only *investment* disputes—they did not consent to international arbitration in which private persons could seek damages under the investment chapter of the NAFTA for violations of any right that such persons may possess under international law. As observed by the NAFTA Chapter Eleven Tribunal in the *Canadian Cattle*

*Claims* case:

NAFTA Chapter Eleven provides private parties with direct access to international jurisdiction in the course of investor-State arbitration for an alleged breach of a *specified, and exhaustive*, list of obligations contained in Section A of Chapter Eleven, but does so only with regard to a circumscribed subject-matter therein.<sup>211</sup>

Contrary to Claimants’ assertions, the specified obligation under Article 1105(1) does *not* serve as a catch-all remedy which can be used to (i) correct any injustice “that would otherwise pass unattended”<sup>212</sup> or (ii) “vindicate” any “fundamental human

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<sup>211</sup> *Canadian Cattle Claims Award* ¶ 42 (emphasis added); see also NAFTA art. 1115 (“[T]his Section establishes a mechanism for the settlement of investment disputes . . . .”); 2 GOV’T ACCOUNTABILITY OFFICE, NORTH AMERICAN FREE TRADE AGREEMENT: ASSESSMENT OF MAJOR ISSUES 24 (1993) (“[The] NAFTA incorporates a dispute resolution mechanism *specific to breaches of obligations of the investment chapter . . . .*”) (emphasis added); *Bayview Award* ¶ 83 (finding that a Chapter Eleven tribunal “has jurisdiction to adjudicate upon claims made by an investor of one NAFTA Party that another NAFTA Party has breached Section A (i.e., Articles 1101-1114) . . . . It has no jurisdiction over claims that do not arise from such alleged breaches”); *Azinian v. United Mexican States*, ICSID ARB(AF)/97/2, Award ¶ 82 (Nov. 1, 1999) (“Arbitral jurisdiction under Section B is limited not only as to the persons who may invoke it (they must be nationals of a State signatory to NAFTA), but also as to subject matter: claims may not be submitted to investor-state arbitration under Chapter Eleven unless they are founded upon the violation of an obligation established in Section A.”).

<sup>212</sup> Reply ¶ 137 (quoting *Sempra Energy Int’l v. Argentine Republic*, ICSID Case No. ARB/02/16, Award ¶¶ 296-97, 300 (Sept. 28, 2007) (addressing the “fair and equitable treatment” provision under the U.S.-Argentina BIT)). Indeed, if the Tribunal were to rely on Article 1105(1) as a catch-all remedy to correct an injustice “that would otherwise pass unattended,” the Tribunal in effect would be resolving the dispute *ex aequo et bono*, which requires the express authorization of the parties. The parties have not provided such authorization in this matter. See UNCITRAL Arbitration Rules art. 33(2) (“The arbitral tribunal shall decide as *amiable compositeur* or *ex aequo et bono* only if the parties have expressly authorized the arbitral tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration.”); Christoph

right.”<sup>213</sup> It is not, as Claimants assert, a “retrograde”<sup>214</sup> position to maintain that Article 1105(1) guarantees a certain baseline level of treatment for the investments of investors of another NAFTA Party, but does not guarantee a remedy for every conceivable injustice under international law.<sup>215</sup>

Like Claimants in this case, the claimant in the *Biloune v. Ghana Investments Centre* investment dispute sought to argue claims based on international law norms applicable to individuals outside the context of foreign investment, specifically unlawful

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Schreuer, *Decisions Ex Aequo et Bono Under the ICSID Convention*, 11 ICSID FOREIGN INV. L.J. 37, 37 (1996).

<sup>213</sup> Reply ¶ 141. Notably, the International Court of Justice declined to interpret the fair and equitable treatment obligation in the United States-Iran 1955 Treaty of Amity, Economic Relations and Consular Rights as providing “a wholesale warranty by each Party to avoid all injury to the nationals and companies of the other Party. . . .” *Oil Platforms (Iran v. U.S.)*, 1996 I.C.J. 803, 816 (Judgment on Preliminary Objection of Dec. 12) (quoting U.S. submission on jurisdiction).

<sup>214</sup> Reply ¶ 134. Indeed, all three NAFTA Parties have confirmed that the content of the customary international law minimum standard of treatment is not static or limited to conduct that was prohibited in the early part of the 20th Century. See Post-Hearing Submission of the United States at 20, *ADF Group Inc. v. United States*, ICSID ARB(AF)/00/1 (June 27, 2002) (“As the United States has previously advised this Tribunal, customary international law, including the minimum standard of treatment of aliens, may evolve over time.”); Canada’s Second Art. 1128 Submission ¶ 33, *ADF Group Inc. v. United States*, ICSID ARB(AF)/00/1 (July 19, 2002) (“Canada’s position has never been that the customary international law regarding the treatment of aliens was ‘frozen in amber at the time of the *Neer* decision.’ . . . Canada’s position has always been that customary international law can evolve over time, but that the threshold for finding a violation of the minimum standard of treatment is still high.”); Mexico’s Second Art. 1128 Submission at 10-11, *ADF Group Inc. v. United States*, ICSID ARB(AF)/00/1 (July 22, 2002) (“[C]onduct which may not have violated international law . . . in the 1920’s might very well be seen to offend internationally accepted principles today.”) (quotation marks omitted).

<sup>215</sup> Similarly, Claimants cite no authority for their assertion that international law imposes on Chapter Eleven tribunals “an independent duty to apply any and all imperative principles of international law to its work.” Reply ¶ 140. In fact, to the contrary, in cases where the International Court of Justice was pressed to read certain international law principles into unrelated international law obligations, the Court declined. See *Oil Platforms*, 1996 I.C.J. at 812, 814 (holding that Article I of the United States-Iran 1955 Treaty of Amity, Economic Relations and Consular Rights, which called for the “firm and enduring peace and sincere friendship” between the Parties, did not incorporate “into the Treaty all of the provisions of international law concerning such relations”); *Barcelona Traction, Light & Power Co., Ltd. (Belg. v. Spain)*, 1970 I.C.J. 3, 32-33 (Second Phase, Judgment of Feb. 5) (finding that Spain’s international responsibility had to be decided “in the light of the general rules of diplomatic protection” rather than in the light of any other body of international law, because norms of treatment for foreign investment had emerged from the growth of international economic relations and, unlike obligations *erga omnes*, were not the concern of all nations).

detention and deportation.<sup>216</sup> The tribunal found that its jurisdiction did not extend to such claims. Similar to the Chapter Eleven obligation under Article 1105(1), the State's consent to arbitrate in *Biloune* was limited to disputes "in respect of" the investment at issue. Given that limitation, the tribunal concluded that it was not "authorized to deal with allegations of violations of fundamental human rights."<sup>217</sup>

Consistent with the *Biloune* decision, it is well-established that international human rights "generally protect the human being and not corporate entities or commercial interests," and that "most minimum standard of treatment provisions only apply to *investments* made by investors and not to individual investors."<sup>218</sup> Article 1105(1) is such a provision. Contrary to Claimants' assertions, Article 1105(1) does not provide a private right of arbitration to seek compensation for every form of injustice under international law.

As a factual matter, moreover, Claimants' allegations of injustice in this case are completely unsupported. As observed above in connection with Claimants' arguments under Article 1102 and Article 1103, the challenged escrow statutes, either in their original form or as amended, present *all* tobacco manufacturers with the same choice,

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<sup>216</sup> *Biloune v. Ghana Invs. Ctr.*, UNCITRAL, Award on Jurisdiction and Liability, 95 I.L.R. 183 (Oct. 27, 1989).

<sup>217</sup> *Id.* at 203.

<sup>218</sup> ANDREW NEWCOMBE & LLUÍS PARADELL, *LAW AND PRACTICE OF INVESTMENT TREATIES* 253 (2009). Notably, the Third Restatement of the Law of Foreign Relations addresses customary international law human rights norms and the customary international law governing injuries to aliens as distinct areas of State responsibility. Specifically, Section 701 outlines State responsibility for violations of customary international law human rights norms, while Section 712 outlines State responsibility for violations of customary international law concerning the impairment to "property or other economic interests of a national of another state." RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 701, 712 (1987). Consistent with that distinction, the 2004 U.S. Model Bilateral Investment Treaty ("BIT"), and recent BITs and Free Trade Agreements signed by the United States, recognize that the customary international law minimum standard of treatment "refers to all customary international law principles that protect the *economic* rights and interests of aliens." *See* Counter-Mem. at 91 n.326.

regardless of nationality, and regardless of indigenous or non-indigenous status: either join the MSA or make escrow payments under the statute. For tobacco manufacturers that opt to remain NPMs and be subject to the escrow statutes, those statutes apply equally to *all* NPMs, regardless of nationality and regardless of indigenous or non-indigenous status. Furthermore, *any* NPM that does not want to be subject to the challenged measures is free to join the MSA as an SPM.

