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

GRAND RIVER ENTERPRISES SIX NATIONS, LTD., JERRY MONTOUR, KENNETH HILL AND ARTHUR MONTOUR, JR.,
Claimants/Investors,
-and-
UNITED STATES OF AMERICA,
Respondent/Party.

STATEMENT OF DEFENSE OF RESPONDENT UNITED STATES OF AMERICA

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Pursuant to Article 19 of the UNCITRAL Arbitration Rules and in accordance with the schedule established by the Tribunal at its First Session on March 31, 2005 (as modified by letter from the Secretary of the Tribunal dated June 13, 2005), respondent United States of America respectfully submits this Statement of Defense.

I. PRELIMINARY STATEMENT

1. In submitting these claims to arbitration, claimants attack the largest civil settlement in U.S. history, the Master Settlement Agreement ("MSA") between the major tobacco companies and nearly all the state governments in the United States. Their claims threaten to unravel this monumental effort to address one of the greatest public health crises in this country, tobacco-related illnesses and deaths. Although this Tribunal is without power to rescind that agreement, claimants' challenge, if successful, would profoundly disrupt the complex regime created by the MSA to apportion among tobacco companies the financial

burdens imposed on the states by cigarette smoking and address the problem of underage smoking.

2. Claimants' challenge not only lacks factual and legal merit, but their claims are not within the jurisdiction of this Tribunal. *First*, the claims are time-barred. Claimants knew, or should have known, of the alleged breaches and any resulting loss or damage more than three years before they submitted their claims to arbitration. Perhaps recognizing this, in their Particularized Statement of Claim ("Statement of Claim"), claimants expressly disavow challenging the 1998 MSA as a measure.[1] Nonetheless, their claims challenging legislative measures implementing the MSA are also time-barred.

3. *Second*, the claims fall outside the scope and coverage provisions of Chapter Eleven. Three of the claimants lack any investments in the United States, and the measures at issue do not relate to the alleged investments of the only other claimant.

4. *Third*, one of the claimants has not satisfactorily proven that he has the requisite nationality to submit a claim.

5. *Fourth*, claimants challenge tax measures without regard for the constraints in Article 2103 on the manner and extent to which tax measures may be challenged under Chapter Eleven.

6. *Finally*, with respect to certain of their claims, claimants failed to provide a notice of intent and wait six months after the events giving rise to the claim before submitting the claim to arbitration.

[1] Despite their express denial that the MSA is one of the measures they are challenging, claimants inconsistently continue to allege loss or damage as a result of the MSA. Specifically, they repeatedly complain that they were not invited to join the MSA within 90 days and gain a payment exemption. Although claimants must be held to their disavowal of the MSA as a challenged measure, the United States addresses both iterations of the claims, where applicable.

7. Accordingly, the United States seeks preliminary treatment of its objections to jurisdiction.[2] These objections, if addressed preliminarily, will dispose of the case and make it unnecessary for the Tribunal to proceed to the merits. Below, the United States describes the grounds for its jurisdictional objections, showing that they involve questions distinct from the merits. The United States also explains below that there is no merit to the claims that the MSA and state legislative actions implementing it the violated Articles 1102, 1103, 1105(1) and 1110 of the NAFTA.

II. STATEMENT OF FACTS

A. The Master Settlement Agreement

8. On November 23, 1998, the attorneys general of 46 states, the District of Columbia, Puerto Rico and four United States territories signed the MSA with the nation's four largest tobacco companies requiring them to make annual payments to states in perpetuity as reimbursement for costs associated with treating smoking-related illnesses.[3] This settlement addresses one of the greatest public health crises in the United States. Tobacco use is responsible for nearly one in five deaths in the United States, or 440,000 deaths per year from 1995 through 1999. Smoking-related medical costs totaled $75.5 billion in 1998, the year the MSA was concluded. Most smokers in the United States begin smoking before age 18.

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[2] *See* Request for Bifurcation of Respondent United States of America (Aug. 29, 2005).

