UNDER THE ARBITRATION RULES OF THE

UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

AND

THE NORTH AMERICAN FREE TRADE AGREEMENT

BETWEEN:

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

CLAIMANTS/INVESTORS

-AND-

GOVERNMENT OF THE UNITED STATES OF AMERICA

RESPONDENT/PARTY

CLAIMANTS' REPLY MEMORIAL
MERITS PHASE

3 MARCH 2009

I. INTRODUCTION

1. Claimants seek damages for the harm caused to them as investors and the harm caused to their investments as a result of Respondent's continuing breach of NAFTA Articles 1102, 1103, 1105 and 1110. In its Counter-Memorial, Respondent altogether ignores or mischaracterizes the facts establishing the business relationship amongst the Claimants; repudiates more than 200 years of history concerning the rights and privileges of Native Americans; suggests that unsupported economic theory and speculative allegations should be accepted over demonstrated facts; and implicitly justifies its NAFTA breaches on discredited policy arguments concerning public health.

2. In dismissing the entirety of Respondent's opposition, the Tribunal need look no further than the fact 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 favoured companies, who are permitted to produce and sell nearly 16 billion cigarettes, per year, without any payment being required. Respondent's arguments are logically and factually inconsistent. It says that its measures were necessary to achieve a "level playing field" for all manufacturers, but their impact creates two tiers of competitors: the grandfathered enterprise, which enjoys a permanent exemption and the rest, who are burdened with what Respondent claims are equal payments.

3. Respondent never justifies the grounds upon which it demands payment, or why Claimants should be forced to compete on the same so-called playing field as the large, multinational corporations that it continues to accuse of having engaged in widespread and well-coordinated strategies of fraud and deceit. Nor does it explain why

its measures still provide one of the very companies it accuses of persistent fraud and evasion, Liggett Group PLC, with a permanent exemption from making payments on millions of dollars worth of its brand of cigarettes annually.

4. Respondent's arguments concerning the threshold matters of "investor" and "investment" are dependent upon a selective parsing of the facts that in no way reflects the true nature of Claimants' business enterprise. As Claimants' Public International Law Expert, Maurice Mendelson, Q.C., has concluded, the facts viewed in their entirety demonstrate: (i) that the collaborative manner in which the Claimants' conducted their enterprise renders them "investors" within the meaning of NAFTA; and (ii) that, even separately, the Claimants' varied and longstanding contributions of capital and labour in their trademarked and proprietary brands constitutes an "investment" in the United States within the meaning of NAFTA. Respondent's mischaracterization of the facts of the case does not obscure the fact that Claimants have demonstrated the existence of a substantial investment in the territory of the United States.

5. Respondent also dismisses as "extraordinary" the various means by which Claimants demand vindication of their rights as indigenous investors in general, and as Haudenosee members in particular. The reluctance of Respondent to acknowledge it, does not change the stubborn fact that the Claimants' status as Native Americans under both United States and international law, and the conduct of their enterprise on sovereign Indian land in the United States, is a determining factor in several of the legal issues presented to the Tribunal. Indeed, through its consular web site Respondent admits that although an Indian may have been born in Canada, and therefore have Canadian

citizenship, he is to be treated as an "American Indian" under United States law.[1] Respondent's seeming withdrawal from its own position before the Tribunal – simply because it is faced with an international damages claim by Native Americans who are nationals of Canada – is nothing short of disturbing.

6. As demonstrated by the materials submitted in support of Claimants' Memorial, the regulatory scheme put in place by Respondent imposes discriminatory payment burdens on Claimants in comparison to competing tobacco companies in the United States. Respondent tries to refute that charge with the expert testimony of Jonathan Gruber. That effort fails on two counts. First, Professor Gruber's use of marginal cost theory, without accommodation for the exempt volumes of the grandfathered SPM or those additional taxes that are imposed exclusively on NPM, impairs his conclusions. Moreover, the evidence of actual pricing in the marketplace contradicts and necessarily trumps Professor Gruber's theoretical pricing assumptions. Second, as Claimants' economists further show, Professor Gruber opines, at best disingenuously, on the "economic cost" of escrow payments without considering such obvious economic factors as tax consequences or timing of payments.

7. Respondent's efforts to describe the MSA and its resulting regulatory apparatus as a crowning achievement in public health promotion is nothing more than the same tired, political self-promotion put forth by various State officials over the years to justify what has best been described as a base profit sharing arrangement between themselves and the major tobacco companies. Fortunately, the untruth of these self-

[1] http://www.consular.canada.usembassy.gov/first_nations_canada.asp, Reply Evidentiary Submissions Ex.40.

serving claims has long since been exposed by scores of commentators, and government authorities who have brought those facts to light in discussing the dismissal record of the states' failure to use the MSA payments to fund smoking-related causes, as well as the diminished impact that the MSA has had on public health under a regime that, when scrutinized closely, is little more than a profit-sharing relationship between the states and the major tobacco companies. In this regard, it is ironic for Respondent to be comparing Claimants' relationship to a "joint venture."

8. Indeed, it is that very relationship between the states and the MSA's manufacturers, and the fact that the states' MSA revenues remain contingent upon the unfettered success of those companies that drove the States to adopt the very measures at issue. The states may reach for the fig leaf of public health concerns when it suits them, but the contemporaneous documents authored by state officials overwhelmingly establish that the measures at issue were enacted to hobble businesses such as Claimants' and to protect the states' revenue streams under the MSA. Express admissions by Respondent's states will further demonstrate the folly to such arguments. Imagine the State of Oklahoma claiming that a carton of cigarettes costs the State $5.70 in health care costs, just prior to its increasing the State excise cigarette tax to over $10.00 per carton, or the State of New York claiming that it incurs $600 million in smoking-related health care costs, while earning almost $1.2 billion from cigarette excise taxes.[2]

9. Where is the justification, then, for Respondent's states to demand (through the Allocable Share Amendment) an additional $480,000,000 per year from

[2] Appellee's Brief of W.A. Drew Edmondson, Reply Evidentiary Submissions Ex.58, and NYC Cigarette Tax Hike Article, Reply Evidentiary Submissions Ex. 59.

companies such as Claimants alone, when no similar increase (or any increase) is imposed on manufacturers enjoying "grandfathered" exemption status under the MSA? In contrast, state cigarette excise taxes are imposed ***equally*** on the products of all enterprises, without regard to some "grandfather" status, or an exception for same. How, the Tribunal should ask, can Respondent's states practice favouritism for a small group of companies under the MSA regime (under the ruse of promoting public health), when a far more efficient, far less complicated, and non-discriminatory, alternative exists in a general sales or excise tax?

10. As the evidence before this Tribunal establishes, Respondent's states' overzealous and illegal enforcement of their measures on-reserve, combined with their blatantly and unjustifiably discriminatory treatment of Claimants, vis-à-vis exempt tobacco companies, have both caused and continue to cause damages to Claimants and their investments, causing them to spend millions of dollars in their defence and shoulder unsustainable, discriminatory payment burdens.

II. FACTS

A. <u>The Investors and Their Investment Enterprise in the United States</u>

11. At pages 33 to 34 of the Counter Memorial, Respondent relies upon the opinion of its experts, Professors Isenbergh and Green, for the allegation that "the only way Grand River Enterprises can remain beyond the reach of U.S. taxation … is if Grand River's relationship to NTD/NWS and Tobaccoville falls outside the bounds of any form of partnership or joint venture." At the risk of stating the obvious, that is beside the point. This is neither a U.S. tax court, nor a Canada-U.S. Tax Treaty, matter and Claimants make no such assertions in this proceeding.

12. The relationship between the individual Claimants, and the enterprises they own and control, constitutes a business association between a Seneca Nation Member and other full-blooded Haudenosaunee, which is operated on and from First Nations land and sovereign Seneca Nation territory.[3] As explained in further detail below, and in the accompanying report of Prof. Mendelson, this business association is recognized as an enterprise under applicable law: the law of the Seneca Nation.[4]

13. Claimants' enterprise does not constitute either a partnership or joint venture under United States "tax" law. In any event, United States "tax" law does not provide the litmus test for determining whether two or more persons or entities have – under the NAFTA or international law – formed an enterprise or agreed to associate for purposes of furthering a common, or mutually beneficial, business interest. Respondent's virtual "side show" on this score reflects the entirety of their mannerisms throughout, in failing to treat seriously, or otherwise side-step, the core facts and damages at issue in these proceedings – and those tactics are consistent with Respondent's history in dealing with Native Americans, including Six Nations peoples.

14. Significantly, while Respondent chooses to focus on U.S. tax law for its characterization of the sort of investment it does not think Claimants have established, Claimaints have long since defined their own relationship within the context of their own custom and law. Thus, the Cigarette Manufacturing Agreement that was originally entered into among Claimants and an additional investor ([redacted]), which was later

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[3] Witness Statement of Arthur Montour, Complainants' Memorial, 7/10/08, Ex. 3; Second Witness Statement of Arthur Montour, at ¶ 4, Reply Evidentiary Submissions Ex. 8; and Seneca Nation Business Code, Reply Evidentiary Submissions Ex. 12.
[4] Expert Opinion of Professor Maurice Mendelson, Q.C., Reply Evidentiary Submissions Ex. 3.

assigned by Native American Company to NWS, expressly provides that it "shall be made and construed in accordance with the laws of the Seneca Nation and the laws of Six Nations."[5]

15. Claimants' business association is built upon the cross-licensing of trademarks; licenses to manufacture and distribute; collaborative efforts to develop a brand, brand image and brand loyalty; financial assistance afforded by GRE; and GRE's willingness to subordinate its liens and individual rights for the benefit of the enterprise and its brands.[6] All of these efforts were undertaken for the undisputed purpose of growing the investments of this enterprise in the United States.[7]

16. Similarly, there can be no serious question that the Seneca® and Opal® brands and associated intellectual property and rights constitute an "investment" within the meaning of NAFTA. There is no dispute that the various Claimants over a period of many years invested capital, property, labour and other resources in the United States market in furtherance of these brands and their enterprise.[8] Moreover, there is clear evidence in the record before the Tribunal as to the importance of a brand and brand loyalty in the tobacco industry.[9] Indeed, even Respondent's states recognize that cigarette brands are assets (*i.e.,* investments into which investors contribute capital, labour, and resources for the purpose of achieving growth and return on that capital,

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[5] Cigarette Manufacturing Agreement, ¶ 13, Reply Evidentiary Submissions Ex. 13.

[6] See Second Witness Statement of Jerry Montour, at ¶¶ 1, 3-4, Reply Evidentiary Submissions Ex. 7; Second Witness Statement of Arthur Akwiraienton Montour, at ¶¶ 18-22, Reply Evidentiary Submissions Ex. 8.

[7] See Second Witness Statement of Jerry Montour, at ¶ 1, Reply Evidentiary Submissions Ex. 7.

[8] See Second Witness Statement of Jerry Montour, at ¶¶ 1, 3, 6-13, Reply Evidentiary Submissions Ex. 7; Second Witness Statement of Arthur Akwiraienton Montour, at ¶¶ 18-22, Reply Evidentiary Submissions Ex. 8.

[9] Second Witness Statement of Jerry Montour, at ¶¶ 1, 7, Reply Evidentiary Submissions Ex. 7.

labour, and resources) as they have demanded, and taken, security interests in certain brands of MSA manufacturers to securitize the latter's payment obligations under the MSA.[10]

17. To circumvent the foregoing, Respondent would have the Tribunal accept an absurd argument, *i.e.*, that Claimants have successful trademarks and intellectual property rights in the United States, but that they do not constitute, nor could be the product of, Claimants' investment in the territory of the United States. Contrary to what Respondent would seemingly have the Tribunal believe, these assets and investments did not just magically appear, or present themselves as windfall gifts to Claimants. To even mention the tortuous premises upon which Respondent's theories of investment are based is to expose its folly.

18. Respondent's twisted and misplaced arguments do not cease in the context of defining the term "investment" under the NAFTA. Rather, they carry over to its persistent refusal to acknowledge Mr. Arthur Montour's lineage, culture and heritage. While no damage could ever recompense Mr. Montour for these aspersions, an apology for Respondent's reckless disregard of Mr. Montour's human rights would appear to be in order. Respondent and its expert witness, Professor Goldberg, appear to maintain some misgivings about whether Arthur Montour is legitimately a member of the Seneca Nation.[11] Their confusion may arise from a lack of awareness of three factors. First, as Haudenosaunee lineage is maternal, rather than paternal, Mr. Montour's national and clan

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[10] See Second Witness Statement of Jerry Montour, at ¶ 30, Reply Evidentiary Submissions Ex. 7.

[11] See: page 31 of the Counter Memorial, 12/22/08; and notes 1 and 7, and page 21, of the Expert Report of Prof. Carol Goldberg.

membership are determined by his Seneca mother's lineage rather than his Mohawk father.[12] Second, they may have forgotten that Mr. Montour served as an elected member of the legislative chamber for the Seneca Nation for four years.[13]

19. Third, and finally, they appear to have neglected to consult section 289 of the U.S. Immigration and Naturalization Act, which represents the partial codification of Respondent's obligations under the 1794 *Jay Treaty* towards the Haudenosaunee and other Indian Nations whose traditional homelands were divided by the border between Canada and United States, in providing:

> Nothing in this title shall be construed to affect **<u>the right of American Indians born in Canada</u>** to pass the borders of the United States, but such right shall extend only to persons who possess at least 50 per centum of blood of the American Indian race. [**<u>emphasis added</u>**]

B. <u>On Reserve Sales</u>

20. At page 43 of the Counter Memorial, Respondent seeks to isolate Claimants as the only apparent 'troublemakers' in Indian Country, citing the witness statement of a lawyer who serves in the office of the Idaho Attorney General, Mr. Delange. In fact, there is no difference between Claimants and the other Native American-owned tobacco enterprises mentioned by Mr. Delange.[14] Each of them rely upon the good faith of the Attorney General in each state to abide by Respondent's

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[12] Second Witness Statement of Arthur Akwiraienton Montour, at ¶ 2, Reply Evidentiary Submissions Ex. 8.
[13] Second Witness Statement of Arthur Akwiraienton Montour, at ¶ 4, Reply Evidentiary Submissions Ex. 8.
[14] See Second Witness Statement of Jerry Montour, at ¶ 36, Reply Evidentiary Submissions Ex. 7.

international law, constitutional law and treaty commitments, which safeguard their trading rights between and among sovereign Indian Nations.[15]

21. For example, much like Claimants' Seneca® brand, the Native® and Smokin' Joe's® brands of cigarette are also produced on Haudenosaunee territory (on the Akwesasne Territory of the Mohawk Nation and on the Tuscarora Nation Territory, respectively). Both of these enterprises, or their customers, are obliged to pay for, and affix, tribal tax stamps, as mandated by the Sovereign responsible for the territory in which they are sold. While the political impetus to subject Native Americans and their Nations to inappropriate state regulation and taxation is often present, at the moment it appears that none of these three successful Haudenosaunee tobacco enterprises are being subjected to demands for escrow payments by the State of New York, nor for that matter does it appear that Mr. Delange's State of Idaho is making such demand for the Native® brand.[16]

22. Mr. Delange offers no evidence to suggest that any of the enterprises he mentions operates with a different set of expectations than the Investors in this case. That is, each enterprise likely also struggles to remain compliant with escrow demands, albeit often under protest, just like the Investors in this case.[17]

23. For example, submitted as Reply Evidentiary Submissions Exhibit 14 is the record of a United States District Court Eastern District of Washington proceeding, in

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[15] Second Witness Statement of Arthur Akwiraienton Montour, at ¶ 11, Reply Evidentiary Submissions Ex. 8.

[16] See Mr. Delange's letter to counsel for the Native® brand, stating that no escrow is due for that brand sold in Idaho, Respondent's Counter Memorial, 12/22/08, Ex. 1, at Ex. F thereto.

[17] Witness Statement of Jerry Montour, at ¶¶ 52-56, Claimants Memorial, 7/10/08, Ex. 1; Second Witness Statement of Jerry Montour, at ¶ 37, Reply Evidentiary Submissions Ex. 7.

which the Yakama Nation was granted a temporary restraining order as against the State of Washington. The dispute arises from the refusal of state officials to accept the legal principle that they cannot unilaterally impose state tax stamp obligations (which would also trigger Escrow Statute obligations) upon members of the sovereign Yakama Nation. One of the enterprises mentioned by Mr. Delange in his statement, King Mountain Tobacco Company, is located on Yakama Nation territory.[18]

24. Another example can be found in the Skydancer® brand, which is produced by the Seneca-Cayuga Tribe on its tribal land within the geographic borders of Oklahoma. In his statement, Mr. Delange says that the Skydancer® brand is on Idaho's certified list. It may have been on Idaho's approved list two months ago, but it is **not** on the list today.[19] This is a perfect demonstration of the instability and unpredictability that has become the norm in the tobacco business, in many states, as a result of uneven reporting; incomplete administration; double counting problems; and uneven, and even sometimes contradictory, enforcement of MSA measures with respect to sales taking place on Native American land.

25. To be clear, while Mr. Delange was likely correct when he said that the Skydancer brand was certified for sale throughout Idaho in November, it would appear to be contraband today. Such uncertainty does great harm to any brand in the discount tier, because wholesalers and retailers understand that delisting can happen at any time, but their customers expect a product that is consistently available – which is why they are

[18] [redacted]

[19] http://www2.state.id.us/ag/consumer/tobacco/manufacturer_directory.htm; accessed February 18, 2009, Reply Evidentiary Submissions Ex. 15.

often willing to purchase the heavily discounted and promoted discount brand of a Grandfathered SPM.[20]

26. It appears that, apparently unbeknownst to Mr. Delange, the Seneca Cayuga have recently been involved in three lawsuits involving the enforcement of three different Escrow Statutes. The Tribe has recently sued the Oklahoma Attorney General in response to some of that office's alleged escrow enforcement activities. The Tribe is also a new defendant in a case just brought by the Office of the Attorney General for Nebraska, for alleged payments owing under its Escrow Statute. In addition, the Attorney General for Tennessee indicated in his 2007 annual report that his office had been pursuing an escrow claim against the Tribe for escrow payments arising from alleged sales of the Skydancer® brand in his state as well.[21]

27. The point is that there is nothing unique about Claimants or their legitimate expectations that state government measures cannot lawfully be applied to the on-reserve tobacco trade of Native Americans.[22] Native American tobacco enterprises naturally seek to avoid becoming the target of state government demands and legal actions, and will even participate in protested settlements in order to keep doing business when States, such as Oklahoma, choose to violate Respondent's constitutional, treaty and

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[20] See Second Witness Statement of Marvin Wesley, at ¶¶ 1-2 (noting same in connection with Mr. Wesley's experience working for Liggett), Reply Evidentiary Submissions Ex. 10.

[21] http://www.tulsaworld.com/news/article.aspx?articleID=070908_1_A11_hTheS51254, Reply Evidentiary Submissions Ex. 16; http://www.tulsaworld.com/news/article.aspx?articleID=070905_1_A1_spanc87386, Reply Evidentiary Submissions Ex. 17; http://journalstar.com/articles/2008/02/06/news/local/doc47a9084aa9820487766380.txt, Reply Evidentiary Submissions Ex. 18; http://www.aoc.state.nc.us/www/public/coa/dsheets/080812-1.htm, Reply Evidentiary Submissions Ex. 19; all accessed February 18, 2009.

[22] Second Witness Statement of Jerry Montour, at ¶ 36, Reply Evidentiary Submissions Ex. 7.

international law obligations in respect of Native American commerce.[23] It is disingenuous to confuse such self-interested compliance, under protest, with any sort of agreement on, or acquiescence to, the fundamental question of whether Mr. Delange can legitimately enforce his state's Escrow Statutes against the on-reserve sales of Claimants or any other Native American tobacco enterprise. Even more disturbing on this point is that earlier memoranda authored by Mr. Delange's office and the States' agents (which have been withheld from production in this case) espouse a position that is contrary to the dogmatic and dispositive claim Mr. Delange puts forth in his statement. Indeed, the memoranda report that the applicability of the States' Escrow laws to sales on Indian Country is not certain.[24] Also troubling is the opinion letter of Respondent's own Department of Justice, which advises (in the context of Nebraska's tobacco regulations) that there are indeed instances where the State has no jurisdiction to tax the sale of tobacco products in Indian Country.[25]

C. <u>Amendments to Eliminate the Allocable Share Release Mechanisms</u>

28. At pages 23 to 29 of the Counter Memorial, Respondent attempts to recast the imposition of the Allocable Share Amendments as a necessary change to address a costly and unforeseen, and yet apparently foreseeable, "loophole." There are many flaws in Respondent's theory of the facts, but by far the most egregious is Respondent's claim that the allocable share releases had to be eliminated because they were unintentionally providing an unfair competitive advantage to NPMs, vis-à-vis the burdens being

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[23] See Second Witness Statement of Jerry Montour, at ¶ 37, Reply Evidentiary Submissions Ex. 7.