Given the above facts, Claimants' "discrimination" claim under Article 1105(1) begins and ends with their allegation that the MSA States failed to consult separately with them prior to adopting the allocable share amendments.<sup>219</sup> But Claimants fail to provide any support for the existence of such a consultation obligation under Article 1105(1). In their Memorial, Claimants attempted to import alleged indigenous rights into Chapter Eleven through reliance on U.N. and other international instruments, but as demonstrated in the U.S. Counter-Memorial, neither the U.N. Declaration on the Rights of Indigenous Peoples nor the International Labor Organization's Convention No. 169 reflects a customary international law right of consultation that is binding on the United States.<sup>220</sup> In response, Claimants now assert circuitous arguments based on the Universal Declaration of Human Rights, the U.N. Charter, and the Vienna Convention on the Law of Treaties.<sup>221</sup> For the reasons discussed below, these arguments are also unavailing.

Claimants' factual allegations concerning their "expectations" with respect to both their on-reservation and off-reservation sales are equally unsupported, as discussed

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<sup>219</sup> Reply ¶ 144.

<sup>220</sup> See Counter-Mem. at 127-29, 134-39.

<sup>221</sup> The United States is not a party to the Vienna Convention on the Law of Treaties. It has recognized since at least 1971 that the Convention is the "authoritative guide" to treaty law and practice. See Letter from Secretary of State Rogers to President Nixon Transmitting the Vienna Convention on the Law of Treaties, Oct. 18, 1971, *reprinted in* 65 DEP'T OF ST. BULL. 684, 685 (1971).

in Section II.A.2 above. As a legal matter, Claimants have not responded to the arguments set forth in the U.S. Counter-Memorial, demonstrating that Article 1105(1) does not obligate the NAFTA Parties to protect an investor's expectations.<sup>222</sup>

Nor have Claimants responded to any of the arguments put forward by the United States with respect to the Jay Treaty, opting instead to “stand on the expert opinion of Professor Clinton.”<sup>223</sup> As demonstrated in the U.S. Counter-Memorial, nothing in the language or history of the Jay Treaty supports the overly broad interpretation that Professor Clinton would assign to it.

Finally, as discussed below, even if the Tribunal had jurisdiction to remedy any injustice that would otherwise pass unattended, Claimants have not demonstrated that they have been subjected to unfair treatment. Requiring Grand River to make escrow deposits to provide MSA States with a source of recovery for potential future tobacco-related judgments or settlements, and to ensure that Grand River internalizes the health-care costs that its cigarettes impose on MSA States, does not deny Claimants justice under international law.

### **1. Claimants Fail To Show Any Discrimination Against Their Alleged Investments**

Notwithstanding the express limitations on the reach of Article 1105(1) discussed above and in the U.S. Counter-Memorial,<sup>224</sup> Claimants would invite this Tribunal to treat Article 1105(1) as a blank canvas on which it can paint any non-discrimination rule it might find under international law. The Tribunal should reject such an invitation, which is flatly inconsistent with the language and meaning of Article 1105(1).

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<sup>222</sup> Counter-Mem. at 96-100.

<sup>223</sup> Reply ¶ 165.

<sup>224</sup> Counter-Mem. 89-93.

As a preliminary matter, Claimants have not shown discrimination *in any form* against their alleged investments. The challenged regulatory measures do not distinguish between domestic and foreign entities, or between indigenous and non-indigenous entities. Moreover, Claimants allege no such distinctions in the application of the measures.

Instead, Claimants’ “discrimination” claim under Article 1105(1) is limited to their allegation that the MSA States failed to “consult and engage in good faith negotiations with Claimants concerning how the adverse impacts of these measures could be mitigated.”<sup>225</sup> But in Claimants’ view, such a duty to consult would apply only to “indigenous tobacco enterprises,” and not to other tobacco manufacturers.<sup>226</sup>

Such an obligation of special treatment for indigenous-owned enterprises is simply nowhere to be found in the minimum standard of treatment obligation under Article 1105(1), which, in the context of Chapter Eleven claims brought against the United States, sets a baseline level of treatment to be accorded in the United States to all Canadian and Mexican investments. Article 1105(1) does not guarantee special treatment for any particular ethnic or indigenous investor from those countries or for any particular classes of investments based on the ethnicity or indigenous background of the Canadian or Mexican investor.

Claimants deny that they are seeking special treatment, citing the proposed amicus submission of the Grand Chief of the Assembly of First Nations of Canada, which

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<sup>225</sup> Reply ¶ 144.

<sup>226</sup> *Id.* ¶ 149.



asserts that Claimants in fact seek only “simple equality.”<sup>227</sup> The Grand Chief, however, fails to address how the treatment Grand River has received as a commercial enterprise subject to state tobacco laws is not equal to what other enterprises have experienced, or conversely why special treatment for one commercial tobacco manufacturer would somehow translate into “equality.”

In fact, the minimum standard of treatment under Article 1105(1) is concerned with equality: it sets an absolute minimum floor below which the treatment of investments of *all* foreign investors “must not fall.”<sup>228</sup> The minimum standard of treatment cannot set one floor of treatment for a certain class of foreign investments, while setting a different floor of treatment for a different class of foreign investments. Moreover, even if Claimants had been given special consultation rights not available to other companies, they have not shown any basis on which they would thereby have been exempted from the challenged measures.

Indeed, even the linchpin of Claimants’ attenuated argument cannot withstand scrutiny. Unable in their last pleading to establish an alleged duty to consult as a standalone obligation under customary international law,<sup>229</sup> Claimants now attempt to

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<sup>227</sup> *Id.* ¶ 143. The Assembly of First Nations’ submission was not accompanied by an application for leave to file a non-party submission. The procedures recommended by the NAFTA FTC concerning non-disputing party participation in Chapter Eleven proceedings—which the Tribunal has indicated will guide their consideration of amicus submissions in this case—require that any proposed amicus submission be accompanied by an application for leave to file. See NAFTA Free Trade Comm’n, Statement on Non-Disputing Party Participation (Oct. 7, 2003); *Grand River Enters. Six Nations, Ltd. v. United States of America*, NAFTA/UNCITRAL, Minutes of the First Session of the Tribunal at 7-8 (Mar. 31, 2005). Because the Assembly of First Nations did not seek leave to file, their submission should not be considered in this arbitration.

<sup>228</sup> *S.D. Myers Partial Award* ¶ 259.

<sup>229</sup> Claimants now state: “[T]he obligations to consult and bargain in good faith with indigenous investors, albeit elaborated in more detail in various international instruments, are not necessarily standalone obligations.” Reply ¶ 147. Unable to demonstrate in their Memorial how the U.N. Declaration on the Rights of Indigenous Peoples is itself binding as a matter of customary law, Claimants now cite an additional instrument, the Draft American Declaration on the Rights of Indigenous Peoples, under

import such a duty into Article 1105(1) via a circuitous path that begins with the Universal Declaration of Human Rights (“UDHR”) and winds its way through the U.N. Charter before supposedly taking root in NAFTA Chapter Eleven. Claimants’ elaborate theories have no foundation in international law and cannot support their claim under Article 1105(1).

**a. Claimants Fail In Their Attempt To Import A Consultation Obligation Into Article 1105(1) Through The Universal Declaration Of Human Rights And The U.N. Charter**

Claimants’ attempt to import an obligation to consult from the UDHR and U.N. Charter into NAFTA Chapter Eleven makes little sense even to summarize. It begins with the assertion that a duty to consult is included within the equality right embodied in Article 7 of the 1948 UDHR, which states: “All are equal before the law and are entitled without any discrimination to equal protection of the law. All are entitled to equal protection against any discrimination in violation of this Declaration and against any incitement to such discrimination.”<sup>230</sup> Claimants fail to establish, however, where the language of Article 7 contains any obligation or duty to consult generally, or with foreign indigenous individuals or companies specifically.