[3] The four territories are American Samoa, Guam, Northern Mariana Islands and the Virgin Islands. The four tobacco companies are Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated and R.J. Reynolds Tobacco Company. These four companies are referred to as the "Original Participating Manufacturers" or "OPMs." *See* MSA § II(hh), *available at* http://www.naag.org/upload/1109185724_1032468605_cigmsa.pdf. The MSA is also included at Exh. 13 to *Grand River Enterprises Six Nations, Ltd., et al. v. United States of America*, Particularized Statement of Claim ("Stmt. of Claim") (June 30, 2005).

9. The MSA settled lawsuits previously filed by forty of the signatory states' ("Settling States") attorneys general against the major tobacco companies.[4] Among the causes of action settled in those lawsuits were several premised on the dangers and health effects inherent in the use and sale of tobacco products, such as: strict liability for selling a defective or unreasonably dangerous product; product liability; unjust enrichment; breach of implied and express warranties; nuisance; and breach of assumed (also variously termed "special," or "voluntarily undertaken") duty. In addition, states also asserted some causes of action that included elements of fraud and deception, such as: deceptive trade practices (violation of consumer protection statutes); fraud; misrepresentation and omission; conspiracy; racketeering; unlawfully marketing to, targeting, and contributing to the delinquency of, minors; and antitrust law violations. The MSA refers to these claims collectively as "Released Claims."[5]

10. The MSA is the largest civil settlement in U.S. history and commits signatory tobacco companies to pay an estimated $200 billion to the Settling States over the first 25 years of the agreement alone, with additional payments thereafter.[6] In addition to these payment obligations, the signatory tobacco companies ("Original Participating Manufacturers" or "OPMs") must fund a national foundation devoted to the interests of public health and make substantial changes in their advertising and marketing practices in

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[4] Other states that had not previously initiated litigation could join the MSA and file suit within 30 days after the signing of the MSA. MSA Exh. D at D-4.

[5] MSA § II(nn).

[6] MSA § IX(c).

order to reduce underage smoking.[7] At the time the MSA was signed, the OPMs represented 98% of the tobacco market in the United States.

11. The four states not party to the MSA – Florida, Minnesota, Mississippi and Texas – had reached earlier, individual settlements with the tobacco companies that call for payments totaling $40 billion over 25 years.[8]

B. Implementation of the MSA

12. The MSA would not have succeeded in attaining its public health objectives if it had not addressed the role of tobacco companies other than the four OPMs. For several reasons, the MSA's negotiators were concerned about tobacco product manufacturers that were not parties to the MSA (referred to as "non-participating manufacturers" or "NPMs").[9] First, the cigarettes manufactured by the NPMs also contributed to the health care costs imposed on the states due to tobacco-related illnesses and deaths, but the NPMs would not be making the payments to reimburse the states that the OPMs would be making. Second, the negotiators feared that NPMs would take advantage of the MSA and the settlement costs it imposed on participating manufacturers to "derive large, short-term profits in the years before liability may arise" and then become "judgment proof."[10] Such a surge in NPMs' sales would threaten the MSA's viability by eroding the OPM's market share, thus reducing the level of reimbursement to the states. Finally, the drafters were concerned that NPMs would engage in the types of advertising, marketing and other practices that promote

[7] MSA § II(hh) (definition of Original Participating Manufacturer) and Exh. T at T-1, ¶ (e); MSA §§ III, VI.

[8] General Accounting Office, *Tobacco Settlement: States' Use of Master Settlement Agreement Payments* ("GAO Report") at 3, Exh. 14 to Stmt. of Claim.

[9] MSA Exh. T at T-1, ¶¶ (b)-(d) (Model Statute "Findings and Purpose" Section).

[10] *Id*. at T-1-T-2, ¶ (f).

underage smoking.[11] Accordingly, the MSA presented NPMs with two options: either join the MSA as a subsequent participating manufacturer ("SPM"), or remain an NPM and make payments into escrow.