[24] Idaho Tobacco and Indian Country Memoranda of May 2004 and August 2006, Reply Evidentiary Submissions Ex. 60.

[25] U.S. Department of Justice Memoranda regarding Cigarettes and Taxation, Reply Evidentiary Submissions Ex. 52.

shouldered by OPMs and SPMs under the MSA. The contradiction is manifest. How can Respondent, assisted by its expert, Professor Gruber, claim that MSA payment exemptions, enjoyed by Grandfathered SPMs such as Liggett, do not constitute a competitive advantage that permits them to compete more effectively on price, while simultaneously taking the position that an NPM's entitlement to an allocable share release, for sales of a regional brand, does constitute a competitive advantage that allows it to compete more effectively on price?

29. Throughout this section of the Counter Memorial, Respondent repeatedly refers to the so-called intent of those who drafted the MSA and the model Escrow Statute, but it provides no contemporaneous evidence to support these claims. Respondent chose not to disclose any of the memoranda, or emails, or minutes of meetings sought by Claimants in this arbitration, which would have revealed what was really on the minds of the drafters at the time the MSA was concluded, and as the Contraband Laws and Allocable Share Amendments were conceived and implemented.[26] Having failed to produce the requested evidence, which would have gone directly to the veracity of its claims, Respondent can only offer its own, post hoc commentary about the Escrow Statutes containing a "loophole" that had become the subject of abuse by Claimants and other so-called NPMs.

[26] In fact, these officials have claimed an inability to remember any facts when Claimants, by permission of Court Order, asked specifically about the contents of those discussions. Contemporaneous accounts of those negotiations paint an entirely different picture and expose the truth behind the measures at issue, *i.e.,* they were designed to shunt and stamp out competition from persons and entities like Claimants and their enterprises. See Deposition on Written Questions of Christine Gregoire with Responses, Reply Evidentiary Submissions Ex.61; Robert Sullivan, "Ten Years Later, Tobacco Deal Going Up in Smoke" MSNBC.com, November 21, 2008; http://redtape.msnbc.com/2008/11/ten-years-later.html; accessed January 10, 2009, Reply Evidentiary Submissions Ex. 26.

30. At page 106 of the Counter Memorial, however, Respondent offers a contradictory view of the facts, which distilled to its essence, presents the crux and entirety of Respondent's defence to this case. Respondent states: "where an industry is already highly regulated, reasonable extensions of those regulations are foreseeable." Assuming, *arguendo*, that one could actually characterize the Allocable Share Amendments as reasonable, how can Respondent argue that Claimants could have foreseen that their regional brand strategy was not supposed to be allowed under the Escrow Statutes when Respondent's own state officials – who drafted the scheme – were allegedly caught unaware as to the existence of this apparently obvious "loophole"?

31. This is the same regime that provided a grandfathered exemption for an otherwise undefined group of companies whose brands were direct competitors with the Seneca® and Opal® brands in the same market place. This is also the same regime that – at least in theory – was not supposed to apply to sales of Native American tobacco brands, Native American sovereigns, their members and their enterprises. How, therefore, would it be so unreasonable for Claimants to have expected that provision was also made for producers of regional brands to only pay into escrow amounts that were reflective of the allocable share of MSA payments that would otherwise be due to the small number of states in which the brand was actually being sold?

32. To be sure, Respondent has failed to produce any internal documents of the states that characterize allocable share release as a loophole. Nor has Respondent produced any documents that identify when the states first realized the existence of this claimed loophole. Given the magnitude of the work performed on structuring the MSA by some of the highest paid lawyers in the world, the notion of a "loophole" of this

magnitude seems a bit incredible. In the face of Respondent's refusal to produce relevant documents on the subject, it is hardly Claimants' burden to establish why the Allocable Share Release might have first been intentionally included in the Escrow Statute, but one obvious possibility is that the absence of the release mechanism exposes the escrow statutes to formidable arguments that they violate the Equal Protection and Commerce Clauses of the United States Constitution because they have extra-territorial effects beyond the borders of the enacting state.[27] Of course, contemporaneous documents in the possession of Respondent would establish the facts in this regard, but the Tribunal will not see those documents. Respondent's decision to withhold documents demonstrating the *bona fides* of its claim of a loophole should be construed, by means of negative inference, as evidence that the parties to the MSA intended to create precisely the regional exemption found in the Allocable Share Release.

33. While the Respondent has managed to keep the truth from this Tribunal concerning the original reason for the Allocable Share Release, the same cannot be said for the reason why it was repealed. This reason is evidenced in the few contemporaneous documents that Respondent was not able to withhold. For example, the following research note from an analyst at Merrill Lynch provides an unvarnished view of why the Allocable Share Amendments were imposed at the time:

> Currently the NPM (non-compliant participating manufacturer) model statue (exhibit T of the MSA) states that if a NPM pays more to a state on a per unit basis than the state would have received if that NPM were a signor on the MSA, then the state must refund the difference. This is often referred to as the "cap release", This new legislation would modify the MSA and eliminate the "cap release", thus requiring a compliant NPM to

[27] Grand River Enterprises Six Nations, Ltd v. Pryor, 425 F.3d 158 (2d Cir. 2005), Reply Evidentiary Submissions Ex. 20.

> pay more per unit basis than all OPM's (original participating manufacturer) and SPM's (subsequent participating manufacturer). The purpose of this legislation is to force the compliant NPM's to drastically increase their prices, (5 states have passed this legislation: Idaho, Montana, Vermont, Washington and West Virginia.)"[28]

34. As made plain by the discussion at ¶¶ 73-80 of Claimant's Memorial and the statements of Respondent's representatives cited therein, the States wanted to force Claimants to raise their prices for brands such as Seneca® because sales of such brands were diminishing OPM market share and thereby lowering payments under the MSA received by the States. Respondent's witnesses may try to wrap themselves in the protection of otherwise laudable public health goals in trying to justify the need for allocable share amendments, but they cannot do so credibly because their own contemporaneous documents demonstrate such protestations to be false.

35. At page 27 of the Counter Memorial, Respondent further disingenuously suggests that the Allocable Share Amendments "created a more equitable framework for all tobacco manufacturers participating in the US market..." allegedly because these measures would prevent an NPM from obtaining an immediate release of escrow funds through concentrating establishment and growth of its brand in only a handful of states. However, in one of the few regular meetings between state officials and the OPMs and Grandfathered SPMs, that has been forced onto the public record, a NAAG official named Mark Greenwald was much more candid about the need for the measure, stating:

[28] Merrill Lynch Global Securities Research, Tobacco Reseller Trial in California Imminent, Email, June 13, 2003, at 55050-8946, Reply Evidentiary Submissions Ex. 21.

"States' allocable share objective is to impose escrow obligations on NPMs equal to that imposed on an SPM without grandfathered market share."[29]

36. That emphasis by Mr. Greenwald on "SPM without grandfathered market share" is at the very heart of this dispute and directly contradicts the testimony of Respondent's economist, Jonathan Gruber. Recall that Claimants' assert that the repeal of the Allocable Share Release put them at a substantial disadvantage vis-à-vis the exempt or grandfathered SPM – those SPM that do not have to pay MSA costs on a substantial portion of their volume. That assertion by Claimants is entirely consistent with Mr. Greenwald's unremarkable statement that it was the intent of the Allocable Share Amendments to impose an escrow obligation upon NPM equal to that imposed upon an SPM *without* grandfathered market share. Professor Gruber on the other hand conflates the MSA costs of exempt SPM and non-exempt SPM by arguing that marginal cost theory renders the MSA exemption irrelevant for competitive purposes.

37. Apart from being empirically contradicted by the work in this matter by Claimants' experts, Drs. Eisenstadt and Dalkir, Professor Gruber's views on the subject, by his own admission, are not informed by any actual knowledge of pricing behaviour in the discount segment of the tobacco market. Indeed, published statements by Liggett, an exempt SPM, reveal that it did use its exemption as a competitive tool to reduce price and gain share from competitors such as Claimants.[30] Moreover, uncontroverted witness statements from persons with actual knowledge of the relevant pricing strategies of

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[29] January 25, 2004 Meeting Minutes, Reply Evidentiary Submissions Ex. 22
[30] Liggett Form 10-K, Reply Evidentiary Submissions Ex. 57.

exempt SPM, reveal that they used their exemption to lower prices to blunt competition from NPM's burdened by full escrow payments.[31]

38. That is not the only subject upon which Professor Gruber is demonstrably wrong. In his report at p 8, Professor Gruber states that merely making escrow payments is somehow an advantage to, and "economically less costly" than making tax-like MSA payments. As the Rebuttal Report of Dr. Eisenstadt shows, that is, at best, a disingenuous statement. When all the factors that comprise economic cost such as tax consequences and timing of payments are considered, escrow payments are more accurately described as economically *more* costly, not less costly as Professor Gruber opines.[32]

39. Moreover, Professor Gruber's idea of a level playing field is premised on a very flawed assumption: i.e. that NPMs could actually be found liable in a U.S. court to pay state-funded health care costs attributable to sales of their brands in that state. Respondent says that the Allocable Share Amendments were necessary to ensure that states could recover their health care costs from NPMs without having to chase them for payment, but it does not – and cannot – explain the basis upon which states would be entitled to recover those costs in the first place or, more importantly, why exempt SPM do not have to pay any of those costs for almost half of all cigarettes they sell.

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[31] Second Affidavit of Larry Phillips, at ¶¶ 6-10, Reply Evidentiary Submissions Ex. 9; Second Witness Statement of Marvin Wesley, at ¶¶ 3-6, Reply Evidentiary Submissions Ex. 10.

[32] Eisenstadt Rebuttal Report, Reply Evidentiary Submissions Ex. 6. In addition, the Respondent's states, with the assistance of the OPM, have managed to keep from this Tribunal prior statements of Professor Gruber that would further impeach his testimony in this matter. Claimants have made an application to the federal court requesting that it lift an order of confidentiality in respect of such statements and Claimants reserve the right to introduce such statements at the hearing in this matter if such application is granted.

40. Until Respondent can provide 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 obligation upon them.[33] If there is no reason for them to be forced to make escrow payments in the first place, there is similarly no justification for withholding release of the entire portion of escrow payments made to a state that would not eventually be available to satisfy a judgment obtained by that state against the escrow account holder. Respondent cannot prove the existence of an obligation that would justify requiring escrow payments by fiat. It must provide sufficient and compelling evidence. An additional flaw in Professor Gruber's rebuttal is that he fails to opine – and cannot do so – as to whether the disparate treatment of Claimants in comparison to Exempt SPM constitutes expropriation or discrimination under the NAFTA. His views are entirely directed to U.S. competition law. Indeed, he candidly admits that Exempt SPM are treated differently and more favourably than NPM: at a minimum, Exempt SPM enjoy a subsidy – an extra pool of funds that applies to their bottom line profit – which is not available or provided to NPM such as Grand River.

41. At pages 27 to 29 of the Counter Memorial, Respondent adopts a similar approach in response to the fact that the MSA states failed to consult indigenous peoples

[33] To clarify, Claimants do not now seek damages for being forced to make proportionate escrow payments to states in which their brand was established for off-reserve sales. They invested in establishing their brands in these states with knowledge that proportionate escrow payments would be due to those states, and they were prepared to abide by those conditions as a cost of doing business. This does not mean, however, that imposition of the escrow obligation was ever justified. Rather, particularly as a consequence of the Tribunal's Decision on Jurisdiction concerning the time limitations imposed under the NAFTA, Claimants are deemed to have taken the market as they found it in each of these states, including the barriers to entry imposed by state governments (i.e. the proportionate escrow payments that were due under the original Escrow Statutes).

affected by imposition of the Allocable Share Amendments, or bargain with them in good faith over their vested rights in brands established under the old rules.[34] That is, Respondent ignores these facts altogether. All that Respondent appears willing to say about the consultation efforts of its state level officials is that some of them submitted the uniform amendments they proposed for their Model Escrow Statutes to legislative committees which would have rubber-stamped the pre-ordained result after allowing for a modicum of public debate. It makes repeated mention of one wholly unrelated, third party organization, called "CITMA" but it provides no reports of consultations or negotiations with sovereign Indian Nations or with their investors or investments.

42. In fact, whatever little debate existed on the subject reflected clear exasperation of legislative officials with the degree and extent to which the State Attorneys General were going to protect the market shares of manufacturers that negotiated and signed the MSA. As State Senator Erdman of Nebraska commented after a lengthy explanation of the need for the Allocable Share Amendments by a Nebraska Assistant Attorney General: "Which is a really nice way of saying we got to protect big Tobacco so we get our money."[35]

D. Respondent Fails to Demonstrate Necessity of Its Measures

43. At pages 6 to 11 of the Counter Memorial, Respondent provides its description of how the MSA operated. It starts, however, by citing a 2004 estimate from the Centers for Disease Control and Prevention (CDC) of the average, annual amount of

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[34] See Second Witness Statement of Jerry Montour, at ¶¶ 25-35, Reply Evidentiary Submissions Ex. 7.

[35] Transcript of Hearing before Committee on Health and Human Services, January 23, 2004, Reply Evidentiary Submissions Ex. 25.

health care costs and lost productivity arising from consumer tobacco use in the United States. Without explanation, Respondent appears to believe that this figure essentially reflects 'the tab' that must be paid by producers of tobacco products as a part of doing business. Absolutely no attempt is made to explain how, absent imposition of the measures at issue in this arbitration, Claimant would be legally obliged to make those payments *to a state government* in relation to this CDC estimate. That is, "the tab" Respondent is referring to includes the costs born by the federal government, individual smokers, private insurers and employers, for example, that incur lost productivity costs when employees are absent from work due to smoking related sickness. ***None*** of that cost is borne by Respondent's States or recoverable by Respondent's States. In fact, Respondent's Department of Justice, as well as individual smokers, and pension funds and insurance companies have all sued tobacco manufacturers to recoup such costs in their own right, and the MSA payments provided no offset to such charges.

44. Again, at pages 15 to 16 of the Counter Memorial, Respondent refers to the measures at issue in this arbitration as being necessary to prevent NPMs "from [exploiting] their ability to operate outside of the restrictions of the MSA while imposing unrecoverable health care costs on the states." Respondent also claims that the escrow statute requires the establishment of accounts that "provide security for potential future damages resulting from the sale and use of the NPM's tobacco products." Respondent nowhere explains how or why health care costs would be "recoverable" against NPMs generally, much less against Claimants in particular.[36] "Recoverability" is simply

[36] On a political level, common sense suggests that the producer of a product or service whose use poses negative economic externalities (such the producer of automobiles or alcohol or the operator of a ski resort) can expect to see taxes imposed upon sales of its particular brand of

assumed without any evidence or justification. Significantly, Respondent has presented no evidence that Claimants have performed any of the conduct of which the OPM were accused.

45. At page 7, Respondent states that the MSA was concluded to settle lawsuits that "included several causes of action premised on the dangers and health effects inherent in the use and sale of tobacco products." It then names grounds for these lawsuits such as product liability, nuisance and breach of implied warranty, before adding that these lawsuits also included claims that the defendants in those cases (the OPMs and the Grandfathered SPM, Liggett) were guilty of fraud, conspiracy and racketeering. Respondent neglects to mention, however, that there is no decided case – anywhere in the United States – supporting the proposition that a tobacco brand owner, manufacturer or distributor is liable to reimburse a state government for a portion of the costs of health care it has provided to its citizens. There is no implied warranty case; no negligent product liability case; no nuisance case, etc. upon which a single governmental entity has established that a tobacco company must pay it for providing health care to its citizens. In fact, every case that has decided the merits of such a novel cost-recoupment theory has been flatly rejected by the Courts.

46. Respondent also fails to include any allegations that could be used as the basis of establishing that any of the causes of action it lists could be pursued against

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product, which might be seen as indirectly addressing the alleged externality. Claimants' brands of tobacco product are taxed in virtually every jurisdiction in which they are sold. It is possible, therefore, that Respondent is likening the MSA – and by extension, the legislative measures and enforcement proceedings at issue in this case – to a tax. However, the description it proceeds to supply is of a litigation settlement involving third parties to Claimants; not a tax that would be applied equally across the board.

Claimants. There is also no mention of any lawsuits ever having been filed by a U.S. governmental body against Claimants for recovery of such costs. There is accordingly no allegation that a judgment has been obtained against Claimants establishing their liability to reimburse a state government for its healthcare costs, or any mention of settlement negotiations involving Claimants and a U.S. governmental body.

47. Also missing from Respondent's description of the operation of the MSA, supported by its implementing legislation, is an outline of how these measures have had the entirely expected result of enriching the OPMs and Grandfathered SPMs, by enabling the OPMs, in particular, to adopt pricing practices that have made them "persistently" more profitable. There is also no mention of how only a fraction of the share of the OPM profits promised under the MSA have actually been spent by those officials on health care or reducing tobacco use.

48. Respondent also fails to admit how these measures have had the perverse effect of making state governments financially dependent upon the continued financial success and market share preservation of the OPMs and Grandfathered SPMs.[37] This result was foreseen by FTC officials, whose study of the 1997 precursor agreement between state governments and the OPMs contributed to the refusal of United States Congressional leaders to endorse it with the national implementing legislation that state and OPM officials had requested.

[37] See, e.g.: Fowler, S. J., & Ford, W. F. "Has a quarter-trillion-dollar settlement helped the tobacco industry?" Journal of Economics and Finance, 28 (2004) 3 at 430-444, Reply Evidentiary Submissions Ex. 23.

49. State and OPM officials vigorously challenged the FTC's opposition to the 1997 agreement, which was very similar to the MSA except that it contained more concessions from OPMs and would have been enforced through national legislation. FTC officials held their ground, however, explaining that the agreement, which would eventually be enforced through passage of the Escrow Statutes in 46 states instead, "would lead to substantial windfall profits for the cigarette industry."[38] The overriding concern about the agreement between the state governments and OPMs, and which prevented it from being implemented by federal legislation across the country, was that its legislative implementation was simply not in the public interest. Yet another concern expressed by FTC staff was the impact such a regime would have upon new entrants into the market place.

50. Rejected by federal legislators, the MSA States and OPMs opted for another way to implement their 1997 agreement. They settled on implementing the agreement through execution of the MSA and passage of a Model Escrow Statute in every state, although because the federal, political failure had weakened the bargaining position of the state governments, the 1998 version of the MSA contained restrictions on OPM conduct that were marginally less onerous than the 1997 version of the agreement.

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[38] "Federal Trade Commission Evaluation of the Tobacco Industry Analysis Submitted to Congress," Report prepared by the staff of the Bureaus of Economics, Competition, and Consumer Protection of the Federal Trade Commission, October 8, 1997; http://www.ftc.gov/reports/tobacco/tobacco9909.shtm, at notes 7-8; accessed February 1, 2008, Reply Evidentiary Submissions Ex. 24. In using the term "industry," it was clear that FTC officials were referring to the handful of large corporations that had dominated – and continue to dominate – the tobacco industry (i.e. the OPMs plus Liggett, which would become the largest Grandfathered SPM).

51. Because the MSA contemplated ongoing, legislative enforcement against third parties, with penalty provisions for state government failure to protect OPM market share, it necessitated close co-operation between the parties to the agreement. Respondent has elected not to provide copies of the agendas and transcripts of the regular meetings held between the OPMs, Grandfathered SPMs and State Officials, although the October 2, 2004 agenda that Claimants obtained through their own devices shows the level of candour and cooperation that took place – as the parties discussed their mutually agreed interests in additional legislative measures being adopted to protect OPM market share (and, by extension, the states' share of the profits derived therefrom). [39]

52. Close co-ordination between the states, OPMs and the Grandfathered SPMs followed from universal adoption of the Escrow Statutes to virtually universal adoption of the Contraband Laws and later the Allocable Share Amendments. In addition, OPM prices rose dramatically in the years immediately following the MSA. FTC predictions about rising profitability of the OPMs also proven true, as the price increases were far higher than necessary to satisfy the terms of the MSA. This co-ordinated pricing behaviour, amongst the OPMs, was directly enabled by the measures at issue in this arbitration, as the primary interest of state officials immediately shifted from reducing tobacco use, and obtaining a global measure of compensation for the OPM's alleged misdeeds, to maintaining each state's ongoing entitlement to a full share of the OPM profit windfall promised to them under the MSA.[40]

[39] Minutes of NAAG – OPM Meeting, October 2, 2004, Reply Evidentiary Submissions Ex. 25.
[40] See, e.g.: Robert Sullivan, "Ten Years Later, Tobacco Deal Going Up in Smoke" MSNBC.com, November 21, 2008; http://redtape.msnbc.com/2008/11/ten-years-later.html; accessed January 10, 2009. Reply Evidentiary Submissions Ex. 26.