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negotiation at the Organization of American States (“OAS”), in an apparent attempt to provide support for a standalone consultation obligation under customary international law. *Id.* ¶ 147. That document, however, is merely a draft and the article cited by Claimants, Article XXI (“Right to Development”), has not been approved even by the negotiating parties to the draft. *See* Permanent Council of the Organization of American States, Comm. on Juridical and Political Affairs, Working Group to Prepare the Draft American Declaration on the Rights of Indigenous Peoples, *Document of the Chair on Proposals Regarding Work for the Special Meeting* at 4, OEA/Ser.K/XVI, GT/DADIN/doc.357/08 rev. 1 (Nov. 24, 2008). Given that the draft declaration has not been finalized, much less endorsed by the member States of the OAS, it does not support the existence of a customary international law rule. It certainly provides no evidence that such an obligation has risen to the level of a peremptory norm. *See* Counter-Mem. at 128.

<sup>230</sup> Universal Declaration of Human Rights, G.A. Res. 217A(III), at 71, 73 U.N. GAOR, 3d Sess., 1st plen. Mtg., U.N. Doc. A/810 (Dec. 10, 1948), *available at* <http://www.ohchr.org/EN/UDHR/Pages/Introduction.aspx> (last visited May 5, 2009).

Claimants then assert that the alleged Article 7 duty to consult is an *erga omnes* norm that falls within the ambit of Article 103 of the U.N. Charter.<sup>231</sup> Article 103 states: “In the event of a conflict between the obligations of the Members of the United Nations under the present Charter and their obligations under any other international agreement, their obligations under the present Charter shall prevail.”<sup>232</sup> Claimants then maintain that a duty to consult is somehow included among “the obligations of the Members of the United Nations under the [U.N.] Charter,” and thus under Article 103 it “pre-empts any limitation that Respondent would otherwise have the Tribunal read into the NAFTA Article 1105(1) requirement for Respondent to act ‘in accordance with international law.’”<sup>233</sup> Left unsaid is that the UDHR—even if it could be proven that it provides a duty to consult—is neither part of the U.N. Charter nor a treaty in its own right. Left unexplained is how the UDHR would come to insert itself into Article 1105(1), or perhaps to supersede it, depending on how one reads the Claimants’ arguments.

Indeed, each link in Claimants’ logical chain is unsupported and unsupportable. First, Article 7 of the UDHR says nothing about a duty to consult with indigenous groups or specifically with indigenous-owned companies or indigenous investors. Claimants provide no support for importing a duty to consult into the text of Article 7, when such a duty is not mentioned anywhere in the UDHR. Further, and regardless of the content of Article 7, Article 103 of the U.N. Charter is limited by its terms to “obligations *under the*

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<sup>231</sup> Reply ¶ 150. Claimants seem to confuse *erga omnes* norms—*i.e.*, norms that reflect a duty that is enforceable by all States—with peremptory norms, *i.e.*, norms from which States may not derogate even by treaty. See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 702(n), (o), Reporters’ Note 11 (1987).

<sup>232</sup> U.N. Charter art. 103, available at <http://www.un.org/aboutun/charter/pdf/uncharter.pdf> (last visited May 5, 2009).

<sup>233</sup> Reply ¶ 150.

*present Charter.*”<sup>234</sup> The UDHR is not part of the U.N. Charter; rather, it is a separate and freestanding declaration of the U.N. General Assembly. Claimants provide no basis for including the UDHR within the ambit of Article 103, and similarly provide no reason for including that particular declaration but not hundreds of others within Article 103. Finally, even assuming that Article 103 were applicable in this case, Article 103 provides that the obligations under the U.N. Charter “shall prevail” over “obligations under any other international agreement” only to the extent that the two obligations *conflict*.<sup>235</sup> Claimants have shown no *conflict* between their alleged duty to consult and the content of Article 1105(1). Article 1105(1) provides a minimum standard of treatment for investments of investors, enforceable through the arbitration provisions of Section B of Chapter Eleven. Article 1105(1) would not “conflict” with the U.N. Charter merely by failing to provide the basis to arbitrate every right contained in that Charter.<sup>236</sup>

For the above reasons, Claimants’ attempt to import a consultation obligation into Article 1105(1) should be rejected.

**b. Claimants Fail In Their Attempt To Import A Prohibition Against Racial Discrimination Into Article 1105(1) Through Article 53 Of The Vienna Convention On The Law Of Treaties**

As addressed above, Article 1105(1) permits the consideration of claims alleging discriminatory treatment against the investments of aliens in particular contexts, including claims alleging denial of justice, expropriation, and the failure to provide full

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<sup>234</sup> U.N. Charter art. 103, available at <http://www.un.org/aboutun/charter/pdf/uncharter.pdf> (last visited May 5, 2009).

<sup>235</sup> *Id.*

<sup>236</sup> See also *Oil Platforms*, 1996 I.C.J. at 812-14 (finding that international law did not require the Court to incorporate “all of the provisions of international law” and “relevant provisions” of the U.N. Charter into Article I of the 1955 Treaty of Amity between the United States and Iran, in light of the limited object of the Treaty and in contrast to other treaties specifically referencing provisions of the U.N. Charter).

protection and security.<sup>237</sup> But Article 1105(1) provides no general obligation of non-discrimination.<sup>238</sup>

Nevertheless, as an alternative argument for their claim under Article 1105(1), Claimants attempt to import a general prohibition against racial discrimination into that provision. According to Claimants, given their status as members of Canadian First Nations, *any* negative impact the challenged measures may have had on them, whether intentional or unintentional, constitutes racial discrimination and must be remedied under NAFTA Chapter Eleven.<sup>239</sup> Like their attempt to import a consultation obligation into Article 1105(1), however, Claimants' argument does not withstand scrutiny.

Claimants cite no NAFTA text in support of their assertion that the investment chapter of the NAFTA provides a private right of arbitration for claims of racial discrimination. Instead, Claimants vainly attempt to import into Article 1105(1) a general norm against racial discrimination by asserting that Article 53 of the Vienna Convention on the Law of Treaties ("Vienna Convention") requires such incorporation.<sup>240</sup> In that attempt, Claimants rely on a type of legal backhand, arguing first that under Article 53, a treaty is void if at the time of its conclusion it conflicts with a peremptory norm of international law (*jus cogens*). Claimants then assert that a treaty provision conflicts with a peremptory norm if it fails to incorporate that norm. Therefore, according to Claimants, since a norm against racial discrimination is peremptory, Article 1105(1) is a void provision unless it incorporates that norm. Such legal contortions do

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<sup>237</sup> See Counter-Mem. at 129-30, 132-33.

<sup>238</sup> See *id.*

<sup>239</sup> See Reply ¶ 145.

<sup>240</sup> See *id.* ¶ 150.

not advance the Claimants' case. Rather than requiring treaties to *incorporate* peremptory norms, Article 53 of the Vienna Convention is designed to codify the principle of international law that a peremptory norm renders void treaties that *conflict* with such a norm.<sup>241</sup> Article 1105, in contrast, compatibly co-exists, rather than conflicts, with any general peremptory norm prohibiting racial discrimination. Moreover, we know of no investment arbitration tribunal that has ever found a treaty to be void because of a conflict with a peremptory norm.<sup>242</sup>

In addition, again assuming arguendo the existence of a peremptory norm of international law prohibiting racial discrimination, a treaty provision does not “conflict” with a peremptory norm merely by failing to provide a private right of arbitration to seek damages against the NAFTA governments for violations of that norm.<sup>243</sup> There is simply no basis in law to conclude that the existence of a peremptory norm requires the NAFTA

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<sup>241</sup> See Int'l L. Comm'n, *Report on the Work of its Eighteenth Session*, [1966] 2 U.N.Y.B. INT'L L. COMM'N 172, 261 [ILC Commentaries on draft Vienna Convention articles 50 and 69, now articles 53 and 64] (“[A] rule of *jus cogens* is an over-riding rule depriving any act or situation which is in conflict with it of legality. An example would be former treaties regulating the slave trade, the performance of which later ceased to be compatible with international law owing to the general recognition of the total illegality of all forms of slavery.”).

<sup>242</sup> See Moshe Hirshe, *Interactions Between Investment and Non-Investment Obligations*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 154, 159 (Peter Muchlinski, Federico Ortino & Christoph Schreuer, eds. 2008) (noting that “international tribunals have demonstrated a cautious approach” when considering claims that a treaty is void under Article 53 for conflict with a peremptory norm).