1. *The Opportunity for Other Tobacco Companies to Join the MSA*

13. The MSA exhibits the clear desire of the negotiators that all tobacco product manufacturers have the opportunity to join the MSA and agree to the advertising restrictions aimed at preventing youth smoking. In part as an incentive for tobacco product manufacturers to join the MSA, the MSA provides that any manufacturer that joined as an SPM within 90 days of its signing would be exempt from making any payments to the states unless its market share exceeded the greater of its 1998 market share or 125% of its 1997 market share.[12] These SPMs are sometimes referred to as "Grandfathered SPMs."

14. The opportunity to become a Grandfathered SPM was available to all tobacco product manufacturers intending their products to be sold in the United States. The invitation to join was open, public and knowable, and should have been known to anyone interested or involved in the U.S. tobacco market, including claimants. The publicly-available text of the MSA itself, as well as the public statements of its negotiators, announced this open invitation.

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[11] *See* Nov. 16, 1998 Media Briefing with Attorneys General, Exh. 15 to Stmt. of Claim (statement of North Dakota Attorney General Heidi Heitkamp) ("If a manufacturer elects not to opt in to this agreement, the manufacturer won't be required to follow the restrictions. What does that mean if there is a change in the types of brands because there is a big, huge influx in marketing programs by a non-participating manufacturer? We are deeply concerned about so-called renegades or rogue manufacturers who are not subject to these same restrictions. And so, consequently, there are incentives built into this deal all around for us to bring as many of those folks in as what [sic] we can.").

[12] MSA § IX (i)(1). The initial period was 60-days when the MSA was signed, but an amendment extended the period to 90 days. *See* Amendment No. 1 to MSA, *available at* http://www.naag.org/issues /tobacco/pdf/Amendment_01.pdf.

15. In response to the public and open invitation, several tobacco product manufacturers besides the four OPMs promptly joined the MSA within the 90-day period to qualify for the payment exemption. Among these Grandfathered SPMs are several foreign-owned tobacco product manufacturers, including: Dhanraj (an Indian company); Imperial Tobacco (a Canadian company); Japan Tobacco (a Japanese company); King Maker (an Indian company); and Societe National d'Exploitation Industrielle des Tabacs et Allumettes (SEITA) (a French company).[13] By the end of the 90-day period, participating manufacturers – including OPMs and SPMs – represented more than 99% of the U.S. tobacco market.

16. Other manufacturers, including foreign-owned companies, have agreed to accept the obligations of participation in the MSA even after expiration of the 90-day period, rather than face the obligations, possible penalties, and exposure to liability entailed in maintaining NPM status. These late subscribers (also referred to as SPMs) make payments in accordance with the formulae and provisions in the MSA applicable to OPMs, with minor differences.[14] Several foreign producers joined the MSA after the 90-day period closed and, unlike the Grandfathered SPMs, receive no exemption from payment. These foreign-owned SPMs include: Canary Islands Cigar Co. (a Spanish company); Chancellor Tobacco Co. (an English company); Eastern Co. S.A.E. (an Egyptian company); House of Prince A/S (a Danish company); MacBaren Tobacco Co. A/S (a Swedish company); Monte Paz (a Uruguayan company); Pacific Stanford Manufacturing Corp. (a Filipino company); Planta

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[13] Imperial Tobacco, Japan Tobacco and King Maker signed the MSA pursuant to amendments that allowed them as importers to fulfill the obligations of the foreign manufacturers for which they serve as exclusive importers. *See* Amendment Nos. 4, 5 and 11 to MSA, *available at* http://www.naag.org/issues/tobacco/pdf/Amendment_04.pdf; http://www.naag.org/issues/tobacco/pdf/Amendment_05.pdf; http://www.naag.org/issues/tobacco/pdf/Amendment_11.pdf.

[14] *See* MSA § IX(i) (describing SPMs' payment obligations).

Tabak-manufaktur Gmbh & Co. (a German company); Poschl Tabak GmbH & Co. KG (a German company) and others.