53. Of course, this is not the story that Respondent is prepared to admit with its version of the facts, but it is the story that is borne out in the record and academic literature – not only in economic journals but in leading journals on law and health policy as well.

54. In addition, Respondent provides two pages of reference to health statistics at pages 12 and 13 of the Counter Memorial. These statistical references are simultaneously vague and contrived, however. No direct causal connection is alleged between these statistics and either the MSA itself, or the way in which its implementing measures gave rise to the Investors' claims. Rather, Respondent only implies the existence of a causal link between these statistics and the original regulatory structure prior to adoption of the measures, even though in this proceeding Respondent must positively establish an actual link to the measures' application in Indian Country and as amended off reservation, in order to justify its prima facie breaches of international law.

55. The story that Respondent wishes to portray, albeit only by indirect implication, is that state officials were forced to breach Respondent's NAFTA obligations in order to achieve certain, justifiable health policy outcomes. That is why, at page 13 of the Counter Memorial, Respondent boldly states that there has been a 25% reduction in "smoking" in the United States over the past ten years, since state and OPM officials first agreed to settle the lawsuits brought by a number of those states against the OPMs. The implication is that it was necessary to impose the measures at issue in this arbitration against Claimants, and their investment, in order to achieve this seemingly impressive decline in consumption. This implied justification is grossly misleading for a number of reasons.

56. First, Respondent chose to support its implied justification with economic data published by the Centers for Disease Control and Prevention ("CDC"), rather than using the health survey data that the CDC actually collects for the purpose, and upon which its own expert, Dr. Gruber, relies in his work.[41] It is not just that Respondent used the wrong data set, however. Respondent also attempts to use what is only an estimated number for 2007 in order to gross up the result. Had Respondent used the correct data, and had it avoided using an estimated statistic rather than an actual result, it would have only been trumpeting a 16% reduction in median tobacco use by state, between 1997 and 2006, rather than the much more impressive average national reduction, of 25%, that it chose to provide.[42]

57. Moreover, even if Respondent had cited the appropriate 16% median figure for its implied justification, its use would have still been misleading. To begin, it is still a national figure; it does not represent the geographical area covered by the MSA and its implementation measures. This number also does not represent the past or current use of tobacco products, much less the Claimants' particular brand, in the states where it had been established for off-reservation sales.

58. Another obvious problem with attempting to credit the MSA and its implementing measures for even a 16% decline in the median amount of tobacco use in

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[41] United States' Written Direct Examination of Jonathon Gruber, USA v. Philip Morris et al, US Dist. Ct. for DC, Civil No. 99-CV-02496, undated, at 12-13, Reply Evidentiary Submissions Ex. 27.

[42] CDC, partial results from the National Health Interview Survey on Drug Use and Health, Reply Evidentiary Submissions Ex. 28; The following table demonstrates the 16% mean drawn from the referenced data:

1997	1999	2001	2002	2003	2004	2006
24.7	23.5	22.8	22.5	21.6	20.9	20.8

all 50 states between 1997 and 2006 is that it ignores all of the other factors that would have also likely contributed to that decline. These factors include: changes in consumer preference, local and state tax increases; the institution of public and private tobacco cessation therapy; and the thousands of federal, local and state measures that have been imposed over the past decade to regulate the places where smoking can take place.[43]

59. Respondent is conveniently silent about how all sorts of other factors will have contributed to the 16% decline in median national tobacco use between 1997 and 2006. In fact, it is not possible to say, with any degree of certainty, what proportion of this national decline in median tobacco use, by state, can be specifically attributed to the MSA generally, much less the specific governmental actions, and resulting treatment, upon which the Investors' claim is based.[44]

60. Another reason for Respondent's silence about the potential impacts of a host of other factors that will also have contributed to a decline in tobacco use is that it knows that an overwhelming majority of MSA states have been widely criticized, ever since the MSA came into effect, for their failure to devote enough of their MSA revenues to tobacco reduction activities. In fact, public health researchers have concluded that most MSA states have not spent their MSA revenues in a manner consistent with the

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[43] See, e.g.: Capehart, T. C. J., "Trends in the Cigarette Industry After the Master Settlement Agreement" (2001) http://www.ers.usda.gov/publications/tbs/oct01/tbs250-01/tbs250-01.pdf; visited January 29, 2009; Sindelar, J.L. and T. Falba. "Securitization of Tobacco Settlement Payments to Reduce States' Conflict of Interest." Health Affairs 23 (2004) 5 at 188–193, Reply Evidentiary Submissions Ex. 29.

[44] While metrics exist to estimate the potential impacts of proposed tax increases in the abstract, there 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.

stated goals of the lawsuits they filed against the OPMs, which led to the MSA in the first place.

61. In 2001 the average state received $28.35 per capita from the tobacco settlement but allocated only about 6 percent of these funds to tobacco-control programs.[45] For example, in North Carolina, a state in which the Seneca® brand is sold off-reserve, it was reported that the state government spent almost three quarters of the settlement money it had received by the middle of 2002 on tobacco marketing and production, including the construction of a modern tobacco auction house outside Asheville; funding grants for tobacco farmers to upgrade their harvesting equipment and even $15,000 for a local tobacco museum to fund a video about the history of the crop.[46]

62. Indeed, between 2002 and 2006 average state spending on tobacco reduction, generally, has decreased substantially, from about $750 million per year in 2004 to only $550 million in 2006. This national total represents less than one third of the global amount recommended by the CDC. Over the same four years, however, MSA states saw revenues from their MSA partnership with the OPMs and Grandfathered SPMs grow from an estimated $18.5 billion to $21.3 billion.[47]

63. By April 2006, a report was issued by Respondent's General Accounting Office (GAO), demonstrating how states had only allocated about 4.7 percent of the over

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[45] C.P. Gross et al, "State Expenditures for Tobacco-Control Programs and the Tobacco Settlement" N Engl J Med. 2002 Oct 3;347(14):1080-6, Reply Evidentiary Submissions Ex. 31.

[46] "The Tobacco Sham: New Farm Equipment, Fighting Satan And Sprinklers: How The States Are Spending Their Settlement Money," Newsweek, Aug 19, 2002; http://www.newsweek.com/id/65416?tid=relatedcl; accessed January 15, 2009, Reply Evidentiary Submissions Ex. 32.

[47] Rahul Rajkumar, C. P. G., Howard P. Forman, "Is the Tobacco Settlement Constitutional?" The Journal of Law, Medicine & Ethics, 34 (2006) 4 at 748-752, Reply Evidentiary Submissions Ex. 33.

$5.8 billion in MSA payments and securitized proceeds they received in fiscal year 2005, towards new or expanded tobacco-control programs. The report also indicates that 32 states spent less than 10% of MSA payments on tobacco control, while some spent nothing at all.[48]

64. Unsurprisingly then, none of the states where the Seneca® brand was sold off-reserve spent anywhere close to what the CDC recommended for tobacco control. In January 2009, the American Lung Association published its annual 'report card' on tobacco regulation and consumption in each state. ALA officials assigned a failing grade to every single state in which the Seneca® brand was established off-reserve. They did so because officials in each of these states failed to devote what would have been only a tiny fraction of their overall MSA revenues towards tobacco prevention and control.[49] For example, one of the few states in which the Seneca® brand had been maintained at some level is Georgia. Despite having received hundreds of millions of dollars in MSA payments, Georgia has budgeted less than 3% of the CDC-recommended amount on tobacco control for 2009. In another State – North Carolina - some of the MSA proceeds to subsidize the construction of a tobacco processing facility.

65. The record for states in which the Seneca® brand was established paints a much different picture than the one Respondent seeks to portray. This record demonstrates that, at least in these particular states, officials have not been pursuing the

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[48] Tobacco Settlement: States' Allocations of Fiscal Year 2005 and Expected Fiscal Year 2006 Payments (General Accounting Office: Washington, 2006), Reply Evidentiary Submissions Ex. 34.

[49] American Lung Association, "State of Tobacco Control: 2008"; Summaries of State Report Cards for: Kansas, Louisiana, Georgia, South Carolina, North Carolina, Oklahoma, Arkansas and Tennessee, Reply Evidentiary Submissions Ex. 35.

lofty goals of tobacco reduction that Respondent would have the Tribunal infer from its creative presentation of national statistics.

66. The consensus opinion among experts who are not in the employ of either Respondent or its state governments, does not support the simplistic implication intended by Respondent's careful use of the wrong statistics. The only consensus that appears to have been reached by neutral, academic observers is that the MSA States, the OPMs and the Grandfathered SPMs have all profited immensely from the legislative implementation and court-assisted enforcement of the MSA against the brands and brand holders of non-MSA competitors.

67. Most telling, however, is that Respondent has failed to provide any evidence concerning how the measures actually at issue in this NAFTA arbitration has contributed to any reduction in tobacco use in the states in question, much less on a national level. In other words, Respondent has made no attempt to justify the treatment that has been accorded to Claimants, vis-à-vis their competitors and in light of their rights as indigenous peoples, on the grounds of necessity to obtain certain health policy outcomes.

68. At page 13 of the Counter Memorial, Respondent further implies that reductions over the past decade in youth tobacco use can also be attributed to the MSA, and presumably the measures at issue in this case, as applied to Claimants and their investments. It fails to acknowledge, however, that independent studies attribute almost one quarter of that reduction to a successful public information campaign executed by the

American Legacy Foundation, funded by the OPMs for only a limited time under the MSA.[50]

69. Respondent also fails to address an admission made by its own witness, Dr. Gruber, that the MSA has actually failed to reduce overall marketing and promotion of tobacco products to youth by the OPMs and Liggett Group PLC:

> Q: Is there an existing structure that has attempted to restrict defendants' youth marketing activities using an input-based approach or strategy?
>
> A: Yes, this was a major focus of the MSA.
>
> Q: Does the application of the MSA provide any guidance regarding the efficacy of an input-based approach?
>
> A: Yes, it does. While I am not an expert on the effects of the MSA on marketing and promotion to youth, Dr. Dolan is, and his testimony makes clear that the MSA has not been successful in reducing overall marketing and promotion aimed at young people. As Dr. Dolan stated:
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>> The MSA's restrictions on inputs, i.e. the way companies can engage in marketing, does present challenges to the companies. Because of the MSA, the companies did modify their marketing practices. As they had in the past, however, they were able to draw on their marketing expertise to come up with a revised marketing approach to achieve their objectives or outputs.[51]

70. It is important to note that, as a Grandfathered SPM, Liggett is among Claimants' most significant competitors.[52] Liggett uses its MSA payment exemption to leverage sales of its flagship Grand Prix® brand at the discount tier, which has displaced

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[50] Matthew C. Farrelly et al, Evidence of a Dose–Response Relationship Between "truth" Antismoking Ads and Youth Smoking Prevalence American Journal of Public Health| March 2005,Vol 95,No. 3, Reply Evidentiary Submissions Ex. 36.

[51] United States' Written Direct Examination of Jonathon Gruber, USA v. Philip Morris et al, US Dist. Ct. for DC, Civil No. 99-CV-02496, undated, at 12-13, Reply Evidentiary Submissions Ex. 27.

[52] See Second Witness Statement of Marvin Wesley, at ¶ 4, Reply Evidentiary Submissions Ex. 10.

the Seneca® brand in many states, following elimination of the allocable share releases between 2005 and 2007.[53]

71. It is not just independent tobacco reduction experts who have withheld their praise for the MSA and its implementing measures, however. Respondent has also strenuously argued before one of its own courts that the MSA has proved largely ineffectual in achieving the same health policy goals for which Respondent now implies its treatment of Claimants is necessary.

72. In a post-hearing brief filed before the United States District Court for the District of Columbia, Respondent has outlined a host of reasons as to why the MSA (and, by extension, the state measures implementing it) have failed to bring about the expected, and still desired, policy goals for youth smoking:

> Defendants vigorously assert that the MSA is fully adequate to prevent any recurrences of the misconduct identified in this action… To the contrary, though, the evidence amply establishes that the MSA is inadequate for any such purpose. Four areas are discussed below; the Court has previously identified all four. The Court identified the first two areas in its 2000 decision denying Defendants' motion to dismiss the injunctive relief sought in the United States' Complaint:
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>> In arguing that the M.S.A. obviates the need for injunctive relief, Defendants implicitly ask the Court to make the following two assumptions: that Defendants have complied with and will continue to comply with the terms of the MSA, and that the M.S.A. has adequate enforcement mechanisms in the event of noncompliance. United States v. Philip Morris Inc., 116 F. Supp. 2d 131, 149 (D.D.C. 2000).
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> … The trial evidence amply shows that Defendants have not complied with the MSA.[54]

Respondent further states:

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53 Second Witness Statement of Marvin Wesley, at ¶¶ 4-6, Reply Evidentiary Submissions Ex. 10.

54 USA Post Trial Brief in RICO case at 161-162, Reply Evidentiary Submissions Ex. 38.

> The second issue that the Court identified in its 2000 decision was whether "the M.S.A. has adequate enforcement mechanisms in the event of noncompliance." Philip Morris Inc., 116 F. Supp. 2d at 149. The evidence demonstrates the MSA's enforcement mechanisms are not currently adequate – and that the problem will only increase next year, in 2006.
>
> … Even if the Court accepts Defendants' view that the MSA currently has adequate enforcement mechanisms while the states' inspection authority remains intact, Defendants' own emphasis upon the importance of this inspection authority shows that the MSA's enforcement mechanisms will steadily become less and less adequate as the authority begins to expire in one state after another, starting just next year.[55]

And further:

> … A further difficulty with MSA enforcement is that – as Defendants acknowledge – the MSA requires "mandatory consultation and discussion" for every issue. JD FF ch. 12, ¶ 58 (citing MSA §§ VII.(b)-(c), XVIII(m) (JD-045158) (A)). This leads to extraordinarily cumbersome and time-consuming enforcement efforts.[56]

And further:

> In addition, the MSA prohibits the states from seeking to enforce the MSA on one another's behalf, MSA § VII(b), (c)(1) at 49 (JD-045158) (A); and RJR has succeeded in getting the state courts to produce inconsistent interpretations of a single provision of the MSA… Defendants nevertheless assert that the MSA's "liaison mechanism for mandatory consultation and discussion" "has almost always resulted in a satisfactory resolution of [the states'] concerns." JD FF ch. 12, ¶ 58. What Defendants do not acknowledge is that they are free to ignore complaints brought to their attention through this mandatory process.[57]

And yet further:

> Defendants assert that the MSA will "address the misconduct alleged by the government." JD FF ch. 12, § II.B (section title; capitalization modified). To the contrary, the Court has previously recognized that the MSA does not include all of the measures necessary to prevent and restrain Defendants from engaging in future misconduct. As examples, the Court has previously recognized that the MSA does not (1) require Defendants to make corrective statements regarding health risks and nicotine addiction; (2) require Defendants to fund effective cessation programs; (3) appoint Court-appointed officials to implement the relief granted; (4) enjoin Defendants from future RICO violations; or (5) enjoin Defendants' alleged youth-marketing practices.[58]

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[55] USA Post Trial Brief in RICO case at 164, Reply Evidentiary Submissions Ex. 38.
[56] USA Post Trial Brief in RICO case at 164-165, Reply Evidentiary Submissions Ex. 38.
[57] USA Post Trial Brief in RICO case at 165, Reply Evidentiary Submissions Ex. 38.
[58] USA Post Trial Brief in RICO case at 166, Reply Evidentiary Submissions Ex. 38.

73. Finally, and significantly, Respondent adds: “[in] addition, Liggett is not subject to the full terms of the MSA.” What Respondent meant by this statement is that Liggett, as a Grandfathered SPM, has never been obliged to make a comparable level of payments as the OPMs (either under the MSA or into escrow like NPMs and other less favoured SPMs).[59]

74. Respondent’s own arguments against the OPMs and the largest Grandfathered SPM, Liggett, tell a much different story about how the measures specifically at issue in this claim are in no way justified as being necessary to achieve any stated health policy goal.

75. Claimants submit that the story told by Respondent to its own court is more accurate than the one Respondent is asking the Tribunal to infer from its Counter Memorial. The story it has told to its own court reflects the abject frustration of US federal officials over a collective decision, by 46 state attorneys general, to enter into what has turned out to be little more than a base revenue-sharing agreement with the OPMs, which has proved overly costly and complicated to enforce.

76. Even leaving all of the foregoing aside, Respondent’s analysis, in the end, suffers from the same deficits that are presented in its experts’ reports. In short, Respondent has failed to address the greatest, critical flaw to its public policy arguments, and such failure is inexcusable and indefensible. Respondent has not shown how the Allocable Share Amendments (the measures that are at the heart of this proceeding) or the exemptions given to exempt SPMs either contributed to the reduction in overall

[59] USA Post Trial Brief in RICO case at 167, Reply Evidentiary Submissions Ex. 38.

smoking or youth smoking as trumpeted by Respondent. The claimed significant declines in these statistical figures manifested *before* the Allocable Share Amendments were adopted, and all while Exempt SPMs enjoyed the grandfather exemptions extolled by Liggett in its 10K annual report.[60] Simply stated, whatever effect the MSA had on reduction of smoking and youth smoking, it had that effect when, and while, the original Escrow Statutes were in place. In short, there is absolutely no evidence before this Tribunal – none – that the MSA and the original Escrow Statutes were "broken" in this respect, and nothing presented by Respondent militated in favour of them being "fixed" through the Allocable Share Amendments.

III. LAW

A. Jurisdiction Has Been Established

77. The definition of investment: Claimants refer the Tribunal to their arguments on jurisdiction found at pages 35 to 45 of the Memorial. Rather than simply repeating those arguments in response to the Counter Memorial, Claimants have engaged the services of renowned public international law scholar, Professor Maurice Mendleson Q.C., who has conducted his own, independent analysis of the case and provided his expert opinion, attached as Reply Evidentiary Submissions Exhibit 3. The question put to Professor Mendelson was as follows:

> Recalling the circumstances of the instant case, are the Claimants, or any of them, 'investors' of Canada, and/or are their businesses, activities or interests, etc., 'investments of investors' in the territory of the United States, within the meaning of Chapter 11 of the North American Free Trade Agreement ('NAFTA') and, in particular, for the purposes of Articles 1102, 1105 and 1110?

[60] Liggett Form 10-K, Reply Evidentiary Submissions Ex. 57.

To answer the question, Professor Mendelson adopts the following interpretative approach, which Claimants commend to the Tribunal for its consideration:

> 18. Using Article 31 as a guide, it is to be noted at the outset that the text of NAFTA Chapters 2 and 11 provides that the definitions 'mean' rather than 'include' certain investment interests. Hence, in particular, the sub-paragraphs of the definition of 'investment' in NAFTA Article 1139 cannot, in fairness, be treated as merely illustrative, as is the case with some other investment treaties.
>
> 19. On the other hand, this conclusion does not justify treating each sub-paragraph in complete isolation, still less doing so in a restrictive manner. First, nothing in the Agreement says that they are mutually exclusive, and it would be surprising if that were the intention. For viewed as a whole, the intention is obviously to create a broad definition, albeit one that is not so broad or all-embracing as to encompass all sorts of rights or interests, whether or not they could normally be regarded as investments. (For instance, simple money claims, without more, are not included.) Secondly, despite the relative detail of the definitions, several of the paragraphs require interpretation, and their application to the facts may call for elucidation of their terms. This process cannot take place without taking into account Article 31 VCLT's injunction to take into account the context and the object and purpose of the Agreement, not to mention the obligation to interpret in good faith, all of which precludes a purely literal interpretation. Thirdly, if there are separate acts or situations that are on the borderline of falling within particular sub-paragraphs, they may yet collectively constitute an investment.
>
> …
>
> 22. Furthermore, in Československa obchodní banka, a.s. v. Slovak Republic, an ICSID Tribunal, referring to Fedax, stated that:
>
> > An investment is frequently a rather complex operation, composed of various interrelated transactions, each element of which, standing alone, might not in all cases qualify as an investment. Hence, a dispute that is brought before the Centre must be deemed to arise directly out of an investment even when it is based on a transaction which, standing alone, would not qualify as an investment under the Convention, provided that the particular transaction forms an integral part of an overall operation that qualifies as an investment.
>
> Referring to a number of investment cases where the status of separate segments or companies was an issue, Schreuer evidently considers that the direct relationship to the broader investment operation may suffice to bring an individual component within the meaning of an 'investment' – a view shared by Dolzer and McLachlan, Shore & Weiniger.
>
> 20. With these points in mind, it is now possible to consider the application of the relevant sub-paragraphs of the definition of 'investment' to the present case.

a) The Enterprise.