<sup>243</sup> See, e.g., Int'l L. Comm'n, *Report on the Work of its Eighteenth Session*, [1966] 2 U.N.Y.B. INT'L L. COMM'N 172, 248 (stating that the “most obvious and best settled” examples of treaty provisions which would conflict with peremptory norms are those “contemplating” the unlawful use of force, acts which are criminal under international law, and slavery, piracy, or genocide); Andrea Bianchi, *Human Rights and the Magic of Jus Cogens*, 19 EUR. J. INT'L L. 491, 496 (2008) (stating that Article 53 was intended to apply in the “highly unlikely [circumstance] that two or more states would make a treaty to commit an act of genocide or to subject certain individuals to torture”).

Parties to provide a private right of arbitration for claims alleging violations of that norm under the investment chapter of the NAFTA.<sup>244</sup>

Moreover, even assuming that a peremptory norm against racial discrimination could be imported into Chapter Eleven, such a norm simply would not be implicated by the facts of this case. The challenged measures do not distinguish between domestic and foreign entities, or between indigenous and non-indigenous entities. Further, Claimants not only allege no intent to discriminate on the basis of race, they do not even allege a disproportionate impact on indigenous manufacturers under the MSA regime. Instead, Claimants assert that when *even one* investor or enterprise from a “historically disadvantaged group”<sup>245</sup> is adversely affected by a generally applicable measure, a peremptory norm has been violated.

That assertion is baseless. Under the International Convention on the Elimination of All Forms of Racial Discrimination, to which the United States, Canada, and Mexico are parties, a claim of racial discrimination requires adverse treatment *based on one’s* minority status.<sup>246</sup> Even the one authority cited by Claimants in support of their racial discrimination allegations, the Advisory Opinion of the Inter-American Court of Human

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<sup>244</sup> See *Armed Activities on the Territory of the Congo (New Application: 2002) (Dem. Rep. Congo v. Rwanda)*, 2006 I.C.J. 6, 32 (Judgment on Jurisdiction and Admissibility of Feb. 3). In that case, the Democratic Republic of the Congo made a related argument to the one Claimants are making here, see Reply ¶ 141, arguing that Rwanda’s reservation to the compromissory clause of the Genocide Convention contravened Article 53 of the Vienna Convention because it sought to “prevent the . . . Court from fulfilling its noble mission of safeguarding peremptory norms” and was therefore void *ab initio*. 2006 I.C.J. at 29-30. While the Court reaffirmed that the principles underlying the Genocide Convention are binding on all States, the Court held that it did not have jurisdiction to consider breaches of those principles without the parties’ consent. See *id.* at 31-32.

<sup>245</sup> Reply ¶ 145.

<sup>246</sup> See, e.g., U.N. Int’l Convention on the Elimination of All Forms of Racial Discrimination art. 1, ¶ 1, Dec. 21, 1965, 660 U.N.T.S. 195, 216 (defining racial discrimination as “any distinction, exclusion, restriction or preference *based on* race, colour, descent, or national or ethnic origin which has the purpose or effect of nullifying or impairing the recognition, enjoyment or exercise, on an equal footing, of human rights and fundamental freedoms in the political, economic, social, cultural or any other field of public life”) (emphasis added).

Rights in the *Juridical Condition and Rights of the Undocumented Migrants* case, agrees that claims of discrimination must allege discrimination “against a specific group of persons *because of* their race, gender, color or other reasons.”<sup>247</sup> If a discrimination claim did not need to show discrimination *on account of* membership in a protected class, any rule of general application intended to promote the public welfare would be subject to challenge from members of protected classes who had been adversely affected by the rule for any reason. In any event, Claimants here allege no discrimination on account of race; thus, simply as a factual matter, their references to “race discrimination” are unavailing.

For the above reasons, Claimants’ discrimination claim under Article 1105(1) should be dismissed.

## **2. The Denial of Justice Claim Brought By Claimants, Who Raise No Complaint “With The US Justice System,” Should Be Rejected**

As addressed in the U.S. Counter-Memorial, Grand River has brought, and continues to litigate, declaratory judgment actions in domestic U.S. courts challenging the allocable share amendments and complementary legislation, and nothing in those measures bars Grand River from pursuing such claims.<sup>248</sup> Indeed, while framing the denial of justice obligation as a State obligation “to provide equal access to its courts in order to adjudicate claims concerning the property rights of foreign investors,”<sup>249</sup>

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<sup>247</sup> *Juridical Condition and Rights of the Undocumented Migrants*, 2003 Inter-Am. Ct. H.R. (ser. A) No. 18, at 99 (Sept. 17, 2003) (emphasis added). The United States takes no position on other aspects of this Advisory Opinion.

<sup>248</sup> Counter-Mem. at 140.

<sup>249</sup> Mem. ¶ 198.



Claimants openly acknowledge that in this matter they have no complaint “with the US justice system.”<sup>250</sup>

Instead, Claimants allege “a denial of administrative and regulatory due process,” on grounds that, as Claimants assert, “[t]he MSA was based upon allegations of fraud, deceit and conspiracy [against OPMs] that could not possibly be alleged, much less sustained, against Claimants.”<sup>251</sup> But that assertion fails to acknowledge that OPMs, which have signed the MSA, and NPMs, which have not, are subject to different obligations and limitations.

The assertion also fails to acknowledge the broad public interest supporting the escrow statutes, which extends well beyond the need to prevent fraud and conspiracy within the tobacco industry, and includes the MSA State interest in ensuring access to an adequate source of funds to cover *any* potential future tobacco-related judgments or settlements obtained by MSA States against NPMs.<sup>252</sup>

In addition, as discussed below, Claimants’ failure to exhaust their denial of justice claim is not excused by their re-casting of the claim as a denial of “administrative and regulatory”—rather than judicial—due process.

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<sup>250</sup> Reply ¶ 181.

<sup>251</sup> *Id.* ¶¶ 182, 189.

<sup>252</sup> See *Grand River Enters. Six Nations, Ltd. v. King*, No. 02 Civ. 5068(JFK), 2008 WL 4615838, at \*1 (S.D.N.Y. Oct. 14, 2008); Counter-Mem. at 142-43; see also *KT&G Corp.*, 535 F.3d at 1138 (“The stated purpose of the escrow statute at issue here is to insure that the state will have an eventual source of recovery from the NPMs if they are proven to have acted culpably.”); *Star Scientific*, 278 F.3d at 349 (explaining that the “stated purpose” of Virginia’s escrow statute “is to ensure that Virginia will be able to recover healthcare costs from cigarette manufacturers regardless of whether the manufacturer has signed on to the Master Settlement Agreement”).

**a. Because OPMs And NPMs Are Subject To Different Obligations And Limitations, Claimants Fail In Their Attempt To Base A Denial Of Justice Claim On Differences In OPM And NPM Conduct**

The core premise of Claimants’ denial of justice claim, that NPM escrow payments “are equal to the payments being made by OPMs under the MSA,”<sup>253</sup> is inaccurate. The escrow statutes did attempt to equalize the burdens on PMs and NPMs “by requiring the NPMs to make payments into escrow that approximate the MSA payments they would make as SPMs.”<sup>254</sup> At the same time, however, the MSA imposed certain multi-billion dollar payment obligations on OPMs for which no corresponding obligations exist under the escrow statutes.

Specifically, OPMs under the MSA were subject to initial annual payments based on their respective market shares from 2000 to 2004 that, in total, exceeded US\$10 billion.<sup>255</sup> No comparable obligations apply to NPMs under the escrow statutes.

Furthermore, unlike settlement payments made by PMs pursuant to the MSA, an NPM retains ownership over, and receives interest on, the funds it pays into escrow.<sup>256</sup> Claimants themselves acknowledge that fact when observing that the deposits they have made under the escrow statutes are “currently the property of Claimants.”<sup>257</sup> An NPM would lose ownership over its escrowed funds only in the event that a tobacco-related judgment or settlement were to be rendered against it in the future.<sup>258</sup>

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<sup>253</sup> Reply ¶ 185.

<sup>254</sup> Gruber Report ¶ 10.

<sup>255</sup> MSA IX(b).

<sup>256</sup> See Counter-Mem. at 142.

<sup>257</sup> Mem. ¶ 119.

<sup>258</sup> See, e.g., OKLA. STAT. tit. 37, § 600.21(A); GA. CODE ANN. § 10-13-1(a); N.Y. PUB. HEALTH LAW § 1399-nn(1); CAL. HEALTH & SAFETY CODE § 104555(a); IDAHO CODE ANN. § 39-7801(a).