17. Many U.S.-owned manufacturers also joined after the 90-day window closed and do not receive any exemption from payments. Among the U.S.-owned companies in that category are: Anderson Tobacco Co., LLC; Farmer's Tobacco Co.; Liberty Brands, LLC; Vector Tobacco Inc.; Virginia Carolina Corp., Inc.; Wind River Tobacco Co., LLC; and VIP Tobacco USA, Ltd.

2. *The Model Statute (Escrow Statute)*

18. Those tobacco product manufacturers that decline to join the MSA are subject to the obligations set forth in Exhibit T to the MSA, known as the "Model Statute." Under the terms of the MSA, Settling States must enact a "Qualifying Statute" (adhering to the Model Statute automatically satisfies this requirement) or face potential reductions in their payments from participating manufacturers if certain other conditions are satisfied.[15]

19. The Settling States all subsequently enacted laws in the form of the Model Statute (referred to herein as "Escrow Statutes"). Those Escrow Statutes require NPMs to deposit into escrow each year an amount per cigarette sold ("Unit Sold") that is slightly less than what they would be required to pay in MSA settlement payments, had they joined the MSA.[16] The Escrow Statutes provide that funds must be placed into escrow by April 15 each

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[15] *See* MSA § IX(d)(2)(B) (Settling State's payment not subject to adjustment if it had a "Qualifying Statute" (meaning a statute in the form of the "Model Statute") in force during the preceding year); *id.* § IX(d)(2)(E) ("A 'Qualifying Statute' means a Settling State's statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement.").

[16] The exact amount to be placed in the escrow fund per year per "unit sold" is calculated using the following formulae, with an additional adjustment for inflation: for 1999, $.0094241; for 2000, $.0104712; for 2001 and 2002, $.0136125; for 2003 through 2006, $.0167539; for 2007 and thereafter, $.0188482. *Id.* Exh. T at T-4, ¶ (b)(1) ("Requirements").

year for a manufacturer's prior year's sales in the state. The escrow payment obligation applies to any NPM whose products are sold in the United States.[17]

20. The number of "Units Sold" is defined in the Model Statute to be the number of individual cigarettes sold in the state as measured by excise taxes collected by the state on packs bearing the excise tax stamp of the state.[18] Thus, an NPM places funds into escrow based only on its sales that are subject to state excise tax stamping requirements.

21. Some states, including New York, do not require tax stamping of cigarettes sold on Indian reservations within their territory by tribal entities to tribal members for their consumption. As to those sales, no payment obligation arises under the Escrow Statutes.[19] A significant volume of cigarettes produced by Grand River Enterprises Six Nations, Ltd. ("Grand River") is sold on reservation. Consequently, these sales are not subject to escrow requirements.

22. One purpose of the Escrow Statutes is to ensure that states are able to obtain reimbursement for medical costs associated with tobacco-related illnesses from tobacco product manufacturers that have not previously been sued or made settlement payments, should the state obtain a judgment or settlement on a claim brought against the NPM.[20]

23. Under the Escrow Statute, NPMs retain title to the funds they place into escrow and receive interest on the funds as it is earned. The funds are available to serve as a source for payment of a judgment or settlement on a Released Claim brought against the NPM by the state.[21]

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[17] *Id*. Exh. T at T-3, ¶ (i)(1) ("Requirements").

[18] *Id.* Exh. T at T-3, ¶ (j) (definition of "Units Sold").

[19] Stmt. of Claim ¶ 89.

[20] MSA Exh. T at T-1-T-2, ¶ (f), T-4, ¶ (b)(2)(A).

[21] *Id.* Exh. T at T-4, ¶ (b)(2)(A).

24. As originally enacted, the Escrow Statutes permitted an NPM to obtain a partial release from escrow if the amount it was required to place into escrow in a particular year was greater than what the state would have received as its "Allocable Share" of the total payments that manufacturer would have made under the MSA if it had been a participating manufacturer.[22] For example, if an NPM made all of its sales in a single state, and that state had an Allocable Share of one percent of the annual payments under the MSA, the NPM would receive an immediate release of 99% of its escrow deposit and it would have no escrow obligations in any other state.