78. At page 55 of the Counter Memorial, and continuing on to page 66, Respondent incorrectly states that Claimants have made "bare allegations of a U.S. parent enterprise aimed at development of the Seneca brand." Respondent's attribution is incorrect in that it characterizes Claimants' enterprise as necessarily involving a "parent." What Claimants argue, at paragraph 118 of the Memorial, is that the three individual Claimants, on their own behalf and through the enterprises they own and control, work in association with each other for the establishment and development of the Seneca®, and later the Opal®, brands.

79. As Professor Mendelson explains in more detail, at paragraphs 21 to 25 of his Opinion, NAFTA Article 1139(a) provides that "investment" includes an "enterprise" and Article 201 provides that "enterprise means any entity constituted or organized under applicable law… including any corporation, trust, partnership, sole proprietorship, joint venture or other association."

80. On September 26, 1988, the Seneca Nation adopted a Business Code, attached as Reply Evidentiary Submissions Exhibit 12. With it, the Seneca Nation re-affirmed its sovereign right to make laws governing all civil and property matters arising within its territory. The Seneca Nation Business Code is accordingly capable of serving as "the applicable law" within the NAFTA context. As the record below indicates, Claimants clearly intended to operate their venture together under Seneca Nation law. Respondent nonetheless leads itself astray, at note 242 of its Counter Memorial, in incorrectly assuming that the applicable law, for determining the character of Claimants' investment enterprise, would be of the State of New York. New York State does not

have any jurisdiction over the constitution or organization of a business enterprise operated on and/or from sovereign Haudenosaunee territory.

81. Native Wholesale Supply (NWS) is a Seneca Nation-licensed entity operated on land owned by a member of the Seneca Nation, Arthur Montour, which is located on the Cattaraugus Territory of the Seneca Nation.[61] Jerry Montour and Ken Hill are members of the Haudenosaunee Confederacy, who, along with Arthur Montour, have caused NWS and Grand River to enter into an exclusive business relationship for the purposes of establishing and promoting the Seneca® tobacco brand in the United States.[62] Both Arthur Montour and Jerry Montour have affirmed that, through NWS, Arthur holds the trademarks underpinning the Seneca® brand beneficially for himself as well as for the owners of Grand River Enterprises Six Nations Ltd., all of whom are members of the Haudenosaunee Confederacy and residing elsewhere than on Seneca Nation territory.[63]

82. Article 1-108 of the Business Code vests the Seneca Nation's Peacemakers Court with territorial jurisdiction and Article 1-109 of the Business Code vests the Seneca Nation's Peacemakers Court with personal jurisdiction over all civil actions occurring with Seneca Nation territory, whenever the rights of a Seneca member, such as Arthur Montour, are directly involved in connection with "any individual, firm, partnership, association or corporation, or business entity" that "transacts, conducts or

[61] Second Statement of Arthur Akwiraienton Montour, at ¶ 4, Reply Evidentiary Submissions Ex. 8.

[62] Statement of Jerry Montour, at ¶¶ 7, 21-28, Claimants' Memorial, 7/10/08, Ex. 1; see Second Witness Statement of Arthur Akwiraienton Montour, at ¶ 9, Reply Evidentiary Submissions Ex. 8.

[63] Statement of Jerry Montour, at ¶ 25, Claimants' Memorial, 7/10/08, Ex. 1.

performs any business or activity within the Nation." Article 1-109(a) of the Business Code defines a legal person as including "any individual, firm, partnership, association or corporation, or business entity."

83. As generally demonstrated in the expert reports of Professors Brandao, Fletcher and Clinton, attached to Claimants' Memorial, it is a custom of the Haudenosaunee Nations to welcome and encourage non-resident members of the Confederacy to conduct business with each other on their respective territories. After all, they are likely the world's longest, surviving economic and political federation.[64] Article 1-102 of the Business Code specifically incorporates 'traditional custom and practice' as applicable law and Article 1-105 confirms that Seneca laws and customs that are not in direct contravention of the laws of the United States are to govern civil matters on Seneca Nation territory.

84. Given the above, it is obvious that Claimants are engaged in a business association with each other, on their own and through the corporations they own and control. Seneca Nation law and custom support the right of 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.[65] Article 2-107 of the Business Code exempts the participants in such business associations from needing to obtain their own Seneca Nation business licenses, so long as they are

[64] See Second Witness Statement of Arthur Akwiraienton Montour, at ¶ 6, Reply Evidentiary Submissions Ex. 8.
[65] See Second Witness Statement of Arthur Akwiraienton Montour, at ¶¶ 5-6, Reply Evidentiary Submissions Ex. 8.

working in concert with a Seneca Nation Member who does have a license, as does Arthur Montour.

85. There is no doubt that if Claimants ever had a disagreement about their association, which they could not solve themselves, it would be the Seneca Nation Peacemakers Court to whom they would turn. Their association has been constituted under Seneca Nation law. Indeed, the Cigarette Manufacturing Agreement, dated March 15, 1999 by and between GRE and Native Tobacco Company, which was subsequently assigned by Native Tobacco Company to NWS, expressly provides that it "shall be made and construed in accordance with the laws of the Seneca Nation and the laws of Six Nations"[66] By the same token, for the purposes of NAFTA Article 201, it is Seneca Nation law that serves as the applicable law for Claimants' business association, which is both a descriptive term for an enterprise in the Seneca Nation Business Code and in NAFTA Article 201.

86. In making its arguments on this particular issue, Respondent has stayed remarkably focused on the Article 1139(a) definition of investment, "enterprise." As it has done so, it has simultaneously restricted itself to viewing Claimants' relationship as having to be either a partnership or joint venture, under New York civil law, or nothing at all. Indeed, at note 219 of the Counter Memorial it pillories Claimants for having adopted various means of describing their business association. It is evident that Respondent favours a very strict, positivist approach to these issues - - one informed by United States law exclusively. It is not Claimants' custom, however, to obsess over which legal business term best describes the nature of their relationship. "Association,"

[66] Cigarette Manufacturing Agreement, ¶13, Reply Evidentiary Submissions Ex. 13

is an apt description of their relationship, but so is "informal venture"[67] or "Seneca business venture" or "integrated commercial undertaking."

87. While Claimants would certainly agree that their relationship is neither a partnership nor a joint venture as those terms may be defined for purposes of U.S. tax law or New York State law, Respondent is missing the point. Under NAFTA Articles 201 and 1139(a), what matters is whether their business association has been constituted under applicable law, which in this case is manifested first and foremost in the Business Code of the sovereign Seneca Nation. In any event, a plain reading of the Seneca nation Business Code demonstrates that Claimants have formed an investment enterprise under Seneca Nation law, and that Haudenosaunee cultural practice and custom affirm that fact.[68] Given the plain meaning of the term 'association' and the expansive definition of the term 'enterprise' in the NAFTA, Respondent cannot conveniently redefine that term, on a *post hoc* basis, so as to exclude its application to Claimants and this case.

88. Finally, Claimants note that, at page 60 of its Counter Memorial, Respondent has mistakenly seized upon a statement made by Claimants' expert, Professor Clinton, as if it proved Respondent's point that there must not be an "enterprise" in this case. In fact, Professor Clinton was actually referring to the remnants

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[67] Claimants notes, with apologies, the typographic error at ¶ 20 of the Memorial, where the term "formal venture" was used rather than "informal venture." Respondent appears to have been led astray by the error, having referred directly to the incorrect term at note 219 and again at note 226.

[68] Moreover, Respondent has not come forth with any evidence or appropriate legal authority stating that United States law, at either the federal or state level, could preclude Claimants' relationship from being regarded as a business association within the terms of the applicable law of the Seneca Nation.

of Grand River's private label production for "third party" trademark holders; not NWS or Tobaccoville.

b) The Brands.

89. At pages 53 and 54, Respondent states that Claimants have not "included" Tobaccoville as part of their investment enterprise in the United States, which is correct. As a result of this simple statement of fact, however, Respondent wrongly concludes that off-reserve sales of the Seneca® and Opal® brands are therefore no longer relevant to the dispute. The root of its error lies in Respondent's apparent failure to grasp the meaning and nature of an intangible property right, which constitutes an investment in the territory of a NAFTA Parties under Article 1139(g).[69]

90. As demonstrated by its interchanging use of the terms "brand" and "trademark" on page 54 of the Counter Memorial, where it discusses the licensing of the Seneca® mark for use by Tobaccoville in off-reserve markets, Respondent displays some confusion about the difference between the two. Respondent also demonstrates further misunderstanding in arguing, at pages 63 and 64 of the Counter Memorial,[70] that "goodwill, by itself, cannot constitute an 'investment' under Article 1139."

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[69] Mendelseon Report, at ¶¶ 40-50, Reply Evidentiary Submissions Ex. 3

[70] Respondent borders on disingenuity in claiming that the three NAFTA Parties "agree" with its statement about goodwill within the context of this case. The NAFTA Parties are free to meet and issue a binding interpretation of Article 1139(g), concerning the issue of whether goodwill, in and of itself, constitutes intangible property, thereby qualifying as an investment under the NAFTA. The mechanism is expressed in NAFTA Article 1131(2). It was also open to both Mexico and Canada to provide non-binding submissions on the interpretation of NAFTA Article 1139 within the context of this case, under NAFTA Article 1128. Given that the three NAFTA Parties have actually provided themselves with treaty mechanisms through which their views can be made known (either on a binding basis or as a matter of interpretative opinion within the context of a specific dispute), for Respondent to claim "agreement" on interpretation is to beg the question as to why the parties could not bother to use the appropriate means to have their views

91. In the tobacco business, product brands are universally acknowledged as being the most important asset of the enterprise.[71] While trademarks are a fundamental part of establishing any brand, they should not be confused with the brand itself, which is larger than just the mark. A brand is defined by its packaging, price, taste, consistency of product quality, advertising, point-of-sale marketing, and consistency of product availability. Similarly, goodwill is nonetheless generally understood to serve as a proxy for the valuation of an intangible asset, as the appellate court in Grand River's federal litigation most recently noted. In a case where the investment is in an intangible asset, goodwill and/or market share further define the scope and value of the investment.

92. For example, economists studying the utility of advertising for maximizing brand equity in the U.S. tobacco industry have treated "advertising expenditures as investments that produced a stock of firm goodwill."[72] The value of the brand itself can be expressed as a combination of goodwill and market share, both of which reflect the returns from capital committed to establishment and growth of the brand, which itself is bound up with both the physical characteristics of the branded product and its manner and success of distribution to the consumer.[73] Accordingly, it is not accurate to simply state that goodwill, in and of itself, could never constitute an

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heard. The answer is: because they have not, in fact, agreed upon the proffered interpretation as claimed.

[71] See Second Witness Statement of Jerry Montour, at ¶ 7, Reply Evidentiary Submissions Ex. 7.

[72] Mark J. Roberts and Larry Samuelson, "An empirical analysis of dynamic, nonprice competition in an oligopolistic industry" 19 Rand J. Econ. (1988) 200 at 201, Reply Evidentiary Submissions Ex. 39.

[73] See, e.g.: Peter Boatwright, Jonathan Cagan, Dee Kapur, Al Saltiel, "A step-by-step process to build valued brands" 18 (2009) 38 at 46, Reply Evidentiary Submissions Ex. 41; and David Haigh, "Brand valuation: what it means and why it matters?" *Brands in the Boardroom*, IAM Supplement No.1; www.brandfinance.com/Uploads/pdfs/BrandValuation_Whatandwhy.pdf; accessed February 10, 2009, Reply Evidentiary Submissions Ex. 42.

investment - because goodwill can represent either a full or partial expression of the very value of one's investment in an intangible asset, such as a proprietary brand.

93. That tobacco brands constitute the most valuable, intangible asset for industry members can also be demonstrated by reference to how the multinational tobacco enterprises refer to them. For example, the University of California at San Francisco Legacy Tobacco Documents Library, which contains a large number of internal OPM documents, returns a result of over eleven thousand documents when one searches the term "brand equity."[74] The following are a few examples of how OPM operationally addressed brand equity and their effort to build it in all market segments, from premium to discount tiers:

> <u>*Protect and build our brand franchises*</u>*. The continued success of our company depends on our ability to maintain the value of our brands in the consumer's mind. To protect their value, our commitment to quality will remain unwavering, and we will work to keep our brand images and attributes relevant and contemporary. This is a continuous, evolutionary process that requires us to be keenly attuned to changing consumer needs and competitive offerings. Furthermore, we will ensure that our marketing efforts effectively communicate our brand values to the consumer. To this end, the Plan includes programs to reinvigorate our brands through a*

[74] http://legacy.library.ucsf.edu/action/search/basic?q=%22brand+equity%22&ps=10&df=er&fd=0&rs=false&ath=true&drf=ndd&p=2&ef=true; visited February 12, 2009, Reply Evidentiary Submissions Ex. 43.

renewed company-wide focus on world-class advertising and to manage price gaps to levels which permit our brands to grow.[75]

* * * *

Brand Equity

- *Build it*
- *Buy it*
- *Borrow it*
- *Steal it*
- *AND THEN USE IT!*

…

Interbrand Measures of Brand Equity

- *Marketshare*
- *Stability*
- *Leadership*
- *Trend*
- *Support*
- *Geographical Spread*
- *Protection*[76]

* * * *

Concepts

1. *Preference: share of choice with equal availability and merchandising;*
2. *Loyalty: willingness to pay a premium, search if note available, resist competitive merchandising;*
3. *Equity: awareness and associations of brand with attributes, benefits, emotions…*[77]

* * * *

Discount Brand Equity Project (Dan Murphy)
I. The History of Discount
A. What has happened to the category over the last ten years
1. Consolidation
2. Trends
3. Private Label
4. Marlboro Friday

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[75] PM, Philip Morris. "Five Year Plan 930000 - 970000". 15 Apr 1993, at 3; http://tobaccodocuments.org/pm/2048383463-3810.html, accessed on 19 February 2009, Reply Evidentiary Submissions Ex. 44

[76] Brown & Williamson, "Brand Equity" undated, at 1; http://legacy.library.ucsf.edu/action/document/page?tid=pub20f00; accessed February 8, 2009, Reply Evidentiary Submissions Ex. 45.

[77] Brown & Williamson, "Brand Equity" undated, at 2; http://legacy.library.ucsf.edu/action/document/page?tid=pub20f00; accessed February 8, 2009, Reply Evidentiary Submissions Ex. 45.

5.PM Discount

II. Equity (Sue Norris / Denis Cohen)
A. What is it?
B. Why is it important?
C. Examples of Equity

III. Consumers (Eva Tomasco / Dave Titus)
A. Overall analysis of Discount consumers
B. Analysis of core Brands
C. Attributes of those Brands

IV. PM Discount Goals & Strategies (Denise, Sue, Dan & Chris)
A. PM Discount interaction w/ Marlboro
B. Managing the Gap
C. Trade Strategies
D. Price vs. Product Promotions
E. Retail as a visibility vehicle

V. How does the Sales Force Effect Equity (Chris)
A. POS Placement
B. Rotating Graphics
C. Product Quality
D. Non branded POS ie custom signs, neon starbursts
E. Distribution[78]

94. Indeed, the OPMs have long since devoted a portion of their substantial resources to gathering detailed market and background information on potential brand competitors in the discount tier. Submitted as Reply Evidentiary Submissions Exhibit 46 are early examples of the OPMs' tracking of Claimants' establishment and early growth, from 1994 to 1999.[79]

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[78] Philip Morris, Discount Brand Equity Outline, April 12, 1999; http://legacy.library.ucsf.edu/tid/vpv70c00; accessed February 8, 2009, Reply Evidentiary Submissions Ex. 47.

[79] In addition to detailed sales tracking tables from multiple OPMs, attached is a 1994 Canadian newspaper article, describing how Grand River Enterprises (then still a partnership led by Jerry Montour) was in the process of obtaining rights to purchase tobacco from local farmers from the Canadian Federal Government, Reply Evidentiary Submissions Ex. 48. This article was found in a market intelligence database maintained by Philip Morris.

95. Claimants' approach to investing in the U.S. tobacco business was not unlike those of the much larger OPMs, albeit with far less resources.[80] At pages 8 to 12 of the Memorial, Claimants explained the nature of their investment in the Seneca® and Opal® brands in the United States, which Professor Mendelson recalls at pages 20 to 26 of his report.

96. [redacted][83] Through their reinvestment of millions of dollars back into the company, the Grand River shareholders enabled it to purchase truly state of the art equipment that permitted the Claimants to produce a quality of product that was unrivalled by any other small NPM. Marvin Wesley describes the result of Claimants' commitment to establishing and growing the Seneca® brand, in particular, in his second witness statement.[84]

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[80] See Second Witness Statement of Jerry Montour, at ¶ 12 (noting that "industry practice" was adopted in connection with investment in the Seneca® brand, off-reserve), Reply Evidentiary Submissions Ex. 7.

[81] Second Witness Statement of Jerry Montour, at ¶¶ 3-4, Reply Evidentiary Submissions Ex. 7; Second Witness Statement of Arthur Akwiraienton Montour, at ¶¶ 19-20, 22, Reply Evidentiary Submissions Ex. 8.

[82] Second Witness Statement of Arthur Akwiraienton Montour, at ¶ 21, Reply Evidentiary Submissions Ex. 8.

[83] Second Witness Statement of Arthur Akwiraienton Montour, at ¶ 22, Reply Evidentiary Submissions Ex. 8.

[84] Second Witness Statement of Marvin Wesley, at ¶¶ 3-5, Reply Evidentiary Submissions Ex. 10.

[redacted]

98. [redacted] it nonetheless does demonstrate that Claimants are prepared to take any steps necessary to preserve and protect their rights in their investments, i.e. the Seneca® and Opal® brands.

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[85] Second Witness Statement of Jerry Montour, at ¶ 10, Reply Evidentiary Submissions Ex. 7.
[86] Second Witness Statement of Jerry Montour, at ¶ 5, Reply Evidentiary Submissions Ex. 7; Second Affidavit of Larry Phillips, at ¶ 3, Reply Evidentiary Submissions Ex. 9.
[87] Second Witness Statement of Jerry Montour, at ¶ 5, Reply Evidentiary Submissions Ex. 7; Second Affidavit of Larry Phillips, at ¶ 2, Reply Evidentiary Submissions, Ex. 9.
[88] Affidavit of Larry Phillips, at ¶ 13, Claimants' Memorial, 7/10/08, Ex. 6.

B. The Measures Are Related to the Claimants' Investment in U.S. Territory

99. At page 52 of the Counter Memorial, Respondent briefly renews a portion of its objection to the Tribunal's jurisdiction to hear Arthur Montour as one of the Claimants in this arbitration. The theory is that the Escrow Statutes technically do not "relate to" him or to his investment because they only impose an obligation upon the manufacturer of a tobacco brand. Respondent asserts that neither Arthur Montour nor NWS are tobacco product manufacturers, as defined under the Escrow Statute.

100. The Respondent is wrong. With respect to the law, the object and purposes of the NAFTA would hardly be realized if a Respondent were permitted to narrow the scope of application of its measure in the abstract. As the Tribunal in *Pope & Talbot* v. *Canada* observed in rejecting the Respondent's similar arguments in that case:

> … where a quota allocation system is involved of the type here under consideration, it necessarily involves that quota be directly conferred upon or removed from such enterprises. It is not a mere linguistic truism to say that such a system applies to a particular enterprise, namely each of the relevant softwood lumber producers in the Listed provinces. It directly affects their ability to trade in the goods they seek to produce, but it can equally be described as the way that the measures applied to the various enterprises affect the total trade in the relevant products.[89]

101. Respondent attempts to rely upon the Award in *Bayview* v *Mexico*, but the case is obviously not relevant. In *Bayview* a group of farmers in Texas tried to convince a tribunal that they had an investment in Mexico derived from a decades-old treaty between Mexico and the United States, under which it was alleged Mexico had promised to preserve some water for downstream use in Texas. In terms of investments in the

[89] *Pope & Talbot, Inc.* v. *Canada*, NAFTA/UNCITRAL Tribunal, Award on Motion to Dismiss re: Whether Measures "Relate to" the Investment, 26 January 2000, at para. 33; Authories, Tab 1.

territory of another NAFTA Party, the *Bayview* Claimants had no enterprise; no brands; no loans; no commitment of capital. They had no interests whatsoever in Mexico, which is not remotely similar to the present case.

102. The other case cited by Respondent is *Methanex* v. *U.S.A*, where the Tribunal opined that "relate to" in Article 1101 "signifies something more than the mere effect of a measure on an investor or an investment and that it requires a legally significant connection between them." In *Methanex*, the Tribunal was dealing with a case where the investor and its investment enterprise in the United States produced an ingredient found in a fuel additive that was going to be effectively banned. As the downstream producer of a product that was not itself subjected to measure (but was instead only an ingredient used in the production of the product to be banned) the majority of Mexthanex's claims fell beyond the scope of the Tribunal's jurisdiction, because the measure did not "relate to" the product Methanex made. As Claimants noted during the early stages of the arbitration, the comparable fact pattern in this case would be if Claimants were only tobacco farmers affected by the MSA and its implementing measures, rather than an enterprise that actually produces and distributes a brand of cigarettes.