U.S. courts have expressly recognized the significance of ongoing NPM ownership of escrowed funds when rejecting Grand River's claims that the allocable share amendments and complementary legislation violate procedural due process under the U.S. Constitution. As found by one U.S. federal court, when rejecting Grand River's domestic procedural due process claim:

While the NPMs are deprived of the use of their escrowed funds pending the post-deprivation remedy, they are compensated for that loss by receiving interest on those funds. Meanwhile, they are able to conduct their business without restrictions on their speech. In the heavily-regulated tobacco industry, the resulting prejudice to the NPMs, on balance, is small.<sup>259</sup>

Similarly, when rejecting a separate domestic procedural due process claim brought by Grand River, the U.S. Court of Appeals for the Second Circuit found that Grand River was not entitled to a hearing before its deposits were placed into escrow because the payment obligations "are legislative preconditions for the privilege of engaging in future cigarette sales in the individual states."<sup>260</sup>

In addition, as discussed in II.A.4.a above, all PMs are subject to wide-ranging limitations on conduct under the MSA, which do not apply to NPMs under the escrow statutes. For example, the MSA abolished two trade associations that were alleged to have misrepresented the health effects of smoking and prohibits OPMs and SPMs from establishing new trade associations that engage in such conduct.<sup>261</sup> The MSA also prohibits OPMs and SPMs from entering into agreements that would limit information or suppress research about the hazards of their product or from making any material

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<sup>259</sup> *Grand River Enters. Six Nations, Ltd. v. Beebe*, 418 F. Supp. 2d 1082, 1098 (W.D. Ark. 2006).

<sup>260</sup> *Pryor*, 425 F.3d at 174.

<sup>261</sup> MSA III(o), (p)(1).

misrepresentations about the health consequences of cigarette smoking.<sup>262</sup> NPMs are not subject to those provisions or to the MSA provisions restricting tobacco-related advertising and marketing.

Because OPMs under the MSA are subject to different obligations and limitations than NPMs under the escrow statutes, Claimants' denial of justice argument, which is premised on the lack of comparable conduct between OPMs and Grand River, is inapposite. Furthermore, as discussed below, escrow deposit obligations under the escrow statutes address a public interest that extends far beyond the narrow categories of fraud and conspiracy, namely the need to impose escrow deposit obligations on NPMs in order to prevent those companies from reaping profits in the short term while avoiding potential liabilities in the long term.

**b. The Public Interest Of MSA States In Adopting The Escrow Statutes Extended Well Beyond Preventing Fraud And Conspiracy Within The Tobacco Industry**

As noted above, Claimants' assertion that "[t]he MSA was based upon allegations of fraud, deceit and conspiracy that could not possibly be alleged, must less sustained, against Claimants,"<sup>263</sup> fails to acknowledge that the public interest behind the escrow statutes extended far beyond redressing such claims.<sup>264</sup> When adopting the escrow statutes, MSA States sought to ensure that funds would be available for *any* potential future tobacco-related judgments or settlements against NPMs, specifically all cases that were "*in any way related to*" the use of or exposure to tobacco products.<sup>265</sup>

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<sup>262</sup> MSA III(q), (r).

<sup>263</sup> Reply ¶ 189.

<sup>264</sup> See Counter-Mem. at 15-17.

<sup>265</sup> MSA II(nn)(2) (defining "released claims" for future conduct as those "directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products");

As stated by Mr. DeLange, in the context of Idaho’s escrow statute:

[P]romptly after the [MSA] was executed, the Idaho Legislature declared that it would be contrary to the policy of the state if a tobacco manufacturer could decide not to enter into such a settlement agreement (nonparticipating manufacturers or NPMs) and thereby use the resulting cost advantage to derive large 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. This legislative determination was driven, in part, by the fact that many diseases caused by tobacco use often do not appear until many years after the affected individual begins smoking.<sup>266</sup>

Because MSA States were concerned about NPMs’ becoming judgment-proof for *any* kind of tobacco-related liability, Grand River’s potential liability in cases that are “in any way related to” the use or exposure to Seneca cigarettes is anything but “mythical.”<sup>267</sup>

**c. The Exhaustion Requirement Applies To Claimants’ Denial Of Justice Claim, Regardless Of Whether Claimants Style The Claim As A Denial Of Judicial, Administrative, Or Regulatory Due Process**

Claimants submit that because their denial of justice claim is not based on a complaint with the U.S. justice system, they need not “pursue all reasonable steps before bringing an international damages claim.”<sup>268</sup> To the contrary, because a denial of justice “simply cannot be said to exist until the self-correcting features of the national system

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*see also King*, 2008 WL 4615838, at \*1 (“The primary purpose of the escrow requirement is to create a resource available to the states in the event they sue and obtain a judgment or settlement against an NPM for damages arising out of the NPM’s cigarette sales in the state.”); *KT&G Corp.*, 535 F.3d at 1138 (“The stated purpose of the escrow statute at issue here is to insure that the state will have an eventual source of recovery from the NPMs if they are proven to have acted culpably.”); *Star Scientific*, 278 F.3d at 349 (explaining that the “stated purpose” of Virginia’s escrow statute “is to ensure that Virginia will be able to recover healthcare costs from cigarette manufacturers regardless of whether the manufacturer has signed on to the Master Settlement Agreement”); Counter-Mem. at 142-43.

<sup>266</sup> DeLange Second Declaration ¶ 7.

<sup>267</sup> Reply ¶ 190.

<sup>268</sup> *Id.* ¶ 181. As addressed in the U.S. Counter-Memorial, Claimants have failed to exhaust their legal challenges to the MSA States’ allocable share amendments and complementary legislation in U.S. courts. *See* Counter-Mem. at 143-46.

have failed,”<sup>269</sup> the exhaustion requirement is an essential pre-condition to all denial of justice claims—even when the alleged injustice originates in a legislative act.<sup>270</sup> Thus, the fact that Claimants now style their denial of justice claim as a “denial of administrative or regulatory due process” does not eliminate the requirement that they exhaust all remedies available to them in U.S. domestic courts, absent a showing of futility, before their international claim can lie.<sup>271</sup>

### III. Merits—Damages

In its Counter-Memorial, and through Navigant’s expert report, the United States demonstrated Claimants’ failure to meet their burden to present evidence of damages. The United States and Navigant showed that Claimants’ valuation theories were unsound, that the application of those theories was incorrect, and that the data relied upon to support those theories was incomplete, contradictory, erroneous, uncorroborated, or otherwise unreliable.

Claimants’ Reply virtually ignores these critical issues, relegating them to three cursory paragraphs. And although Claimants’ valuation expert, Mr. Wilson, addresses some of these issues, his rebuttal report underscores, and perpetuates, these very deficiencies. As addressed in greater detail below:

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<sup>269</sup> JAN PAULSSON, DENIAL OF JUSTICE IN INTERNATIONAL LAW 130 (2005); *see also* Counter-Mem. at 143-46.

<sup>270</sup> *See, e.g., Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award ¶¶ 139-40 (Dec. 16, 2002) (considering requirements for finding “denial of due process or denial of justice” claims under international law and concluding that the claimant’s challenge to the decision of the Mexican Ministry of Finance and Public Credit could not lie because “Mexican courts and administrative procedures at all relevant times have been open to the Claimant”); Clyde Eagleton, *Denial of Justice in International Law*, 22 AM. J. INT’L L. 538, 547, 559 (1928) (stating that denial of justice claims can arise from “executive or legislative action as it interferes with the process of obtaining judicial relief,” but that “injurious acts on the part of executive or legislative agencies” do not become denials of justice under international law until “local remedies against such acts have been sought in vain”).

<sup>271</sup> *See* C.F. AMERASINGHE, LOCAL REMEDIES IN INTERNATIONAL LAW 195 (1990) (explaining that international law does not require exhaustion of local remedies only when the “obvious futility or manifest ineffectiveness” of those remedies is established).

- Mr. Wilson continues to rely on evidence that Claimants declined to make available in this arbitration, and he fails to address or explain gaps, inconsistencies, and contradictions in Claimants' valuation evidence;
- Mr. Wilson has sought to correct four elementary accounting errors contained in his initial report, but in so doing slashed Claimants' principal valuation by 60-70 percent, thus undermining the reliability of his work;
- Mr. Wilson continues to misapply Claimants' principal valuation approach (the so-called brand-impairment analysis) by failing to analyze any actual impairment to Claimants' brands; and
- Mr. Wilson has sought to confirm the reliability of his principal valuation approach through an alternative valuation approach, but in so doing produced a discrepancy exceeding 500 percent.