103. The record demonstrates that Arthur Montour became the unwitting subject of a lawsuit under the Escrow Statutes in December 2002, courtesy of the Attorney General for Missouri. Currently Arthur Montour and NWS are personally facing three active lawsuits, under the Escrow Statutes of Idaho, New Mexico and California. Claimants just won the dismissal of the case brought against them, including NWS, by the State of Oklahoma. However, now the Oklahoma Attorney General has

reconfigured his lawsuit in order to name and individually punish all of the Creek Nation members whom he has been able to identify as having worked for the Nation in the distribution or sales of Seneca® branded cigarettes.[90]

104. Obviously all of the measures at issue in this case are being applied to all of the Claimants, both individually and as associates in the same business venture: i.e. promotion of the Seneca® brand in the United States. Accordingly, Respondent's objection to Arthur Montour continuing as a Claimant should be dismissed in its entirety.

C. National Treatment and MFN Treatment

a) Outstanding Issues

105. Respondent sets out its understanding of the Article 1102 and Article 1103 obligations, and their application to the instant case, at pages 73 to 84 of the Counter Memorial. In terms of the applicable law, the parties appear to be in agreement that a breach of Articles 1102 and/or 1103 is established by an investor who demonstrates that the treatment it, or its investment, has received from a NAFTA Party is less favourable than the treatment received by a similarly-situated investor or its investment. They differ, however, as to:

i. Whether the language of Articles 1102 or 1103 requires an investor to additionally prove that any difference in treatment received was the result of overt or intended discrimination on the basis of nationality; and

ii. The nature of the treatment to which Claimants should be entitled.

i. Proof of Discriminatory Intent Not Required

106. Respondent only devotes page 80 of the Counter Memorial to its claim that Articles 1102 and 1103 cannot be breached unless a claimant can prove that less

[90] Second Witness Statement of Marvin Wesley, at ¶ 9, Reply Evidentiary Submissions Ex. 10.

favourable treatment was accorded on the basis of nationality. The brevity of Respondent's argument belies its obvious weakness: that it finds no support in the treaty text.

107. Of the two NAFTA cases cited by Respondent, *Myers* v. *Canada* and *Loewen* v. *USA* both were examples of cases where the facts revealed overt, intentional discrimination against the investor on the basis of nationality. In neither case did the tribunal state that a claimant is obliged to prove that the measure was imposed on the basis of nationality. Rather, in both cases the investors said – and each tribunal agreed – that the measures were motivated by discriminatory animus.

108. As Professors Newcombe and Paradell state in their treatise on international investment law standards of treatment:

> § 4.17 **The existence of protectionist intent or motive.** Host state measures motivated by protectionism will normally involve either *de jure* or *de facto* discrimination between nationals and foreign investors. Where a foreign investor is able to demonstrate that the less favourable treatment was motivated by protectionism, a breach of national treatment will usually follow.
>
> However, proof of protectionist intent is neither a necessary nor a sufficient condition for a finding that there has been a breach of national treatment. The analysis focuses on the objective effect of the treatment in question[91]

Claimants also refer the Tribunal to pages 103 to 105 of the Memorial for examples of other awards where – unlike the two awards cited by Respondent – tribunals address themselves directly to the question of whether proof of discriminatory intent is required to prove a breach of either of the national treatment or most-favoured-nation treatment obligations.

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[91] Andew Newcombe & Lluis Paradell, *Law & Practice of Investment Treaties: Standards of Treatment* (Wolters Kluwer: New York, 2009) at 174; Reply Memorial Book of Authorities, Tab 3.

ii. The Treatment to Which Claimants Were Entitled

109. Determining the treatment that should have been accorded to Claimants is first a function of determining whom to compare. At page 76 of the Counter Memorial, Respondent says that Claimants can only properly be compared to "other NPMs". Implicit in this statement is the tautological argument that the Tribunal should use the measures at issue as the means by which the comparators should be identified. Given that the object of the Article 1102/1103 analysis is to determine whether a measure unfairly discriminates as between two or more investors, it makes no sense to use the measure as the basis of deciding whom to compare.

110. Because Respondent remains steadfast in maintaining its illogical position – that Claimants can only be compared to tobacco enterprises receiving the same less favourable treatment – throughout the Counter Memorial, it never addresses the Claimants' case under Articles 1102 and 1103. In this regard, Respondent clearly misconstrues the oft-cited analysis set out by the Tribunal in *Pope & Talbot* v. *Canada*. The following is a popular synopsis of the Tribunal's national treatment findings:

> The concept of national treatment under Article 1102 of [the] NAFTA resurfaced in *Pope & Talbot Inc. v. Canada*, where breach of the provision was rejected by the Tribunal. The Tribunal first held that the expression "no less favourable" means equivalent to, not better or worse than, the best treatment accorded to the comparator'. It further rejected an argument raised by Canada that it was necessary to establish some disproportionate disadvantage to the foreign investor. Instead the Tribunal reformulated the test in the following terms:
>
> > … as a first step, the treatment accorded a foreign owned investment protected by Article 1102(2) should be compared with that accorded domestic investment in the same business or economic sector. However, the first step is not the last one. Differences in treatment will presumptively violate Article 1102(2), unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face *de facto*, between foreign-owned and domestic companies, and (2) do

> not otherwise unduly undermine the investment liberalizing objectives of [the] NAFTA.[92]

111. Contrary to the above, Respondent says that the result in the *Pope & Talbot* case supports its position: i.e. that the Investors can only be compared with other tobacco companies that did not "opt" to join the MSA. The facts of the case reveal, however, why Respondent's reliance on it is misplaced. In *Pope & Talbot*, the investor was a lumber producer based in one of only four provinces subjected to an export fee regime by the federal government. The investor observed that lumber producers based in provinces where the measure did not apply were enjoying better treatment because they were paying no export fees. The Tribunal found that the reason the measure did not apply in all provinces was that it was imposed in response to a U.S. Government threat of trade sanctions, which only applied to lumber producers in the four provinces that would subsequently be covered under Canada's measure. Since the U.S. Government was not threatening producers located in other provinces, there was no reason to impose export taxes on them. Hence, the appropriate comparators were all lumber producers in the threatened provinces.

112. The difference between the two cases is obvious, although somewhat ironic. The irony stems from the fact that Claimants' on-reserve investment is being subjected to measures whose territorial jurisdiction does not extend to the territories in which they are doing business. In other words, at least with respect to on-reserve sales, Claimants are supposed to be the 'lumber producers in other provinces' who receive better treatment because they are not being forced to pay the import tax. Sadly, too many

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[92] Campbell McLachlan, Laurence Shore & Matthew Weiniger, *International Investment Arbitration* (OUP: London, 2007), at 253; Reply Memorial Book of Authorities, Tab 2.

state governments are refusing to respect the sovereign, territorial jurisdiction of First Nations.

113. With respect to off-reserve sales, the *Pope & Talbot* analogy would only apply if Claimants were pointing to the treatment being received by tobacco enterprises selling proprietary brands in non-MSA states (where no escrow payments are demanded, etc.). That is not, nor has ever been, Claimant's complaint. Claimants' primary argument is that under the MSA and its implementation legislation, a select, class of tobacco enterprises – the Grandfathered SPMs – are receiving better treatment than other enterprises because the other enterprises do not receive an exemption for historical brand performance upon joining the MSA. When they established their brands off-reserve, starting in 2002, Claimants 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.

114. The events that triggered Claimants' 'more favourable treatment' claim for off-reserve sales of their brand were: the decisions by each MSA State, where Claimants' brands are sold off-reserve, to change the status quo ante – thereby frustrating Claimants' expectation that an allocable share release would be forthcoming from states where their brands were established. Like all participants in the discount brand tier who were not enjoying an MSA exemption, Claimants relied upon the promised releases to be able to compete, off-reserve, against the Grandfathered SPMs.[93] After the releases were

[93] First Witness Statement of Jerry Montour, at ¶¶ 43-45, 50-51, Claimants' Memorial, 7/10/08, Ex. 1; see Second Witness Statement of Jerry Montour, at ¶¶ 16-17, Reply Evidentiary Submissions Ex. 7.

eliminated, Claimants' brands were no longer price competitive, as compared to the brands of Grandfathered SPMs.[94]

115. It is disingenuous for Respondent to now argue that Claimants are somehow disqualified from comparing themselves to MSA members because MSA members are not subjected to the Escrow Statutes. Respondent is the one insisting that the Allocable Share Amendments were necessary to 'level the playing field' between tobacco enterprises that joined the MSA and those who 'chose' not to do so. The fact that the so-called 'brand playing field' was not 'level,' following elimination of the allocable share release mechanisms, does not detract from the fact that Respondent has itself demonstrated who the appropriate comparators are in this case. They 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. The issue is whether any member of the former group is now receiving less favourable treatment than a member of the latter group, as a result of the elimination of allocable share releases in each Escrow Statute?

b) Treatment Accorded Under the Allocable Share Amendments

116. At page 79 of the Counter Memorial, Respondent cites Professor Gruber's Report for the proposition that Grandfathered SPMs are not receiving more favourable treatment under the modified MSA regime. With respect, Professor Gruber does not say, anywhere in his report, that Grandfathered SPMs are not receiving more favourable treatment. What he says is that, as a matter of theoretical economics, the advantages they

[94] Second Affidavit of Larry Phillips, at ¶ 2, Reply Evidentiary Submissions Ex. 9; Eisenstadt & Dalkir Report, Claimants' Memorial, 7/10/08, Ex. 13; Second Witness Statement of Marvin Wesley, at ¶¶ 4-6, Reply Evidentiary Submissions Ex. 10; Witness Statement of Jerry Montour, at ¶¶ 53-56, Claimants' Memorial, 7/10/08, Ex. 1.

are receiving do not translate into a competitive advantage in the market place. Common sense, more rigorous economic evaluation, and on-the-ground experience contradict the learned professor's opinion.[95]

117. Indeed, Respondent and its expert appear to be missing the bigger point when they argue, at page 79 of the Counter Memorial, that enterprises with regional brand strategies enjoyed a competitive advantage over "PMs" who did not. They are admitting Claimants' case: that prior to imposition of the Allocable Share Amendments, Claimants were able to compete on an approximately equalized basis with Grandfathered SPMs. The issue is not whether an NPM with a successful regional brand was more favoured under the old regime than a SPM that did not enjoy any MSA payment exemption. The issue is whether – under the new regime – the NPM with a regional brand is receiving less favourable treatment than the Grandfathered SPM, which still enjoys the same MSA payment exemption it did before the regime was changed.

118. In this respect, the State of Kentucky has taken the opportunity to clarify matters in a pleading before a local court. The court was being asked by a group of SPMs to prevent Kentucky and the other MSA States from agreeing to permit an NPM named General Tobacco from joining the MSA on special terms. General Tobacco is a competitor of Claimants in the discount brand market tier.[96]

> It is not difficult to understand why Movants seek as their primary remedy exclusion of an MSA competitor. As grandfathered SPMs, they already enjoy terms much more favourable than those imposed on General Tobacco – but apparently this is not good enough. Thus, for its 2005 sales, General Tobacco

[95] Eisenstadt & Dalkir Report, Claimants' Memorial, 7/10/08, Ex. 13; Second Witness Statement of Larry Phillips at ¶¶ 2-3, 6-10, Reply Evidentiary Submissions Ex. 9.

[96] See Second Witness Statement of Jerry Montour, at ¶ 27 (noting that General Tobacco, referred to as "GTI", is a competitor), Reply Evidentiary Submissions Ex. 7

> will owe MSA payments of approximately $4.20 per carton on all of its cigarette sales in the Commonwealth and elsewhere in the United States and in addition will have made millions of dollars in payment of principal and interest on its Back Payment amount, i.e. MSA payments imposed retroactively and calculated as if General Tobacco had joined the MSA when it began to sell cigarettes. By contrast, Movants will owe MSA payments only on sales above their grandfathered shares. If its MSA payment obligation for 2004 sales is any guide, Movant Vector will likely owe no MSA payments at all for 2005 sales, whereas the average payment by the others will range between approximately $0.70 and $3.00 per carton. Indeed, if Movants really wanted the Commonwealth to "provide the same financial obligations" to them as those that were provided to General Tobacco, the Commonwealth would happily oblige.
>
> …
>
> "Movants Already Enjoy MSA Payment Terms That Are Far More Favorable Than Those Afforded General Tobacco"[97]

119. Claimants note that they have not even been offered as favourable treatment as the MSA States were apparently enthusiastic about providing to General Tobacco. Claimants made efforts to join the MSA, starting in 2006, on the good faith basis that the MSA States would permit them to retain the opportunity to vindicate their rights before the United States Federal Court and the Tribunal, and that they be provided with sufficient time to make the "back payments" that would be demanded as a condition of joining.[98] The MSA States declined Claimants' request, although for General Tobacco, the Attorney General for Kentucky described the arrangements made with General Tobacco to join the MSA as follows:

> As to the other aspects of General Tobacco's claimed "special terms," the Commonwealth would gladly provide Movants "similar terms" to those afforded General Tobacco. For example, if Movant Vector would make full MSA payment on its second half of 2004 sales, agree to quarterly escrow of future payment amounts in full, provide a security interest in its trademarks, and agree to limitations on its right to claim an NPM Adjustment, the Commonwealth

[97] See: Response to Motion By Liggett Group Inc., Vector Tobacco Inc., Commonwealth Brands, Inc., King Maker Marketing, Inc., and Sherman's 1400 Broadway N.Y.C. Ltd. to Enforce Master Settlement Agreement, in Commonwealth of Kentucky v. Brown & Williamson Tobacco Corp., Civil Action No. 98-CI-01579 (filed Sept. 12, 2005) @ pp 3-4 & 14; attached as Exhibit G to: Vibo Corporation Inc. v. Conway at al, Civil Complaint, 28 October 2008, US Dist. Ct., West. Dist. KT, Louisville Div., File No. 3:08-CV-571-JBC, Reply Evidentiary Submissions Ex. 51.

[98] Second Witness Statement of Jerry Montour, at ¶¶ 20-22, Reply Evidentiary Submissions Ex. 7.

> would gladly agree to a 12 year payment period for receiving MSA payments on its first half of 2004 sales. Similarly, if any Movant were prepared to treat as a Back Payment amount the difference between what it actually paid under he MSA and what the full payment amount would have been on its sales absent the grandfather share and agree to the same payment and other terms related to that Back Payment amount, the Commonwealth would gladly agree to provide it "similar payment provisions" to those provided General Tobacco.[99]

120. The Kentucky Attorney General's arguments, about why the Grandfathered SPMs should be much happier with the treatment they received from the MSA States than what was then on offer to General Tobacco, are unequivocal about the nature of the advantage accorded to them under the original Escrow Statutes vis-à-vis an SPM who joined without entitlement to a grandfathered share exemption. For example, Liggett enjoys a permanent 1.60834% (40.3 million carton) exemption from annual MSA payments, while Commonwealth Brands, which enjoys a 0.74345% (20.5 million carton) exemption. Moreover, when it joined the MSA, Liggett was not required to make any payment to the Settling States for its pre-MSA sales and for decades of allegedly tortious and unlawful conduct.

121. Relying upon rules of the game established under the original Escrow Statutes, Claimants mitigated what the entire industry saw as Liggett's (and Commonwealth's and Premier's) competitive advantage by adopting a regional brand strategy for off-reserve sales that qualified for allocable share releases. Respondent repeatedly admits that under its amended Escrow Statutes, the regional brand strategy was effectively neutralized. Whereas Respondent focuses exclusively on how removing

[99] See: Response to Motion By Liggett Group Inc., Vector Tobacco Inc., Commonwealth Brands, Inc., King Maker Marketing, Inc., and Sherman's 1400 Broadway N.Y.C. Ltd. to Enforce Master Settlement Agreement, in Commonwealth of Kentucky v. Brown & Williamson Tobacco Corp., Civil Action No. 98-CI-01579 (filed Sept. 12, 2005) @ 16; attached as Exhibit G to: Vibo Corporation Inc. v. Conway at al, Civil Complaint, 28 October 2008, US Dist. Ct., West. Dist. KT, Louisville Div., File No. 3:08-CV-571-JBC, Reply Evidentiary Submissions Ex. 51.

entitlement to the allocable share release placed Claimants on theoretically "even terms" with a non-exempt SPM or OPM, it cannot, run away from admissions like those of the Kentucky Attorney General – because they demonstrate that the MSA States have always known that the best treatment available under the MSA Regime was that which was provided to Grandfathered SPMs such as Liggett. As state officials admitted, in discussion with the OPMs and Exempt SPMs behind closed doors: "[the] States' allocable share objective [was] to impose escrow obligation on NPM equal to that imposed on an SPM without grandfather share."[100]

122. The intended result could not have been more clear: enterprises that had adopted, and thrived upon pursuing, a regional brand strategy were going to receive treatment less favourable than that which was – and would continue to be – provided under the Escrow Statutes, as amended by their new measures. Worse, if the Allocable Share Amendments worked as designed – and companies like Claimants' enterprise were forced to apply to join the MSA, shifting from a regional to national strategy in a last-ditch effort to drive down costs by achieving economies of scale – the more favourable treatment which formed the basis of the Grandfathered SPM's entry into the MSA would not be made available to the new entrants. Whereas Claimants would be told, in 2007, that they would be required to pay over $200 Million before they could join the MSA, allegedly to "compensate" MSA States for their historic sales, Grandfathered SPMs such as Liggett were effectively given a free pass on any and all alleged "compensation" owing for consumers' use of their products.[101]

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[100] January 25, 2004 Meeting Minutes, Reply Evidentiary Submissions Ex. 22.
[101] In a pleading filed against the MSA States, after their agreement apparently fell through, General Tobacco has contributed the following details to the story behind Liggett and

123. It is very difficult to fathom how a company such as Liggett, whom Respondent has repeated castigated as being a charter member of a “rogue and deviant” industry, and guilty of acts of fraud and deception for decades up until the present,[102] could be in receipt of more favourable treatment under a measure, much less for that measure to have been amended with the specific purpose in mind of perpetuating that advantage vis-à-vis competitors such as Claimants’ enterprise. That such favourable treatment could include requiring Claimants to pay “compensation” for all previous sales of its brands, before being permitted to join the MSA (thereby crystallizing the difference in treatment as a matter of current US law),[103] while having allowed a company with an alleged history like Liggett to avoid paying a penny in compensation for past sales of its brands when it joined the MSA, is simply beyond the pale.

124. The list of Grandfathered SPMs includes United States owned enterprises such as: Liggett Group, PLC; Commonwealth Brands and Premier Manufacturing. It also includes foreign-owned enterprises such as: King Maker Manufacturing and Japan

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Commonwealth Brands joining the MSA. Apparently the formula for calculation of grandfathered shares allowed both Liggett and Commonwealth Brands to maximize their respective exemptions by including sales of certain brands that were either divested or acquired shortly before those companies joined the MSA. Liggett was apparently allowed to include as part of its grandfathered share the sales of three brands it had sold through a transaction with Philip Morris immediately prior to signing the MSA. Commonwealth Brands was apparently allowed a grandfathered exemption that included sales from three brands it had acquired from Brown & Williamson shortly before the MSA was signed even though Brown & Williamson had built up demand for those brands during the period immediately leading up to signing the MSA. Complaint with Jury Demand, *VIBO Corp., Inc. v. Conway*, 3:08-cv-571 JBC, Reply Evidentiary Submissions Ex. 37.

[102] USA Post Trial Brief in RICO case at 165, at 171 to 175, Reply Evidentiary Submissions Ex.38.

[103] See: VIBO Corporation, Inc. v. Jack Conway et al, Memorandum Opinion and Order, Civil Action No. 08-571-C, U.S. Dist. Ct. (West. Dist. Kentucky, Louisville Div), January 9, 2009, Reply Evidentiary Submissions Ex.37, where the Court dismisses General Tobacco’s application to strike down portions of the MSA Regime on the basis that it waived such rights upon joining the MSA.

Tobacco. Accordingly, both of Articles 1102 and 1103 apply in the circumstances of this case, with Article 1104 confirming that the matter of any treatment available, as between Articles 1102 and 1103.

c) Reasonable Nexus to Rational Government Policies That Do Not Otherwise Unduly Undermine the Investment Liberalizing Objectives of the NAFTA

125. The story of Liggett likely explains why Respondent cited the *Pope & Talbot* Tribunal without addressing how it might justify the treatment accorded by its state governments under their Allocable Share Amendments. The *Pope & Talbot* Tribunal recommended that where a *prima facie* case has been made out by a claimant, the NAFTA Party could avoid liability by explaining how 'a reasonable nexus' exists between the less favourable treatment being accorded and a 'rational government policy that would not unduly undermine the investment liberalizing objectives of the NAFTA.' Claimants submit that it is not possible for Respondent to establish a reasonable nexus between the abominable way the MSA States have treated Claimants and the treatment they decided to accord to companies like Liggett, Premier and Commonwealth Brands.