#### **A. Critical Valuation Evidence Remains Missing, Incomplete, Or Contradictory**

The most significant gap in Claimants' valuation evidence is the absence of audited financial statements. As Navigant explains, "[t]he reliability of any damages claim depends in large part on the accuracy and completeness of the underlying financial data that is relied upon" for the damage analysis.<sup>272</sup> "One of the most important documents a damage expert would usually need to review prior to developing a damage claim," Navigant observes, "is a complete set of audited financial statements"—including at a minimum those "for the years in which historical damages are being claimed."<sup>273</sup>

Audited financial statements are essential in that they: (i) provide a snapshot of the company's financial performance over a given year; (ii) are certified by an independent auditor and prepared in accordance with generally accepted accounting principles; and (iii) serve as benchmarks for assessing the reliability of underlying sales, financial, and operating data.<sup>274</sup>

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<sup>272</sup> Rejoinder Report of Navigant Consulting, Inc. ¶ 76 (May 13, 2009) [hereinafter Navigant Rebuttal Report].

<sup>273</sup> *Id.*

<sup>274</sup> *See id.* ¶ 77.

Although the United States and Navigant highlighted the importance of this information—especially for the years ending 2006 and 2007—Claimants still have failed to make that information available in this arbitration, relying instead on unaudited sales, financial, and operating data. But as Navigant observes:

There have been numerous undocumented changes in the underlying data, and it is not possible to verify the accuracy of this data. Our review of the underlying data indicates that it is unreliable and replete with discrepancies and internal inconsistencies.<sup>275</sup>

Navigant cites three examples to illustrate the inconsistency and unreliability of Claimants' sales information. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] Claimants may have deliberately underreported sales to U.S. states, to lessen their escrow payment obligations. Or Claimants may have exaggerated the declines in sales to this Tribunal, to inflate their damages claim. Or Claimants may simply be negligent in keeping their books. In any event, there remains a large, unexplained discrepancy between Claimants' 2005 and 2006 sales figures.

Second, Mr. Wilson's new off-reservation sales data directly contradicts the data he used in his initial report. [REDACTED]

[REDACTED] Unsurprisingly, Mr. Wilson's "new" data serves to inflate Claimants'

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<sup>275</sup> *Id.* ¶ 17.

<sup>276</sup> *Id.* ¶ 80 & tbl. 13 ("Comparison of Sales Volume Data relied upon by Mr. Wilson vs. Sales Volumes reported in the State Escrow Accounts").

<sup>277</sup> *Id.* ¶ 81.



damages claim. Mr. Wilson has provided no explanation for these large discrepancies in Claimants' own data.

Third, there are irreconcilable discrepancies between sales from Grand River to Tobaccoville and sales from Tobaccoville to its customers. Some discrepancies are to be expected, of course, depending on whether Tobaccoville is building up or drawing down its inventory. [REDACTED]

These discrepancies, which Claimants have declined to explain, at a minimum confirm the poor quality of sales data produced by Claimants.

Similar problems can be found with Claimants' cost figures. Mr. Wilson conceded that, when calculating Grand River's per-carton profits, he ignored substantial costs incurred by Grand River, including overhead, finance and accounting, repair and maintenance, and depreciation costs. Mr. Wilson now claims to have fixed his mistake, after obtaining data from Grand River plant accounting personnel. Mr. Wilson, however, failed to make available the information underlying his cost calculations. Neither the United States nor the Tribunal, therefore, can test the veracity of Claimants' "new" information. Because Grand River's chief executive officer, Jerry Montour, has admitted that Grand River *deliberately misallocates* costs between the United States and Canada,<sup>278</sup> the authenticity of any unsubstantiated cost figures cannot be presumed.

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<sup>278</sup> Jerry Montour: "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." Transcript of Record at 149:5-9 (Testimony of Jerry Montour), *Grand River Enters. Six Nations, Ltd. v. Pryor*, No. 02 Civ. 5068 (S.D.N.Y. Apr. 26, 2006). In an attempt to distance himself from his prior testimony, Jerry Montour now states that "it has never been our practice at GRE . . . to prepare a sophisticated analysis of incremental costs to determine just how much profit we earn in the U.S." Jerry Montour's Second Statement ¶ 37. But such a lack of "sophisticated analysis" only confirms the unreliable nature of the cost data put forward by Claimants.

This is not the only occasion on which Mr. Wilson revised his valuation based on supposedly “new” information. In his rebuttal report, Mr. Wilson states:

- “I have received further information” concerning Tobaccoville’s purchasing and selling activities, and “have since adjusted my model to smooth out these fluctuations” (paragraph 33).
- “I have received more accurate sales data which is also incorporated into my damages model and calculations . . .” (paragraph 37).
- “I have received more accurate [on-reserve] sales data than is incorporated into my previous calculations” (paragraph 40).
- “I have received additional information from the Claimants regarding On-Reservation sales in the state of California” (paragraph 43).
- “Upon further investigation and having received additional data, I concur that the appropriate investment value for incremental fixed asset costs is lower . . .” (paragraph 45).
- “I have received more accurate GRE sales data than is incorporated into my previous calculations. The most significant of these were volumetric in nature, but also impact per stick costs which are integral components of my On- and Off-Reservation damages model” (paragraph 47).

This “new” information, however, merely highlights the serious flaws in Claimants’ entire valuation exercise. Claimants, for example, initially sought \$123 million in damages for “lost profits” for on-reservation cigarette sales in four states, including [REDACTED] for damages allegedly suffered in California alone. Navigant pointed out, however, that Claimants’ sales information showed that on-reservation sales appeared to be flourishing in California. Mr. Wilson now concedes that Claimants’ on-reservation sales in California recently *doubled*, [REDACTED]. As a result, Claimants have dropped their [REDACTED] claim for “lost profits” in California.

Similarly, in the case of Nevada, Mr. Wilson initially calculated damages of over \$31 million for lost sales on-reservation from 2003 to 2008. Navigant pointed out that Claimants’ own information showed that sales in Nevada remained reasonably steady

throughout that period. Claimants now no longer seek *any* damages for “lost sales” in Nevada from 2003 to 2008. In fact, Mr. Wilson has slashed Claimants’ on-reservation damages claims by ██████████<sup>279</sup>

These examples show that Claimants have simply invented damages where none exist, and they underscore the need for accurate sales and cost data from Claimants, including their *audited* financial statements. Based on these (and other) examples, Navigant has concluded that the absence of these governing documents, combined with the poor reliability of the underlying data produced, establish “that there is insufficient information to support a reliable damages claim in these proceedings.”<sup>280</sup> Because Claimants have failed to provide that critical information, the Tribunal should reject, for lack of proof, Claimants’ damages claims.

**B. Acknowledging Serious Errors In His Initial Report, Claimants’ Valuation Expert Slashed Claimants’ Principal Damages Claim By 60 Percent**

Although Claimants failed to introduce evidence establishing their damages claims, Navigant concluded from the evidence that was produced that Mr. Wilson’s expert report was rife with errors. In response, Mr. Wilson sought to correct at least four fundamental errors contained in his initial report. In his rebuttal report, Mr. Wilson:

- Reduced ██████████ his base-year (2005) data for projecting future cigarette sales.<sup>281</sup> (Navigant pointed out that Mr. Wilson had failed to account for the spike in fourth-quarter 2005 sales of Grand River cigarettes, in anticipation of large cost increases beginning in 2006.)

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<sup>279</sup> See Navigant Rebuttal Report ¶ 32 & tbl. 5 (“Summary of Mr. Wilson’s Revised Primary Damages Estimates”) (quoting ██████████ change in on-reservation lost profits under Mr. Wilson’s “growth” scenario).

<sup>280</sup> *Id.* ¶ 19.

<sup>281</sup> See Wilson Rebuttal Report ¶ 36.

- Accounted for actual sales volumes when calculating on-reservation sales of Grand River cigarettes.<sup>282</sup> (Navigant pointed out that Mr. Wilson had purported to calculate on-reservation sales by extrapolating from Claimants’ 2006 sales information, without examining Claimants’ *existing* 2007 sales information.)
- Included NWS’ costs when estimating NWS and Grand River’s combined future profits for on-reservation cigarette sales.<sup>283</sup> (Navigant pointed out that Mr. Wilson had calculated that Grand River and NWS would have earned an astounding [REDACTED] profit margin on their on-reservation cigarette sales, but only because Mr. Wilson had ignored *all* costs incurred by NWS.)
- Accounted for indirect costs incurred at Grand River’s manufacturing facility.<sup>284</sup> (Navigant pointed out that Mr. Wilson, when calculating Grand River’s per-carton profits, had ignored Grand River’s indirect costs, including overhead, finance and accounting, repair and maintenance, and depreciation costs.)