126. Liggett has been a significant player in the US tobacco business for over six decades. One of its executives, Ed Horrigan, was a member of the infamous "Seven Dwarfs of Tobacco" – who stood before the United States Congress in 1994 and stated, under oath, their collective belief that nicotine is not addictive. This event is widely seen as the turning point in the history of public tobacco litigation – shortly after which state governments began launching lawsuits against Liggett and the OPMs for a host of torts that had nothing to do with product liability, such as fraud, deceit and conspiracy. Liggett Group was also among the defendants that Respondent chose to pursue in 2005,

in the RICO case in which it and its expert, Dr. Gruber, admitted that the MSA was ineffective at controlling youth tobacco consumption.

127. Despite the fact that Liggett shares the exact same history as the OPMs, and has stood accused with them for all of the actions that Respondent and its state governments have alleged exclusively against them – and not Claimants – Liggett is nonetheless entitled to sell hundreds of millions of dollars worth of its brands each year without any payment obligations arising. As Marvin Wesley, a former Liggett executive, explains in his Second Witness Statement, it was Liggett's Grand Prix® brand that was so aggressively marketed against Claimants' Seneca® brand, after the Allocable Share Amendments came into effect in states such as Kansas and Oklahoma, that it supplanted the Seneca® brand on store shelves in those states.[104]

128. There is simply no rational basis for the MSA States having permitted Liggett, since 1998, to make literally hundreds of millions of dollars in cigarette sales for which no payment had to be made to the Settling States, while demanding Grand River and NWS make escrow payments for all of their sales (but refusing to release the portion representing states where the brand is not available off-reserve).

129. It cannot be, as Respondent contends, that the amended Escrow Statues were necessary to enable state governments to collect from Claimants, in the event that one decided to become the first state government in United States history to obtain judgment against a tobacco enterprise requiring payment of compensation for general health care costs. If that were the reason, Liggett would not have been excused from

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[104] Second Witness Statement of Marvin Wesley, at ¶ 6, Reply Evidentiary Submissions Ex. 7.

making compensatory payments, not only for hundreds of millions of dollars in future sales, in perpetuity, but also for the billions of cigarettes it sold in the decades running up to the MSA, during which time Respondent itself says Liggett acted criminally.

130. The alternative argument advanced by Respondent is that the Allocable Share Amendments were necessary to 'level the playing field' between PMs and NPMs, i.e. to ensure that every tobacco enterprise was paying its 'fair share' under the regime. How then to explain the hundreds and hundreds of millions of dollars in brand sales made each year by the likes of Liggett, Commonwealth Brands and Premium that do not attract any payment obligations? If the Tribunal finds that these companies, with their grandfathered exemptions, are receiving more favourable treatment under the amended Escrow Statutes, this alternative rationale is meaningless. At the end of the day, after the measure is applied, either the field is level or not.

131. At page 81 of the Counter Memorial, Respondent does briefly state: "Grandfathered SPMs are particularly inappropriate as comparators to [Claimants] because Grandfathered SPMs, unlike [Claimants], were selling cigarettes in the U.S. market at the time the MSA was signed." If everything Respondent says about how state governments are legally entitled to compensation from tobacco enterprises for general health care costs is true, logic would dictate that the longer a company has been in business the less entitled it should be to an exemption from payment. Moreover, the dissuasion of new entrants from entering a market is inconsistent the liberalizing objectives of the NAFTA.[105]

[105] In fact, the *Pope & Talbot* Tribunal recognized that it was "necessary and reasonable" to include a means by which new entrants could join the market place, where the measure in

132. On the other hand, if the policy being put forward by Respondent to justify the Allocable Share Amendments is that the State must take account of an enterprise's vested rights, in valuable assets such as brands, measured on the basis of market share held prior to imposition of the measure, Claimants agree with the principle behind it. Claimants would submit, however, that it would be utterly arbitrary – and therefore not rational – for this principle to be applied in 1998, when the regulatory rules of the game were first changed, but not in 2004 and 2005, when the rules were changed again.

133. To the best of Claimants' knowledge, the products that the Grandfathered SPMs sell under their brands – and which have displaced Claimants' brands on store shelves in a number of states after the Allocable Share Amendments were implemented – share all of the same physical characteristics as the Seneca® and Opal® brands. There being no significant difference between the products that Claimants and the Grandfathered SPMs sell under their respective brands, Claimants submit there is simply no justification for treating them differently than the Grandfathered SPMs under the amended Escrow Statutes.

D. FAIR AND EQUITABLE TREATMENT, IN ACCORDANCE WITH THE CUSTOMARY INTERNATIONAL LAW MINIMUM STANDARD OF TREATMENT

a) The Customary International Law Minimum Standard of Treatment Includes Fair and Equitable Treatment

question was an export fee system in which historical market performance was used as the basis upon which quotas – which entitled the holder to an exemption from fee payment – were distributed; *Pope & Talbot Inc* v *Canada*, Award on the Merits of Phase 2, Ad hoc—UNCITRAL Arbitration Rules, IIC 193 (2001) at 92; Memorial Authorities, Tab 56.

134. At pages 88 to 93 of the Counter Memorial, Respondent presents the same retrograde arguments that it has made before past NAFTA tribunals, both as Respondent and as third Party, without success. Claimants have already cited the passage from the *Mondev Award* that best demonstrates how other NAFTA tribunals have been unwilling to accept the proposition that Article 1105 requires no more of a NAFTA Party than to avoid conduct that is “notoriously unjust” or “egregious” or “which offends a sense of judicial propriety,” at paragraph 154 of the Memorial. Claimants would nonetheless submit that, in any event, the treatment received by Claimants at the hands of many of Respondent’s state governments could certainly be characterised as egregious and notoriously unjust, and which should offend the Tribunal’s sense of judicial propriety.

135. Claimants stand by their arguments, and the modern cases and texts cited by both parties, for the proposition that the minimum standard of treatment in customary international law now includes the duty of a Host State to accord fair and equitable treatment to the national of another State. The content of this standard is informed by applicable rules of international law, as per NAFTA Article 1131(1) and VCLT Article 31(3)(c), as well as by the context of the instant case.

136. There is no shortage of doctrinal assistance on this issue, the vast majority of which appears to be converging on a meaning for the ‘fair and equitable treatment’ obligation that is consistent with customary international law, and which contemplates all of the elements of certainty, transparency, good faith and due process that Respondent appears determined to disallow:

> The question whether fair and equitable treatment is or is not additional to the minimum treatment requirement under international law is a question about the

> substantive content of fair and equitable treatment and, whichever side of the argument one takes, the answer to the question may in substance be the same.[106]
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> ***
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> The question whether fair and equitable treatment is or is not additional to the minimum treatment requirement under international law is a question about the substantive content of fair and equitable treatment. In 1927, the US-Mexican Mixed Claims Commission considered in the *Neer* case that a State has breached the fair and equitable treatment obligation when the conduct of the State could be qualified as outrageous, egregious or in bad faith or so below international standards that a reasonable and impartial person would easily recognize it as such. This description of conduct in breach of the fair and equitable treatment standard has been considered as the expression of customary international law at that time. For the Tribunal the question is whether, at the time the Treaty was concluded, customary international law had evolved to a higher standard of treatment.
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> It emerges from this review that, except for *Genin*, none of the recent awards under NAFTA and *Tecmed* require bad faith or malicious intention of the recipient State as a necessary element in the failure to treat investment fairly and equitably, and that, to the extent that it has been an issue, the tribunals concur in that customary international law has evolved. More recently in *CMS*, the tribunal confirmed the objective nature of this standard "unrelated to whether the Respondent has had any deliberate intention or bad faith in adopting the measures in question. Of course, such intention and bad faith can aggravate the situation but are not an essential element of the standard." That tribunal also understood that the conduct of the State has to be below international standards but not at their level in 1927 and that, as in *Tecmed* and *Waste Management II*, the current standard includes the frustration of expectations that the investor may have legitimately taken into account when it made the investment.[107]

137. At pages 93 to 96 of the Counter Memorial, Respondent also attempts to reshape Claimants' arguments on the principle of good faith into a claim that the principle should be used to "override" the language of Article 1105. Claimants say nothing of the sort. Indeed, the very notion that the principle of good faith could be used to override the text of Article 1105 is absurd. The principle of good faith obviously

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[106] Azurix Corp v Argentina, Award, ICSID Case No ARB/01/12, llC 24 (2006) 14 July 2006, at para. 364; Memorial Book of Authorities, Tab 8.

[107] *Siemens AG* v *Argentina*, Award, ICSID Case No ARB/02/8 (6 February 2007) at para's 293 and 299; Memorial Book of Authorities, Tab 66.

informs what "fair and equitable treatment" means within the context of a given case. As the Tribunal in *Sempra Energy v. Argentina* observed:

> The Tribunal finds the Respondent to be right in arguing that fair and equitable treatment is a standard that is none too clear and precise. This is because international law is itself not too clear or precise as concerns the treatment due to foreign citizens, traders and investors. This is the case because the pertinent standards have gradually evolved over the centuries. Customary international law, treaties of friendship, commerce and navigation, and more recently bilateral investment treaties, have all contributed to this development. Not even in the case of rules which appear to have coalesced, such as denial of justice, is there today much certainty.
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> The evolution that has taken place is for the most part the outcome of a case-by-case determination by courts and tribunals, as is evidenced by many investment treaty and NAFTA decisions, including the Tecmed, OEPC and Pope & Talbot cases cited. This shows that, as with the international minimum standard, there has been a fragmentary and gradual development. However, it has been rightly commented that essentially "the purpose of the clause as used in BIT practice is to fill gaps which may be left by the more specific standards, in order to obtain the level of investor protection intended by the treaties." The principle of good faith is thus relied on as the common guiding beacon that will orient the understanding and interpretation of obligations, just as happens under civil codes.
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> It follows that it would be wrong to believe that fair and equitable treatment is a kind of peripheral requirement. To the contrary, it ensures that even where there is no clear justification for making a finding of expropriation, as in the present case, there is still a standard which serves the purpose of justice and can of itself redress damage that is unlawful and that would otherwise pass unattended. Whether this result is achieved by the application of one or several standards is a determination to be made in the light of the facts of each dispute. What counts is that in the end the stability of the law and the observance of legal obligations are assured, thereby safeguarding the very object and purpose of the protection sought by the treaty.[108]

138. Where detrimental reliance upon a pre-existing government policy or law is alleged, the principle of good faith may be useful in comprehending the reasonableness of the alleged reliance. Similarly, when the treatment of indigenous peoples is at issue in

[108] *Sempra Energy International* v *Argentina*, Award and Partial Dissenting Opinion, ICSID Case No ARB/02/16 (28 September 2007) at para's. 296-297 and 300; Memorial Book of Authorities, Tab 64.

a case, solemn treaty obligations undertaken by the Host State for their benefit may also be used to inform what "fair and equitable treatment" means within the context of that case.

139. In their recent treatise, McLachlin et al have contributed some thoughtful analysis to these issues, including: (1) the content and meaning of the customary international law minimum standard; (2) the role of general international law principles in interpretation of the standard; and (3) the role of international human rights norms in investment treaty law. Given the complex and sensitive nature of these topics, Claimants provide an extended excerpt:

> It is suggested that this controversy [between attributing different meanings to the 'fair and equitable treatment' standard and that which is required under the customary international law minimum standard of treatment of aliens] is misguided, and the dichotomy presented by the opposing views is a false one on a number of levels. It takes an overly simplistic view of differences in formulation of the right in different treaties. It suggests the only choice open to a tribunal is between complete discretion to determine whether particular conduct is 'unfair and inequitable' on the one hand, and the application of a conception of customary international law 'frozen in amber' at some time in the past. Most seriously of all, it falsely presents the minimum standard of treatment of aliens in customary international law as having a well-settled content. In doing so, it ignores the level of dissent among States throughout much of the twentieth century not only over the content of such a standard, but even over whether it existed at all.
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> … In the current BIT practice these two standards, traditionally placed in opposition, are almost universally placed alongside one another without any attempt at reconciliation.
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> It is submitted that it is both possible and necessary to reconcile the particular treaty language with the requirements of general international law. Indeed, as it was put in one recent award, 'the difference between the Treaty standard… and the customary minimum standard, when applied to the specific facts of a case, may well be more apparent than real. In any event, the legal protection afforded by the guarantee of fair and equitable treatment cannot be understood without a conception of the proper function of international law in assessing the standards of justice achieved by national systems of law and administration.

> … Seen in this light, the fair and equitable standard gives modern expression to a *general principle of due process* in its application to the treatment of investors. The foundation of this principle is that, by agreeing to extend such treatment to nationals of a reciprocating country, States have accepted that there is an objective standard of treatment by which their own legal and administrative system may be judged. The standard thus encapsulates the minimum requirements of the rule of law…
>
> In the past, debates on minimum treatment have foundered upon the traditional hurdles of customary international law: the lack of a sufficiently uniform practice, let alone an acceptance of *opinio juris*, given the deep divergences in the views of States exposed during the many fruitless negotiations on investment law. But the voluntary acceptance of the principle by treaty transforms the question from one of obligation to content.
>
> Then the issue becomes one of locating a sufficiently common consensus among civilized nations as to content. In this, reference to 'general principles of law common to civilized nations' as the third basic source of international law becomes of crucial importance. In the task of finding common principles in this field, the development of modern international law presents a substantial advantage over the position in the early twentieth century as a result of the elaboration of relevant international human rights standards, and of the gradual emergence of global administrative law. Reference to these courses facilitates the application of standards which may be seen as genuinely common to civilized nations. It is not, as has sometimes been suggested, that the emergence of international human rights norms would subsume and render obsolete both the international minimum standard and the standard of national treatment. Rather, some elements of human rights law may furnish a source of general principle from which the obligation of fair and equitable treatment may be given contemporary content.[109]

140. In spite of the doctrinal developments described by Professor McLaughlin and his colleagues above, however, Respondent nonetheless takes issue with the notion that international human rights should inform the Tribunal's analysis under NAFTA Article 1105, at pages 129 to 133 of the Counter Memorial. In response, Claimants submit that, as a matter of public international law, any international tribunal vested with authority to determine issues in dispute on the grounds of applicable international law owes an independent duty to apply any and all imperative principles of international law to its work. In the appropriate case, such applicable law will necessarily include

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[109] Campbell McLachlan, Laurence Shore & Matthew Weininger, *International Investment Arbitration* (OUP: London, 2007), at 203-205.

international human rights instruments, principles and doctrine. As Newcombe and Paradell observe:

> State measures that affect individual foreign investors may well violate international human rights law and give rise to a claim under regional and international human rights instruments. Violations of international human rights may also give rise to a violation of the minimum standard of treatment provisions in llAs. With respect to procedural rights, there may be significant overlap between claims of human rights violations on the one hand, and claims of denial of justice and due process on the other.[110]

141. Indeed, as per the application of Article 103 of the United Nations Charter, and consistent with VCLT Article 53, even if Respondent was correct that NAFTA Article 1105 cannot be used by an investor to vindicate a fundamental human right – in application of the NAFTA Parties' binding interpretative statement of July 31, 2001 – such application would be void, *ab initio*. The Article 1105 promise of "treatment in accordance with international law" must be construed as obligating the NAFTA Parties to provide treatment to the investor of another Party that is consistent with any fundamental human rights norms that the investor seeks to vindicate, including claims founded upon violations of the UN Charter. Professor Hirsch agrees:

> Since some fundamental human rights are protected by peremptory rules of international law as well as the UN Charter, recognizing the superior status of these rules may require future investment tribunals to subject some provisions included in investment treaties to these higher principles of public international law (e.g. with regard to the prohibition against racial discrimination).
>
> The primacy of some international human rights over investment obligations may be invoked not only by host governments but also by foreign investors or some NGOs. Thus, for instance, individual investors may invoke the superior status of the above rules with regard to their right to property as well as regarding their right to fair trial.[111]

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[110] Andrew Newcombe and Lluis Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Wolters Kluwer: New York, 2009) at 252; citing: Ian Brownlie, *Principles of Public International Law*, 6th ed. (Oxford University Press: Oxford, 2003) at 537.
[111] Moshe Hirsch, "Interactions Between Investment and Non-Investment Obligations" in: Peter Muchlinski, Federico Ortino & Christoph Schreuer, eds., *The Oxford Handbook of International*

142. In summary, Claimants submit that their approach is the one that is in line with established authorities and consistent with the broader doctrine of public international law. It is accordingly submitted that the Tribunal disregard the constricted and narrow version of the NAFTA Article 1105 standard advanced by Respondent as self-serving and inconsistent with the current practice of international law generally, and investment treaty law in particular.

b) Discrimination Against Indigenous Investors

143. At pages 125 and 126 of the Counter Memorial, Respondent attempts to reconfigure Claimants' grounds for a remedy on the basis of the principle of non-discrimination against indigenous peoples. It says Claimants are seeking "special treatment" to which they are not entitled under the measures or under international law. Claimants are asking for no such thing, but they refer Respondent to the amicus submission of the Grand Chief of the Assembly of First Nations of Canada, Mr. Phil Fontaine, in which the honourable Chief and respected lawyer observes:

> Instead of responding directly to the claimants' position, the United States of America has adopted a tactic commonly used by opponents of First Nations rights: they argue that the claimants are seeking "special treatment" rather than simple equality.[112]

144. Claimants explained the grounds for their non-discrimination claim at pages 72 to 78 and 89 to 91 of the Memorial. They say that when Respondent's state governments resolved to promulgate the Allocable Share Amendments they knew their application would result in worse treatment of Claimants and their investment in the

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Investment Law (Oxford University Press: Oxford, 2008) 154 at 159; Reply Memorial Book of Authorities, Tab 4.

[112] Amicus Submission of the Grand Chief, Assembly of First Nations of Canada, January 19, 2009, Reply Evidentiary Submissions Ex. 4.

Seneca® brand, off-reserve, than had been made available to Claimants' competitors, the Grandfathered SPMs. Claimants argued that, as a function of applicable international human rights norms, Respondent was obligated to both consult and engage in good faith negotiations with Claimants concerning how the adverse impacts of these measures could be mitigated.

145. Respondent does not answer this claim on the facts. It wrongly states that Article 1105 must be construed in a manner that denies Claimants their rights to non-discrimination under the UN Charter, as elaborated by numerous other human rights instruments dedicated to the protection and promotion of indigenous peoples. It also attempts to defuse the argument by referring to this bundle of rights, fostered to prevent racial discrimination against indigenous peoples, as effectively unenforceable because they are only 'emerging norms' of customary international law. Respondent misses the point that there is nothing 'emerging' about the prohibition against racial discrimination in customary international law. States are under a positive duty to take remedial steps to both correct and prevent even unintended acts of discrimination against historically disadvantaged groups, such as First Nations.

146. In this regard, Claimants recall that Article 7 of the Universal Declaration on Human Rights provides:

> All are equal before the law and are entitled without any discrimination to equal protection against any discrimination in violation of this Declaration and against any incitement to such discrimination.[113]

[113] *Universal Declaration of Human Rights, G.A. res. 217A (III), U.N. Doc A/810 at 71 (1948);* Memorial Book of Authorities, Tab 97.

147. Equality before the law and equal protection of the law are broad and remedial concepts that prohibit much more than just overt and/or intended measures of discrimination on the basis of race. As such, the 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. In the teeth of a *prima facie* breach of an equality right owed to a First Nations investor, Respondent and its state governments can be scrutinized for their failure to take necessary remedial steps to prevent that breach from occurring and to remedy it if already imposed. Consultation and good faith negotiation are advocated as necessary elements of preventing discriminatory measures affecting indigenous peoples, whose communities are often among the least economically developed in North American Society:

> **Art. XXI. Right to development.**
>
> The States shall take necessary measures to ensure that decisions regarding any plan, program or proposal affecting the rights or living conditions of indigenous people are not made without the free and informed consent and participation of those peoples, that their preferences are recognized and that no such plan, program or proposal that could have harmful effects on the normal livelihood of those populations is adopted. Indigenous communities have the right to restitution or compensation in accordance with international law, for any damage which, despite the foregoing precautions, the execution of those plans or proposal may have caused them; and measures taken to mitigate adverse environmental, economic, social, cultural or spiritual impact.[114]

148. In this case, consultation and good faith negotiation are the natural and obvious remedy for the impact of the ASA on Claimants and their investments. This is because the very design of Respondent's measures was intended to encourage an affected tobacco enterprise to seek to "join" a multiparty agreement: i.e. the MSA. How then can

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[114] Permanent Council of the Organization of American States, Committee on Juridical and Political Affairs, Working Group to Prepare the Draft American Declaration on the Rights of Indigenous Peoples, OEA/Ser.K/XVI; GT/DADIN/doc.334/08, April 18, 2008; Reply Memorial Book of Authorities, Tab 5.

Respondent say that consultation and bargaining in good faith are not relevant or applicable obligations in this context? The international instruments cited by Claimants at pages 53 to 58 and 66 to 71 of the Memorial speak to the same result and thereby merely reinforce this conclusion. For example, please see the latest draft of the Organization of American States' *American Declaration on the Rights of Indigenous People*, which provides:

> **Article XXIX Right to Development**
>
> …
>
> 5. The States shall take the necessary measures to ensure that the decisions referring to any plan, program, or project that affect the rights or living conditions of indigenous peoples are made with the free, prior and informed consent or agreement of the indigenous peoples affected, on the basis of the measures proposed.

149. Claimants submit that, certainly by the time the Allocable Share Amendments were being contemplated, Respondent's state government officials must have been aware that there were a small and easily identifiable group of indigenous tobacco enterprises functioning in the marketplace. Their partners, the OPMs, were certainly tracking the market performance of these much smaller participants,[115] and numerous MSA State attorneys general were involved in legal disputes over the potential application of the original Escrow Statutes on-reserve. It would not have been logistically or administratively difficult for state government officials, acting on their own or through the National Association of Attorneys General, to both consult with, and enter into good faith negotiations with, at least the most significant of these enterprises, including the Claimants, and the makers of the Smokin Joe's® and Skydancer® brands that were also popular at that time.

[115] 1994 Canadian Newspaper Article, Reply Evidentiary Submissions Ex. 48.

150. Moreover, under Article 103 of the UN Charter it is not permitted to argue – as Respondent attempts to do at pages 128 to 129 – that because the United States has not chosen to recognize the existence of its obligation to consult and bargain in good faith with indigenous peoples under the United Nations *Declaration on the Rights of Indigenous Peoples*, the obligation does not exist. In point of law, however, the Article 7 equality right is an *ergo omnes* norm that pre-empts any limitation that Respondent would otherwise have the Tribunal read into the Article 1105 requirement for Respondent to act "in accordance with international law." It cannot be denied by a Respondent State in answer to a claim for its breach.

c) Legitimate Expectations

i) Claimants' Expectations for their Brands Sold On Reserve

151. Claimants' submit that the Haudenosaunee have a customary right to traverse and trade in their traditional territories, protected under Six Nations custom and law, and under international law. This right would be meaningless unless they were not inhibited from exercising the right to adapt and modernize their customary practices so as to preserve their cultural identity as trading, cross-border peoples, and to promote economic development in their communities.

152. At page 58 of the Memorial, Claimants cited the judgment of the Inter-American Court of Human Rights concerning the *Mayagna (Sumo) Awas Tingni Community* v. *Nicaragua* case,[116] which demonstrated how States owe obligations under customary international law to respect the rights of indigenous peoples to occupy and

[116] *The Mayagna (Sumo) Awas Tingni Community* v. *Nicaragua*, Judgment (31 August 2001), Inter-Am. Ct. H.R., (Ser. C) No. 79 (2001); Memorial Book of Authorities, Tab 41.

enjoy their lands. The property rights protections afforded by Awas Tingi arose from the inexorable connection that existed between their customary land use and the distinct cultural identity of those claimants. Likewise, the Claimants are engaged in a practice of cross-border trade that reflects their own customs that have similarly been in effect since time immemorial.

153. Trade in pursuit of a sustainable livelihood and economic well being are protected rights in international law reflected in the customary practice of trade by and amongst Haudenosaunne members, such as Claimants.[117] It should be axiomatic that a contemporary approach to interpreting indigenous rights in international law is one that recognizes the reality of historic and systemic dislocation, as well as the need for indigenous peoples to acquire and access modern resources and develop their own capacity. Thus, it is entirely incorrect to adopt a frozen rights approach that would disallow a modern form of the customary practice to manifest itself as the additional rights recognize the need for sustenance and economic well being.

154. The advancement of European culture in North America over the first four centuries after contact with the Haudenosaunee exacted a heavy toll in colonization of the majority of their traditional, geographic territories. As Professor Clinton has observed, this collective right has been affirmed and recognized in several treaties, which Claimants and their communities have always expected Respondent to honour in good faith.

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[117] See page 68 of the Memorial and following. Also, please note Article XVIII(2) of the draft *American Declaration of the Rights of Indigenous Peoples*, supra note 114, which provides: Indigenous peoples have the right to the recognition of their property and ownership rights with respect to lands and territories they have historically occupied, as well as to the use of those to which they have historically had access for their traditional activities and livelihood.

155. Scholars familiar with the history of treatment suffered by indigenous peoples in North America generally acknowledge the impact that such treatment has had on the ability of indigenous peoples to maintain the customary practices that reinforce their cultural identities, and permit them to attract sustainable economic development. One scholar familiar with United States Federal Indian Law has noted:

> The federal government has long been aware that its disruptive policies of removal, dispossession, and relocation have produced discontinuities in tribal organization. For example, in California, tribal groups were forced apart, and fragments from different groups reassembled at a few reservations. Federal laws directed at individual Indians or groups of individual Indians have aimed to repair these effects.[118]

156. The scholar responsible for this observation was none other than Respondent's expert on United States Federal Indian Law in these proceedings, Professor Carol Goldberg. In the same article, Professor Goldberg outlines her position about how U.S. courts should categorize "Indian" identity, for the purposes of answering 'reverse discrimination' cases brought to challenge programs offering better treatment for indigenous peoples. The following are some of her observations:

> I suggest that the Indian Commerce Clause response requires the application of a criterion for "Indianness," and a nexus between benefiting individual Indians and benefiting a tribe. There is something disturbing about delivering such a task to non-Indian courts. The Supreme Court in particular has not discharged this type of responsibility in a manner that inspires confidence or respect.[119]
>
> Federal constitutional law should not require tribes to conform to some outsider's image of Indians from film or literature in order to receive federal benefits, nor should it force tribes to freeze their culture and practices in time.[120]

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[118] Carol Goldberg, "American Indians and 'Preferential' Treatment" 49 UCLA L. Rev. 943 at 970-971, Reply Evidentiary Submissions Ex. 55.
[119] Carol Goldberg, "American Indians and 'Preferential' Treatment 49 UCLA L. Rev. 943 at 971, Reply Evidentiary Submissions Ex. 55.
[120] Carol Goldberg, "American Indians and 'Preferential' Treatment 49 UCLA L. Rev. 943 at 973, Reply Evidentiary Submissions Ex. 55.

> The Indian Commerce Clause response, in contrast, combines the self-determinationist conception of group rights with a more flexible and historically sensitive understanding of group membership. It is also the response that is most consistent with existing Supreme Court doctrine.[121]
>
> Political theory and philosophy seem to lend greatest support to the Indian Commerce Clause response to concerns about Indian preferences. This body of scholarship also identifies potential problems with this response--especially difficulties that may arise when the group benefited is not clearly enough defined. Thus, any legal doctrine informed by the Indian Commerce Clause response should privilege the views of federally recognized tribes in making decisions about entitlement, even for individuals who are not actually enrolled members of such tribes. The federal government has long adopted this practice. For example, in determining whether individuals are subject to federal prosecution as Indians under federal Indian country criminal statutes, the federal courts have inquired into ancestry as well as into recognition of the individual by an Indian community. Membership in a federally recognized tribe has not been required, but the view of such a tribe as to an individual's status is crucial to the operation of the statute.[122]

157. It appears that, sometime over the past six years, Professor Goldberg must have had a serious change of heart. It is difficult to reconcile the positivist approach to determining "Indian identity" that she demonstrates at pages 12 to 21 of her "*confidential*" report with the one she advocated above. At pages 116 to 121 of the Counter Memorial, with Professor Goldberg's assistance Respondent takes great pains to sharply demarcate what the learned professor has argued elsewhere is anything but a cut-and-dry exercise: i.e. whether an individual, or the business in which he participates, should be entitled to enjoy the various protections afforded under U.S. Federal Indian Law.

158. There are several obvious flaws in the Goldberg analysis, starting with her omission of Section 289 of the Immigration and Naturalization Act, cited at paragraph 19, above. This is especially problematic for Respondent, given that Professor Clinton

[121] Carol Goldberg, "American Indians and 'Preferential' Treatment 49 (2002) UCLA L. Rev. 943 at 989, Reply Evidentiary Submissions Ex. 55.
[122] Carol Goldberg, "American Indians and 'Preferential' Treatment 49 (2002) UCLA L. Rev. 943 at 988, Reply Evidentiary Submissions Ex. 55.

addressed the provision, and canvassed its import within the context of the Haudenosaunee – United States relationship, at page 29 of his Report. Section 289 is universally understood as Respondent's recognition of the obligations it holds arising from the *Jay Treaty*, and to the Haudenosaunee, whom Professor Clinton explains were the Treaty's intended beneficiaries.

159. To be clear, Respondent's immigration statute does not just provide for a special right of entry for Canadians who just so happen to be Indians. It provides virtually unlimited rights of entry and exit, and effectively unconditional approval for requests for permanent residency status, to "American Indians born in Canada". The language is unmistakable, and provides a resounding answer to Professor Goldberg's question, found at page 21 of her Report:

> If Canadian Indians were to receive the benefit of federal Indian law, it's difficult to see why indigenous peoples from all over the world – Maori from New Zealand, Zapotec from Mexico, Ami from Taiwan – would not be entitled to the same treatment.

160. The answer to Professor Goldberg's concern about an entire world of indigenous peoples arriving in the United States and demanding recognition of their status in its territory is that, for over 200 years, Respondent has not considered the Haudenosaunee and other "American Indians born in Canada" to be foreigners. Moreover, as described above, neither does the Seneca Nation treat other members of the Six Nations, including Seneca members residing in other portions of Haudenosaunee territory, as foreigners to its territory. It welcomes them; grants them business licenses upon request; or waives license requirements if they are engaged in a business association or partnership with a registered Seneca member – just as Claimants are doing in this case.

161. Most devastating for her opinion is Professor Goldberg's disavowal, at note 2 of her report, of any expertise with respect to any of the treaties governing the relationship between the Haudenosaunee and the United States. Indeed, there is not a single mention in her report of the *Jay Treaty, the Treaty of Canandaigua, the Treaty of Buffalo Creek*, or any other instrument governing the relationship between the Haudenosaunee and the United States of America. It is simply unacceptable for an expert on American Indian Law to provide an opinion about the cross-border investments of Haudenosaunee investors ***without*** entering into at least a cursory analysis of the treaty obligations that govern the relationship between the two respective Sovereigns. The devastating effects of this omission arise in two locations in Professor Goldberg's Report.

162. First, after incorrectly proceeding on the basis that Claimants are not operating in association together, in Indian Country (i.e. from Seneca Nation land), Professor Goldberg categorically states that Claimants are not entitled to the benefit of any exemption from the full application of state regulation to the entirety of the business, as a function of United States Federal Law. It is only when one notices footnote 5 that the professor reveals how – even with respect to interpretation of the "federal Indian Trader Statutes" – she "does not address any special treaty rights that may pertain to Claimants by virtue of their belonging to nations of the Haudenosaunee Confederacy."

163. As an aside, it also appears lost on Professor Goldberg that since various state attorneys general are currently taking the position – in court – that their escrow statutes apply regardless of how, why, when or where Claimants (and other Indian tobacco enterprises) are selling their brands, it is incorrect to state that there is no

evidence of discrimination against Claimants on the basis of their Haudenosaunee nationality.

164. Second, in citing tobacco tax cases that she believes to be relevant to determining the case against Claimants on page 10 of her Report, Professor Goldberg adds the following qualifier: "*Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450 (1995) (upholding imposition of state income tax on tribal members who earned income within Indian country, but resided outside Indian country, **in the absence of a treaty provision to the contrary**)." [**emphasis added**]. Professor Goldberg repeats the caveat on page 22 as well: "As the Supreme Court held in *Wagnon v. Prairie Band Potawatomi Nation*, 546 U.S. 95 (2005) and *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450 (1995), discussed at pages 9-10, supra, once it is established that the state's power is directed wholly or partly off-reservation, state jurisdiction will be upheld absent a congressional directive or treaty right to the contrary."

165. Claimants submit that unless and until Professor Goldberg is prepared to opine on the entirety of the applicable local law – which customarily incorporates treaty obligations in the analysis – Respondent will have completely failed to even raise a doubt as to rebut Claimants' *prima facie* showing of their detrimental reliance upon what were supposed to have been the protections offered under Respondent's own legal system for First Nations investors. With respect to Respondent's arguments on the applicability of the *Jay Treaty*, found at pages 111 to 116 of the Counter Memorial, Claimants will stand on the expert opinion of Professor Clinton, which they submit is dispositive of the issue.

166. Claimants held, and were fully entitled to hold, an expectation that on-reserve sales of their brands would never be disturbed by state regulation of the kinds at issue in this case. The facts are undisputed: Claimants distribute their brand on a nation-to-nation basis. Where applicable, their products are tax stamped by the local sovereign before entering the stream of commerce. If the Attorneys General in California, Nevada, New Mexico, or any other state have concerns about non-Indian third parties re-selling what is alleged to be Seneca® products off-reserve, they should take the matter up with those individuals and respect Claimants' rights under international and domestic federal law.

ii) Claimants' Expectations for their Brands Sold Off Reserve

167. At pages 102 to 103 of the Counter Memorial, Respondent says it made no offer to NPMs with regional brands to receive escrow releases equivalent to allocable shares of the states in which their brands were sold. Either Respondent is mistaken or it does not consider the published legislation of its state governments to be capable of officially compelling or inducing behaviour. Obviously the Escrow Statutes themselves presented tobacco enterprises with a choice of joining or not joining the MSA. The only reasonable strategy for a comparatively small tobacco enterprise, such as Claimants, when presented with the original Escrow Statutes, was to focus on building equity in one or more regional brands.

168. At ¶ 15 of his report, Professor Gruber actually sets out the basis upon which an enterprise in the position of Claimants would plan out its investment under the Escrow Statutes, prior to their amendment:

> Under the original escrow statute, the allocable share compared the escrow due on sales of an NPM in any given State, to the amount that the State would have received had the company been an SPM with national payment obligations under the MSA. The result of the allocable share release was to exempt NPMs from any effective escrow obligation to the extent the proportion of their sales in a given State exceeded that State's allocable share. A consequence was that any NPM that concentrated its sales in a given State or in a few States ultimately was required to escrow much less than the NPM would have been required to pay under the MSA, had the NPM joined the MSA as an SPM.

169. There is no reason why the above statement should be regarded as anything less or more than an explanation of how and why the Claimants decided to establish their brand in a small number of state markets. Admittedly, investors were entitled to question the legitimacy of being forced to make escrow payments to a state government in the first place. Nonetheless, the proposition that they would be only required to leave funds in escrow for states in which their brands were actually going to be sold makes obvious sense.

170. That Respondent would now claim that such a rational business decision – induced by its own measures – could somehow be "unforeseen" or courtesy of a "loophole" strains credulity. The provisions laid out an option for tobacco enterprises: expand nationally and join the MSA or invest in building their brands locally. It was entirely reasonable for the Claimants to expand their investment, off-reserve, in reliance on these provisions.

171. Undeterred by this simple logic, Respondent now says, at page 104, that "[the MSA was not intended to grant such a windfall to NPMs." This statement obviously begs the question: of why the MSA <u>was intended</u> to grant a windfall to SPMs such as Liggett, Commonwealth Brands or Premier? The same sort of faulty logic can be

seen in an amicus submission made by the MSA states in a recent domestic court proceeding:

> "The language of the Escrow Statute contains a detailed set of findings and purposes, and supporting one class of NPMs at the expense of both Participating Manufacturers and other NPMs is not among them. The States had no intention of creating any class of NPMs that would be exempt from the obligation of keeping sufficient funds on deposit to compensate the State for damages imposed by its cigarettes or of creating a massive incentive for certain NPMs to remain outside of the MSA and its advertising and marketing restrictions. The clear intention of the MSA and the Escrow Statute was to require companies either to pay to the States or to put on deposit a per-cigarette amount that was roughly equivalent and was designed to compensate the State for the damage imposed by cigarette smoking. A regional NPM that sells 100 million cigarettes in New York and none elsewhere does as much damage to New York and its citizens as a national NPM that sells 100 million cigarettes in New York and 1 billion cigarettes elsewhere.[123]

172. Two issues appear to be lost on the NAAG lawyers who drafted the above statement. First, there is really no such thing as a "national NPM." As a simple function of the checkerboard nature of tobacco market regulation in the United States, the marketing and distribution of NPM brands occurs on a state-by-state and Nation-by-Nation basis. NPMs have regional brands because they have generally never possessed the substantial resources required to market and distribute their brands, off-reserve, nationally. The MSA and Escrow Statutes both recognized this phenomenon and reinforced it with the allocable share release mechanism.

173. Second, the NAAG drafter appears to have been unaware of the jaw-dropping irony implicit in this statement: the "… States had no intention of creating any class of NPMs that would be exempt from the obligation of keeping sufficient funds on deposit…" Claimants wholeheartedly join with the lawyer who drafted this pleading, indignant about the prospect that the MSA States could have had "any intention of

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[123] Amicus Brief filed on behalf of various MSA States in *Freedom Holdings v. Spitzer*, Second Circuit Court of Appeals, File No. 02-cv-7492.

creating any class" of tobacco enterprises "that would be exempt" from any obligations that they saw fit to impose on the remainder of the industry. It is because the MSA States did just that, however, that Claimants have sought relief under NAFTA Chapter 11.

174. Respondent will likely observe that there is a difference between offering a class of tobacco enterprises a payment exemption (as an inducement for them to join the MSA and thereby comply with its marketing restrictions) and permitting NPMs to obtain releases of escrow paid for states in which their brands are not sold – inducing them to remain outside of the MSA and its marketing restrictions. There are three flaws in such an argument. First, Dr. Gruber and Respondent admit that those marketing restrictions have proved woefully inadequate for the tobacco reduction goals they seek to achieve. Second, regional NPMs, including Claimants, never had the wherewithal to advertise in national magazines or sponsor NASCAR races, which are the kinds of things that the 1997 Agreement would have fully curtailed and that the MSA was designed to partially curtail.[124]

175. Third, there is nothing inequitable or illogical about an NPM receiving a release of funds paid into escrow for a state that can never, even under Respondent's fanciful theory of product responsibility under U.S. law, make use of them. If Professor Gruber truly believes that the MSA States used in his examples did not receive "enough" money in their escrow accounts, following the allocable share releases, the blame lies squarely with the MSA States themselves. They were the ones who determined what the allocable share amounts would be for each state; not the NPMs who paid into escrow as they were told, and received releases as they were promised.

[124] Campaign for Tobacco Free Kids Article, Reply Evidentiary Submissions Ex. 56.

176. When the SPMs were told that the MSA States would be imposing a new escrow regime, which would radically change the basis upon which they marketed their brands, they were offered a clean slate, in terms of immunity from past and future state tort claims, and permanent, forward-looking payment exemptions, which would grandfather their existing market share. These payment exemptions were an implicit acknowledgement, by the MSA States, of the value of the SPMs' brands. If they wanted these companies – many of which had never been named in a state lawsuit – to start making payments and participating in an agreement that contained new rules for promoting their brands, the MSA States had to offer them an inducement that recognized the goodwill (or "equity") they had established in their brands. After all, as Claimants have demonstrated at paragraphs 93 to 95 below, in the tobacco business proven brands are the *sine qua non* of a successful investment.

177. Of course, as Respondent has admitted, the SPMs were not obliged to join the MSA; rather, they chose to do so. If 'choice' was involved, however, it had to be between at least two reasonable alternatives – or it was not actually a 'choice.' As demonstrated in a contemporaneous news magazine article describing how that choice was being offered, and how some made it,[125] the alternative to joining the MSA and receiving a payment exemption was electing to retain one's regional brand and receive escrow releases based upon the allocable share of each state in which the brand was not sold.

178. Seven years later, the MSA states breached Respondent's international law obligations by not making the same offer to tobacco enterprises that would be affected by

[125] The American Lawyer, *After the Smoke Cleared*, Reply Evidentiary Submissions Ex.53.

their decision to eliminate the allocable share release mechanisms. No choice was offered this time, between joining the MSA and trying to make a go of it under the new rules – where the offer of a grandfathered payment exemption would recognise the value of the investment that the regional NPM's had made in its brands.