Correcting just these four elementary errors caused Mr. Wilson to slash Claimants’ primary damages claim [REDACTED]

[REDACTED] These errors cast serious doubt on the integrity and reliability of Claimants’ valuation expert’s damages calculations, particularly in the absence of audited financial statements.

### **C. Claimants’ “Brand-Impairment” Analysis Does Not Analyze Impairment To Claimants’ Brands**

Mr. Wilson’s most significant error continues to be the misapplication of his principal valuation methodology, the so-called brand-impairment analysis. Mr. Wilson contends that Claimants’ primary investment in the United States consists of the Seneca and Opal brands.<sup>285</sup> According to Mr. Wilson, the damage to these brands—and hence

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<sup>282</sup> See *id.* ¶ 40.

<sup>283</sup> See *id.* Ex. 4.3.

<sup>284</sup> See *id.* ¶ 46.

<sup>285</sup> See *id.* ¶¶ 12, 15 n.6. As previously stated, the Opal brand should not be considered part of Claimants’ claim. See Counter-Mem. at 63 n.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.”).

the extent of Claimants’ alleged injury—is equal to the profits allegedly lost from Claimants’ “enterprise” in the United States as a result of the challenged measures.<sup>286</sup> As Navigant demonstrated, however, there are four fundamental problems with Mr. Wilson’s analysis.

First, Mr. Wilson failed to establish that the Seneca and Opal brands have any value that is distinct from Claimants’ underlying product. Quoting authoritative valuation texts, Navigant explained that “in order for an intangible to have economic value, it should generate some measurable amount of economic benefit to its owner” and should “potentially enhance the value of the other assets with which it is associated.”<sup>287</sup> Mr. Wilson, by contrast, finds it “rather mundane to be asking whether a brand of cigarettes with millions of dollars in sales has value and whether it enhances the value of Claimants’ other brands and products.”<sup>288</sup> Mr. Wilson’s error, Navigant explains, is conflating the value of a product with the value of a brand.<sup>289</sup> Generic aspirin, for instance, may generate millions of dollars in sales for its manufacturer, but it has (by definition) no brand value whatsoever. Like generic products—and unlike well-established premium cigarette brands such as Marlboro or Camel—discount cigarettes have little if any brand value, as they have minimal brand loyalty and compete almost exclusively on price.<sup>290</sup> Mr. Wilson, in fact, concedes this point, noting that “market shares for discount and deep discount cigarettes are three or more times as responsive to

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<sup>286</sup> See Wilson Rebuttal Report ¶¶ 12-13.

<sup>287</sup> Navigant Rebuttal Report ¶ 46 (quoting R. REILLY & R. SCHWEIHS, VALUING INTANGIBLE ASSETS 8 (1999)).

<sup>288</sup> Wilson Rebuttal Report ¶ 26.

<sup>289</sup> See Navigant Rebuttal Report ¶¶ 44, 48.

<sup>290</sup> See *id.* ¶¶ 49-52.

own-price changes as are premium market shares.”<sup>291</sup> The value of the Seneca and Opal brands, therefore, cannot be assumed as “obvious,” as Mr. Wilson would have the Tribunal believe.<sup>292</sup> That value must be proved, and Claimants have not done so.

Second, even assuming that the Seneca and Opal brands have value, the measure of that value cannot be established through lost profits. As Navigant demonstrated, evaluating lost profits may be used to establish damage to an entire *enterprise*, which is the sum of its fixed assets, organizational and distribution structure, human capital, and other tangible and intangible assets (including any brands).<sup>293</sup> A lost-profits analysis, therefore, captures impairment to far more than just a brand. By contrast, valuing the brand itself requires, for instance, looking at what a licensee would pay in royalties for the brand.<sup>294</sup> Mr. Wilson performs no such analysis.

Third, even assuming that brand value could be established through lost profits, Mr. Wilson failed to show that the challenged measures caused all of the lost profits that Claimants allege they suffered.<sup>295</sup> NAFTA Chapter Eleven requires Claimants to demonstrate that they suffered “loss or damage by reason of, or arising out of,” a specific breach.<sup>296</sup> Many factors, beyond the challenged measures, may have contributed to reduced sales of Seneca and Opal cigarettes, and hence to Claimants’ alleged lost profits. Claimants themselves, in fact, clearly acknowledge this point, observing:

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<sup>291</sup> Wilson Report ¶ 35 (quoting Frank J. Chaloupka et al., *The Role of Retail Prices and Promotions in Determining Cigarette Brand Market Share*, 28 REV. OF INDUS. ORG. 253, 253-84 (2006)).

<sup>292</sup> *Id.* ¶ 26.

<sup>293</sup> See Navigant Rebuttal Report ¶ 21.

<sup>294</sup> See *id.* ¶ 58.

<sup>295</sup> See *id.* ¶¶ 90-96.

<sup>296</sup> NAFTA arts. 1116-17.

[T]here is simply no means of accurately assessing which of the following factors, in any given state, contributed in what specific amount to the overall mean reduction in tobacco use nationally: local and state smoking bans or usage restrictions; changes in consumer tastes and preferences; public advisory campaigns; availability of cessation therapy programs; and the price-setting aspects of the MSA in a given state, as well as the various tax changes that will have been made in various jurisdictions over the same period.<sup>297</sup>

Claimants' own arguments thus belie Mr. Wilson's (erroneous) assumption that the challenged measures necessarily caused all of Claimants' lost sales, and hence their lost profits. Mr. Wilson has not even attempted to demonstrate how the challenged measures—as separate from the other factors cited by Claimants—specifically affected the value of Claimants' brands. Mr. Wilson's "brand-impairment" analysis, therefore, does not accurately capture the value of the injury Claimants allegedly suffered, and thus should be rejected.

Fourth, even assuming that the challenged measures caused all of Claimants' lost profits, Mr. Wilson nonetheless miscalculated those alleged lost profits. Mr. Wilson grossly exaggerated Claimants' lost profits from off-reservation sales by (i) ignoring major costs reported in Claimants' financials, including U.S. tax levies and overhead costs; and (ii) misallocating costs between the United States and Canada, to exaggerate the alleged profitability of Claimants' cigarettes sold off-reservation in the United States.<sup>298</sup>

Mr. Wilson also exaggerated lost profits from on-reservation sales. Mr. Wilson originally calculated that Claimants would earn over five dollars' profit from each carton of cigarettes sold. After Navigant pointed out that Mr. Wilson had failed to account for

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<sup>297</sup> Reply ¶ 59 n.44.

<sup>298</sup> See Navigant Rebuttal Report ¶¶ 27-28. Claimants' figures show that U.S. sales comprise nearly three-quarters of Claimants' overall sales volume but account for only half of Claimants' overall costs.

any costs incurred by NWS, Mr. Wilson slashed his profit calculation [REDACTED] [REDACTED]. Even that figure, however, is too high, as Mr. Wilson failed to account for USDA assessment costs on cigarette sales.<sup>300</sup> Mr. Wilson claims to have excluded those costs from his valuation because they “are in dispute due to their conflict with the rights and accords granted the Six Nations peoples under treaty.”<sup>301</sup> These charges, however, are not “in dispute” in this arbitration. Mr. Wilson’s personal belief concerning what Claimants ought to be required to pay “under treaty” should not interfere with his professional obligation to properly account for Claimants’ actual costs.

Mr. Wilson also ignores NWS’ indirect costs (depreciation, advertising, marketing, and so forth) when calculating NWS’ net profits. Mr. Wilson has not explained how an appraiser could, under any theory, calculate net profits without accounting for costs.<sup>302</sup>

Correcting for these (and other)<sup>303</sup> errors, and relying on Claimants’ own data, Navigant demonstrated that Claimants’ lost profits for off-reservation and on-reservation sales are practically zero. Thus, even if Claimants were entitled to lost profits as a result of the alleged “impairment” to their brands (which they are not), they would not be entitled to the exaggerated sums drawn up by Mr. Wilson.

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<sup>299</sup> See *id.* ¶ 32 & tbl. 5 (“Summary of Mr. Wilson’s Revised Primary Damages Estimates”); *id.* ¶¶ 106, 109.

<sup>300</sup> *Id.* ¶¶ 108-09.

<sup>301</sup> Wilson Rebuttal Report ¶ 49 (citing Arthur Montour, Jr. Second Statement ¶ 7).

<sup>302</sup> See Navigant Rebuttal Report ¶ 103-05.