179. The last time the states collectively overhauled the basic rules for participation in the market, in 1998, the MSA states created a category of favoured tobacco brand holder: the Grandfathered SPM. This time around, with the elimination of the allocable share release mechanisms, NPMs were fully entitled to expect that the MSA States would treat like enterprises and situations alike. Just like the Grandfathered SPMs in 1998, NPMs deserved recognition for the value of their brand investment achieved under the status quo ante regulatory regime. Just like most Grandfathered SPMs in 1998, NPMs were not the subject of past or current product liability, fraud or conspiracy lawsuits. However, unlike Grandfathered SPMs in 1998, Claimants and other NPMs were not offered anything when the MSA States decided to radically change the basis upon which their investment had been made.

d) The Customary International Law Minimum Standard of Treatment Prohibits Denials of Justice

180. At pages 140 to 146, Respondent completely misconstrues Claimants' basis for alleging that their due process rights have been violated as a matter of international law. First, it states that Claimants have been granted full access to Respondents' courts to challenge the measures on the basis of U.S. law. Second, Respondent says that Claimants are not finished with the cases they launched, or those

against which they are defending, and that therefore a claim for denial of justice or failure to accord due process is premature. What it does not do is answer the complaint.

181. Claimants are not obliged to seek an international law remedy before a local court. It is not Claimants' position, before this Tribunal, that they have been denied due process in respect of the manner in which the dozens of cases pursued against them, or in the one case they are pursuing against the MSA States violates international principles of due process. Claimants agree that if their complaint was with the US justice system, it would be in their interest to reasonably pursue all reasonable steps before bringing an international damages claim.

182. Claimants ground for claiming that a denial of justice, or more properly, a denial of administrative and regulatory due process, has taken place is that they were never sued for the same things for which Liggett and the OPMs were sued. Nobody came to Claimants and presented them with an opportunity to defend themselves against that kind of charge and therefore nobody came to them offering the opportunity to settle either. It is not enough for Respondent to offer claimant its day in court under its measures because Claimants' argument goes to the root of the false claim that would serve as the premise upon which the measures are based. Telling Claimants that they must take their day in court under the measures is to presume the validity of the denial, *a priori*.

183. In other words, to permit Respondent to merely offer due process to Claimants in administration of the measures is to crystallize and imbed the harm flowing from Respondent's election to refuse due process to Claimants on the same basis that it

was offered to the OPMs and Liggett. The difference is demonstrated by the damages that are owed under the breach identified by Claimants versus the breach envisaged by Respondent. Under Respondent's theory, the harm flows from a lack of due process in the operation of its measures, with the corresponding losses including professional fees and opportunity cost in terms of wasted resources. Under the breach actually alleged by Claimants, the foundation for the measures is removed. Damages include any cost incurred by Claimants as a result of their imposition.[126]

184. Although Respondent never avers to it, there is simply no comparison between the claims that its state governments brought against the OPMs and Liggett, and the theoretical claims for "culpable conduct" it says justify the measures. Respondent says that its state governments are entitled to be compensated by tobacco enterprises for past and future health care expenses paid out for their citizens, but it does so by fiat. There is no rational basis for the statement. There is no historical precedent to which Respondent can refer the Tribunal. There is no Supreme Court judgment; no appellate court judgment; not even a trial judge's reasons for decision.

185. The cases upon which the MSA was founded are simply not comparable to the theoretical grounds upon which a MSA state could recover escrow funds from Claimants. In other words, the basis for Respondent's 'fairness' argument is fatally flawed. It cannot say that Claimants should be forced to make payments into escrow that

[126] To be clear, Claimants are not seeking damages for the manner in which the original MSA Regime related to off-reserve sales of their brands, even though its application to any tobacco enterprise other than the OPMs and Liggett was fundamentally unjustified and unjustifiable. Should the Tribunal find that Respondent breached Article 1105 in applying the MSA Regime to Claimants in the first place, by virtue of the timing of Claimants' claims, such finding would have no bearing on Claimants' national treatment and MFN treatment claims in respect of their regional brand investments in off-reserve sales.

are equal to the payments being made by OPMs under the MSA because the basis upon which the MSA was concluded would not ever have taken place if Claimants had been named in such a suit.

186. The trouble with Respondent's fairness argument is that fairness requires treating similarly situated parties in a similar manner. Even a cursory review of the original complaints filed against the OPMs, which led to the MSA and its implementation measures, demonstrates the falsity of Respondent's implied 'fairness' argument. Whereas Respondent now makes only the most vague and general of claims about public health and welfare (without even attempting to connect the measures actually at issue in this case with them), between 1994 and 1997 state attorneys general were very clear about the conduct they sought to stop. It is encapsulated the complaints filed against the OPMs and Liggett, after the former Brown & Williamson research vice president, Dr. Jeffrey Wigand, blew the whistle on his – and the rest of the OPMs' and Liggett's - past practices, in 1997.

187. The following excerpt from New York's 1997 complaint against the OPMs, and Liggett, includes a recitation of the factual claims and causes of action commonly found in these complaints:

> TOBACCO COMPANIES HAVE A HISTORY OF CHOOSING SALES OVER PUBLIC HEALTH AND SAFETY FOR ADULTS AS WELL
>
> In the 1930's and through the 1950's, in response to what industry spokesmen referred to as "the health scare", the tobacco companies made express claims and warranties as to the healthiness of their products with reckless disregard to the falsity of their claims and the consequential adverse impact on consumers. Examples of these health warranties include the following: Old Gold- "Not a cough in a Carload"; Camel- "Not a single case of throat irritation due to smoking Camels"; Philip Morris- "The Throat-tested cigarette."

In 1942, Brown and Williamson claimed that Kools would keep the head clear and/or give extra protection against colds.

In 1952, Liggett & Myers conducted a test for advertising purposes to demonstrate the absence of harmful effects of smoking Chesterfields on the nose, throat and affected organs. The test was conducted by Arthur D. Little, Inc. and was designed so as to have little scientific value. Nonetheless, its conclusion that smoking Chesterfields had no harmful effect on the organs in question was widely publicized and the purported results used to assure the general public that Chesterfields were harmless.

During the 1950's, Ligget & Myers sponsored the nationally popular Arthur Godfrey radio and television show wherein health claims were made based on the alleged scientific studies assuring "smoking Chesterfileds would have no adverse effects on the throat, sinuses, or affected organs." Arthur Godfrey died from lung cancer caused by smoking cigarettes.

Earlier consumer oriented ads from the 1930's and 1940's often carried wide-ranging medical claims that placed cigarette-touting physicians in the company of endorsers such as Santa Claus ("Luckies are easy on my throat"), movie stars, sports heroes and steady nerved circus stars. Similar ads even appeared in medical journals, where ads were directed solely at physicians. One, for example, touted the Camel cigarettes booth as the American Medical Association's 1942 Annual Meeting. In the New York State Journal of Medicine, Chesterfield ads began running in 1933. They often carried claims such as, "Just as pure as the water you drink...and practically untouched by human hands."

The tobacco companies sponsored cigarette ads the New England Journal of Medicine, Journal of the American Medical Association ("JAMA"), and The Lancet from the 1930's though the 1940's.

For 15 years, Philip Morris used various claims, including one it ran in JAMA in 1949: "Why many leading nose and throat specialists suggest, 'Change to Philip Morris'.." In 1935, Philip Morris ran an ad in the New York State Medical Journal touting studies that purportedly showed Philip Morris cigarettes were less irritating. An ad by the company in a 1943 issue of the National Medical Journal read: 'Don't smoke' is advice hard for patients to swallow. May we suggest instead, "Smoke Philip Morris/' Tests showed three out of every four cases of smokers' cough cleared on changing to Philip Morris. Why not observe the results of yourself?" Other companies added different angles for physicians. Camel cigarettes paid tribute to medical pioneers and concluded: "Experience is the best teacher...experience is the best teacher in cigarettes too." Old Gold reacted to the early negative medical studies with the slogan: "If pleasure's your aim, not medical claims.."

The appearance of landmark studies such as the 1952 JAMA article on smoking and bronchial carcinoma, by Alton Ochsmer, M.D., and others prompted JAMA's decision to ban cigarette ads from their journal.

The health-claim advertising campaigns were patently false, misleading, deceptive and/or fraudulent. These campaigns were disseminated nationally in popular magazines, press, radio and television and were calculated to induce non-smokers to commence smoking and the induce smokers to continue their addiction.

During the 1950's the tobacco companies employed yet another method of deception in manufacturing and advertising sales to counter the "health scare"— "the Filter Derby" and "Tar Wars". The tobacco companies manufactured filtered cigarettes that were advertised with explicit and/or implicit warranties of tar/nicotine content and health claims. The tobacco companies' health claims and claims as to effectiveness of the filters in removing tar and nicotine were knowingly deceptive when made, and/or were made with reckless disregard for the health risks to cigarette smokers.

…

NATURE OF DEFENDANTS' WRONGFUL CONDUCT AND CONSPIRACY

This action arises out of an ongoing course of wrongful conduct by each defendant individually and in conspiracy with each other.

Defendants have pursued a course of conduct and conspiracy of deceit and misrepresentation against the public in order to promote and maintain sales of tobacco products, and the profits derived therefrom, to shield themselves from having to pay the health care costs of tobacco-related diseases and to shift those costs to others, such as the State of New York.

Defendants conspiracy consists of two strategies: first, they agreed to represent falsely to the public that they were creating a new, unbiased and therefore trustworthy source to answer questions about smoking and health, and second, they counted on the public's acceptance of their representations of such trustworthiness to misrepresent, suppress, distort and confuse the facts about the health dangers of tobacco products, including nicotine addiction.

The tobacco companies set their plan in motion by creating a joint industry research organization in 1954. Since that time, they have used the credibility gained by false claims of disinterested industry-funded research to suppress and/or misrepresent the material facts to the public. Although knowing of the serious health dangers inherent in the use of their products and the addictive nature of their products, the defendants have utilized the above scheme to further their fallacious arguments that there is insufficient "objective" research to determine if use of tobacco products causes disease and death, and that tobacco products are not addictive.

The two interconnected strategies of suppression of material information and misrepresenting their objectivity to gain credibility, and using that credibility better to deceive the public about smoking and health, have been repeated consistently for more than four decades. Defendants have engaged in a continuous conspiracy to deceive the public regarding facts material to the decision to purchase tobacco products.

Moreover, as internal industry research confirmed the dangers of using tobacco products and addiction, the defendants' deception rose to a new level; although promising the public that they would make full disclosure of the results of their

> research, defendants concealed their own negative health and addiction research results from both the public and public health officials. These research results have still not been voluntarily released.
>
> Defendants also have not disclosed to the public that the tobacco companies manipulate and control the content and delivery of nicotine in their products to create and sustain consumers' addiction to tobacco products.
>
> The success of the industry's campaign of deceit and misinformation depended, in large part, on the tobacco companies acting in concert. Without the agreement of each tobacco company to suppress the truth about the health consequences and addictive nature of using tobacco products, the deception that the joint industry research efforts were objective would be revealed, and the substantive claim that "not enough facts are known" to indict the use of tobacco products would ring hollow. The tobacco companies agreed to come together and to stay together in order to accomplish what would not have otherwise occurred-- the unified and consistent distortion of public information about the use of tobacco products, health and addiction.[127]

188. In fact six MSA States, including North Carolina, did not even have a lawsuit pending against the Majors at the time the MSA was concluded. The content of their complaints, filed against the OPMs after the fact, in order to qualify for membership in the MSA, are even more revealing of the mischief at which the MSA was actually targeted.

189. Reminiscent of Respondent's 2005 RICO case against the OPMs and Liggett, the above excerpts speak for themselves. This is not the kind of behaviour in which Claimants have ever been involved. Accordingly, it is simply beyond reason to presume that a lawsuit similar to the ones whose settlement led to the MSA could be made against Claimants. The MSA was based upon allegations of fraud, deceit and conspiracy that could not possibly be alleged, much less sustained, against Claimants. The complaints uniformly alleged that the defendants conducted research into the addictiveness of tobacco, but withheld it. They are rife with allegations that the

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[127] *State of New York v. Philip Morris Inc.*, New York County, New York, Reply Evidentiary Submissions Ex. 67.

defendants deliberately misled government officials and consumers about the health effects of long-term tobacco use. Every complaint included allegations that the OPMs and Liggett intentionally targeted under-aged customers for decades, and were continuing to do so. Every complaint also alleged that the Majors had been acting in concert to protect their markets for decades, and even that they had sought to establish national institutions, such as the Tobacco Institute, which would take any steps necessary to further their own interests above all others.

190. Claimants have never conducted research into how to make products sold under their brands addictive to consumers, and they have certainly never conspired with other parties to withhold such information or promote untruths about tobacco use. Claimants have never engaged in advertising campaigns promoting use of their products as a means to fight the common cold. Claimants have never marketed their brands to minors or famously misled legislators, under oath, about their knowledge of the health effects of tobacco use. Respondent would nonetheless have the Tribunal find that escrow payments should still be collected from Claimants and held by all MSA States, in order to satisfy a mythical judgment for unspecified "culpable conduct."

191. Claimants submit that it is simply delusory for Respondent to state, by fiat, that Claimants' business activities are so likely to give rise to an obligation for them to compensate the MSA States – on a basis similar to the grounds upon which the MSA payment obligations were based – that escrow deposits should be demanded from them, without first having to prove such liability before a court of law.

E. INDIRECT EXPROPRIATION WITHOUT COMPENSATION

a) Respondent Mischaracterises the Test for Expropriation and the Investment Its Measures Have Expropriated

192. At page 147 of the Counter Memorial, Respondent sets out a novel analysis for a finding of expropriation that bears no relationship to the text of NAFTA Article 1110. Claimants set out the generally accepted test at pages 119 to 123 of the Memorial. The Article 1110 obligation requires the payment of prompt, adequate and effective compensation for indirect takings of an investment, as defined under Article 1139. An indirect taking can be distinguished from an act of mere or ephemeral interference with an investment on the basis of whether the investor has suffered a substantial deprivation of the use or reasonably expected benefit of the investment.

193. Whereas Respondent attempts to assign a notional investment of its own choosing to Claimants, the claim is, and has consistently remained, for substantial interference that certain amended Escrow Statutes have imposed upon Claimants' brands. The Seneca® and Opal® brands are Claimants' investment for the purposes of Article 1110. This is not an alternative pleading, as Respondent alleges at page 153. As amended, the Escrow Statutes impose unsustainable demands for escrow payments upon Claimants. When they cannot make the payments owing in a given state, because they cannot sell their brands at the appropriate price due to price competition from Grandfathered SPMs, court orders are sought under the Escrow Statute and the brand is flagged as contraband under the state's enforcement legislation and administration.

194. This is not a complicated analysis. Claimants' brands have been driven out of the market in both Arkansas and Oklahoma in 2005. As Marvin Wesley explained in his statement, the Seneca® brand was simply not able to compete with aggressively

priced brands from Grandfathered SPMs such as Liggett. Claimants only retain a brand presence in Georgia, Tennessee, North Carolina and South Carolina [redacted][128]

195. Claimants are not alone in treating substantial regulatory interference with a tobacco brand as causing its expropriation without compensation. When commenting to governments upon proposed 'plain packaging' regulations or prohibitions on descriptive name branding, tobacco enterprises have consistently expressed concern about harm caused to their brands. For example, in submissions made to the Government of the United Kingdom in 2008, the world's largest tobacco companies, Philip Morris, Imperial Tobacco and British American Tobacco, each confirmed that they regard their brands as crucial assets in which they have invested for decades. The measure under consideration was a mandatory "plain paper packaging law" which would have limited the ways in which trademarks could be used on tobacco packaging. Opposing the measure, Phillip Morris observed: "plain packaging amounts to nothing less than the expropriation of manufacturers' valuable brands," explaining that the measure could "destroy the value of the brands and the large investments manufacturers have made to build up and maintain the goodwill associated with their brands."[129]

196. British American Tobacco similarly observed:

> Intellectual property rights are "a cornerstone of economic activity", hence both their significant value to their owners and the wider economy

[128] See Second Witness Statement of Marvin Wesley, at ¶¶ 4-6 (noting same in connection with Mr. Wesley's experience working for Liggett), Reply Evidentiary Submissions Ex. 10.
[129] Philip Morris Limited's Response to the Department of Health's Consultation on the Future of Tobacco Control (2008), at 37; Reply Evidentiary Submissions Ex. 65.

> and the need for them to be protected effectively at both the domestic and international levels. The UK Government is not entitled to interfere with trade mark and related intellectual property rights in respect of lawful products by reference to the nature of those products, because such an interference would be contrary to the harmonised EU and international system of trademark protection with which it is obliged to comply.
>
> Furthermore, plain packaging regulations would amount to a deprivation of manufacturers' valuable property rights in the trade marks, copyright and designs incorporated in the packaging and the goodwill arising in the resulting brand, contrary to Article 1 of the First Protocol to the [European Court of Human Rights]. Such a deprivation is unlawful unless justified, which it cannot be in this case, and, even if justified, would require the payment of compensation to those who have been deprived.[130]

197. Similarly, Philip Morris has made a similar submission to the Government of Canada:

> Under NAFTA Article 1110, Canada must compensate foreign investors when measures expropriate, or are tantamount to expropriation of, investments in Canada. As one NAFTA arbitration tribunal recently observed:
>
>> Thus, expropriation... includes not only open, deliberate and acknowledged takings of property... but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property, even if not necessarily to the obvious benefit of the host state.
>
> Here, tobacco companies developed and marketed low yield brands with the express encouragement and approval of the Canadian government. They obtained valid, registered trademarks containing terms identifying these brands, and invested substantial sums to develop brand identity and consumer loyalty for these low yield products. Moreover, descriptors denote clear taste differences within brand families and have, over the decades, become markers for those taste differences. Indeed, brand styles with descriptors have their own specific identity and loyal consumer following. Banning these terms would destroy these valuable trademarks and the specific brands and goodwill they represent. Following a ban, the affected trademarks would simply disappear from the Canadian market. This measure would be inconsistent with the protections afforded intellectual property under Chapter 17 of NAFTA and would constitute

[130] British American Tobacco, Response to the Department of Health Discussion Document: Consultation on the Future of Tobacco Control (2008), at 28; Reply Evidentiary Submissions Ex. 66.

> an expropriation of that property and the investments underlying it in violation of Article 1110.[131]

198. Indeed, the MSA States themselves understand the value of branding in the tobacco industry, which is why they have a policy of requiring all MSA applicants to assign a security interest in the trademarks used in support of their brands.[132] It should accordingly be uncontroversial that, in the three states where Claimants have been substantially deprived of the use and/or benefits of the Seneca® and Opal® brands by the relevant, amended Escrow Statute, compensation should be paid in accordance with Article 1110(2).

F. DAMAGES

199. The Reply Report of Wayne R. Wilson, Jr. ("Wilson Reply Report") addresses the many shortcomings in the report of Navigant Consulting, Inc. ("NCI"). Among them are NCI's misapprehension or mischaracterization of the Claimants' enterprise; misapplication of fundamental valuation concepts in connection with the valuation of Claimants' investments; and utilization of inconsistent or incorrect data.

200. Based upon additional work by Mr. Wilson and his staff, the Wilson Reply Report provides a most conservative conclusion that the impairment to Claimants' investment is in the range of $50,671,234 to $73,048,376 and that the damage to Claimants' investment in physical assets related to its operations in the United States is

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[131] Philip Morris International, Inc., Submission in Response to The National Center for Standards and Certification Information Foreign Trade Notification No. G/TBT/N/CAN/22, at 7; Reply Evidentiary Submissions Ex. 64.

[132] Second Witness Statement of Jerry Montour, at ¶ 29, Reply Evidentiary Submissions Ex. 7.

$24,197,030.[133] The Wilson Reply Report also sets forth an alternative measurement of damages in the amount of $238,612,872 to $267,858,694 based upon the value of exemptions wrongfully withheld from Claimants.

201. In addition to the foregoing, Claimants have spent enormous sums in legal fees attempting to vindicate their rights in connection with the measures, and the states' efforts to enforce the MSA on reserve. Beyond legal fees previously described in Claimants' Memorial (which continue to accrue), NWS has spent well in excess of $400,000 defending the litigation commenced by various states in 2008 and described more fully in Claimants' Supplemental Memorial. Such fees also continue to accrue, and Claimants will provide a current accounting of all legal fees at the time of the hearing.

Respectfully submitted,

[133] With Respect to Claimants' investment in physical assets related to its operations in the United States, Claimants refer to paragraph 319 of the Memorial, where the Tribunal in *Myers v. Canada* confirms that damages suffered by a cross-border investor participating in an integrated enterprise should not be limited to the harm caused to its investment and illegal governmental measure applied to it in the Host State. The right of an investor to make a claim on its own behalf is confirmed under Article 1116. It is only where the investor brings a claim under Article 1117 that damages must, of necessity, be those of the investment enterprise alone.

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