<sup>303</sup> See *id.* ¶¶ 112-17 (noting Mr. Wilson’s miscalculation of Tobaccoville’s “but for” and actual off-reservation sales); *id.* ¶¶ 106-07 (summarizing Mr. Wilson’s changes to his estimate of NWS’ “but for” and actual off-reservation sales); *id.* ¶¶ 121-22 (rejecting the discount rate used by Mr. Wilson to calculate the present value of future lost profits).



#### **D. Claimants' Revised "Lost Investment" Analysis Remains Flawed**

Mr. Wilson contends that Claimants' remaining "investment" in the United States (along with the Seneca and Opal brands) consists of the physical equipment needed to produce cigarettes for the U.S. market.<sup>304</sup> Claimants initially sought [REDACTED] as the value of this equipment. After "further investigation," however, Mr. Wilson concluded that [REDACTED] of Claimants' "investment" in the United States was in fact wholly unrelated to their U.S. sales.<sup>305</sup>

Claimants now seek just over [REDACTED] for this equipment, which Mr. Wilson claims is necessary to make Claimants "whole."<sup>306</sup> But that claim is demonstrably false, for three reasons. First, the equipment continues to be owned by Claimants; it continues to be used in producing cigarettes for Claimants (including for their flourishing sales in California, New York, and elsewhere in the United States); and even if it were not used for the U.S. market, it could be sold or used for Claimants' other markets. To compensate Claimants for the "loss" of assets that they continue to own, use, and profit from would not make Claimants whole—it would give them an unwarranted windfall.

Second, even if Claimants could no longer use the equipment, Claimants cannot recover both for "lost profits" and for the equipment used to generate those alleged profits, as this "constitutes double recovery."<sup>307</sup> That is, Claimants needed to invest in the equipment in order to generate the profits that were allegedly lost, and thus cannot recover for both.

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<sup>304</sup> See Wilson Rebuttal Report ¶ 12.

<sup>305</sup> See *id.* ¶ 45.

<sup>306</sup> See *id.* ¶ 12.

<sup>307</sup> Navigant Rebuttal Report ¶ 24.

Third, Claimants cannot recover for physical assets located abroad, as they are not investments in the territory of a NAFTA party, as required by the express terms of the NAFTA.<sup>308</sup> Claimants' "lost investment" claim, therefore, must be rejected.

Even if Claimants' "lost investment" theory had merit, Claimants have provided no evidence that the equipment was purchased exclusively to serve the U.S. market. Mr. Wilson himself recognized the importance of this point in proving Claimants' claim. Earlier this year, Mr. Wilson's colleague emailed Claimants, stating: "I need to know whether this equipment was purchased solely to meet the needs of the U.S. market or if Grand River would have purchased said equipment for plant efficiency, economies of scale, normal non-U.S. growth, etc."<sup>309</sup> Although Mr. Wilson claims to have "received additional data" bearing on this question,<sup>310</sup> neither he nor Claimants have provided *any* data concerning "whether this equipment was purchased solely to meet the needs of the U.S. market." Claimants thus failed to provide the very evidence that Claimants' own expert identified as essential to proving Claimants' [REDACTED] claim. That claim, therefore, must be rejected.

#### **E. The Massive Discrepancy Between Claimants' Primary And Alternative Valuation Approaches Undermines The Reliability Of Those Approaches**

Claimants' primary damages claim sought to measure the value of the Seneca and Opal brands and the equipment used to produce the Seneca and Opal cigarettes that are sold in the United States. Claimants' alternative valuation approach purports to calculate

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<sup>308</sup> See NAFTA art. 1101(1)(b); see also *Archer Daniels Midland Award* ¶¶ 272-74 (observing that the Tribunal had jurisdiction "only to award compensation for the injury caused to Claimants in their investment made in Mexico [the host state]"); Counter-Mem. at 52 n.206 (citing additional cases).

<sup>309</sup> Based on "[i]nterviews and discussions with GRE personnel," Wilson Report ¶ 48 n.23, Mr. Wilson stated in his first report that "GRE has invested in excess of \$38 million in the plant at Oshweken, Ontario for the sole purpose of meeting what they believed were the requirements of the U.S. market." *Id.* ¶ 48.

<sup>310</sup> Wilson Rebuttal Report ¶ 45.

the present value of Claimants' increased escrow costs under the allocable share amendments. Both approaches seek, through different avenues, to capture the damage allegedly caused to Claimants' U.S. investment. The use of alternative valuation approaches is common, as it allows appraisers to test their methodologies and data. When different valuation approaches produce similar results, the appraiser can be confident of his or her results. Conversely, wildly divergent valuation results indicate problems with the appraiser's valuation methodologies or data.

Mr. Wilson's alternative valuation produced results [REDACTED] percent greater than his principal valuation.<sup>311</sup> Mr. Wilson has offered no explanation for this massive discrepancy. As Navigant observed, "[t]wo methods that allegedly quantify damages resulting from the same disputed measures . . . cannot logically be described as 'alternatives' when the results differ by over [REDACTED] percent."<sup>312</sup> In fact, when two different valuation methods result in such drastically different conclusions, one (or both) of the methods is in error.<sup>313</sup>

According to Mr. Wilson's alternative theory, Claimants are entitled to recover the difference between the amounts they are required to pay under the allocable share amendments and the amounts they claim they would have paid in escrow to the five "original states" had they been afforded "volumetric exemptions."

There are two principal flaws in Mr. Wilson's alternative valuation theory. First, Mr. Wilson assumes that Tobaccoville—not Claimants—is responsible for making the escrow payments. Tobaccoville is not a party to this arbitration, and Claimants cannot

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<sup>311</sup> See Navigant Rebuttal Report ¶ 137.

<sup>312</sup> *Id.* ¶ 137.

<sup>313</sup> See *id.* ¶ 136.

claim damages on its behalf. Furthermore, even if Mr. Wilson had correctly identified Grand River, rather than Tobaccoville, as the entity responsible for making escrow deposits, Grand River nevertheless would be barred from recovering damages for those deposits, as the United States demonstrated that Grand River's off-reservation claim is not properly before this Tribunal.<sup>314</sup>

Second, Mr. Wilson estimates the value of the "volumetric exemption" by calculating the present value of the increased escrow *costs* that Tobaccoville could avoid, rather than by calculating the present value of the incremental *profits* that Tobaccoville could earn as a result of the exemption.<sup>315</sup> Future profits are a direct measure of a company's value, and thus any "exemption value" must be derived from the incremental profits that Tobaccoville could earn, not from incremental costs that it could avoid.<sup>316</sup> If the Tribunal were to award damages based on future escrow costs that Tobaccoville might or might not incur, Tobaccoville would receive compensation [REDACTED] times greater than the value of the *entire company*.<sup>317</sup> As Navigant notes, there would be no reason for Tobaccoville to remain in business if it were to receive an award that is [REDACTED] times greater than the value of the entire company.<sup>318</sup>

In addition, as the Counter-Memorial noted, Claimants' alternative valuation theory mistakenly assumes that the escrow obligations are *payments*, not deposits.<sup>319</sup> Claimants essentially demand that the United States make Claimants' escrow payments

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<sup>314</sup> See *supra*, Section I.A.1.

<sup>315</sup> Navigant Rebuttal Report ¶ 142.

<sup>316</sup> *Id.* ¶ 144.

<sup>317</sup> *Id.*

<sup>318</sup> *Id.*

<sup>319</sup> See Counter-Mem. at 169.

for them, pay Claimants interest on those payments, and then, twenty-five years later, “return” to Claimants the principal payments made by the United States. These windfall payments, moreover, are *in addition* to any profits Claimants could make on cigarette sales in the United States.

Mr. Wilson’s damage calculations are, on their face, unsound. United States taxpayers are being asked to pay hundreds of millions of dollars for demonstrably erroneous claims based on “evidence” that has not been made available or that is incomplete, contradictory, erroneous, uncorroborated or otherwise unreliable. Claimants have failed to meet their burden of proving damages, and their claims should be rejected.

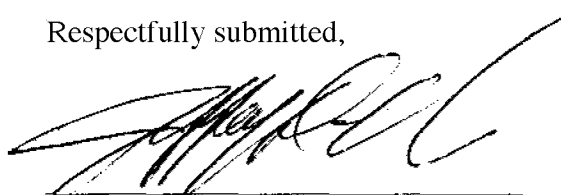
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**RELIEF SOUGHT**

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: May 13, 2009

Respectfully submitted,



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