25. Several tobacco product manufacturers, including Grand River, have exploited this Allocable Share release provision by concentrating their sales in a small number of states to maximize their entitlement to a release of escrow payments.[23]

26. Funds in escrow revert to the NPM twenty-five years after they are placed into escrow in the event that they have not already been released to the depositor and the state has not sought to recover the funds to satisfy judgments or settlements of any Released Claims brought against the NPM by the state.[24]

27. The Escrow Statutes require that NPMs annually certify to the states that they are in compliance with the escrow requirements. The Escrow Statutes authorize state

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[22] "Allocable Share" is defined in the MSA as "the percentage set forth for the State in question as listed in Exhibit A hereto . . .; or , solely for the purpose of calculating payments under subsection IX(c)(2) (and corresponding payments under subsection IX(i)), the percentage disclosed for the State in question pursuant to subsection IX(c)(2)(A) prior to June 30, 1999 . . . ." MSA § II(f). *See also id*. Exh. T at T-4-T-5, ¶ (b)(2)(B).

[23] The MSA's negotiators never intended NPMs to be able to evade their share of the financial burdens imposed by their products on the states' health care systems. To correct this unintended consequence, most of the settling states have enacted amendments to the Allocable Share release provision in their Escrow Statutes. *See* Amendment to the Allocable Share Release Provision of State Escrow Statutes Status of State Legislation, *available at* http://www.naag.org/upload/1114100143_Allocable_Share_Status _Table_for_NAAG_ Website_4_21_05.pdf (table).

[24] MSA Exh. T at T-5, ¶ (b)(2)(C).

officials to bring civil actions against NPMs for failure to comply. A finding of a violation of the payment and certification obligations can result in a civil penalty in addition to a judgment requiring immediate payment of the amount owed in escrow. In the case of a knowing violation, a court may impose a civil penalty of up to 15% of the amount improperly withheld from escrow per day of the violation and a total amount up to 300% of the original amount improperly withheld.[25] After a second knowing violation, the state may ban the NPM from selling cigarettes within its boundaries for up to two years.[26]

28. In 1999 and 2000, every one of the 46 signatory states enacted an Escrow Statute following the model provided at Exhibit T to the MSA.[27] As a result, by the end of 2000, an NPM was required to comply with the escrow payment obligations stated in the Escrow Statutes in order to do business in any of the 46 states that are parties to the MSA.

29. Grand River has not joined the MSA. As an NPM, it is subject to the Escrow Statutes in every Settling State where its products are sold.

3. *Publicity Surrounding the MSA and Escrow Statutes*

30. The MSA was widely publicized. The state attorneys general held press conferences to announce the landmark deal. For example, on November 16, 1998, the attorneys general of seven states, including New York – where Native Wholesale Supply and Native Tobacco Direct are located – held a press conference in Washington, D.C. where they heralded the deal and expressed their hope that all tobacco manufacturers would sign on to

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[25] *Id*. Exh. T at T-5, ¶ (b)(3)(B).

[26] *Id*. Exh. T at T-5, ¶ (b)(3)(C).

[27] The District of Columbia, American Samoa and Puerto Rico also enacted Escrow Statutes by the end of 2000. Only three territories party to the MSA enacted Escrow Statutes after 2000: the Virgin Islands (February 2001), Guam (March 2001) and the Northern Mariana Islands (April 2001).

the MSA.[28] Other attorneys general, for example, in California and North Carolina, held separate press conferences to announce the MSA.[29]

31. The tobacco industry also made public announcements about the deal. Philip Morris, R.J. Reynolds, Brown & Williamson, and Lorillard released a statement on November 16, 1998, the same date the attorneys general held their press conference.

32. The text of the MSA in its entirety – including Exhibit T, the Model Statute – was publicly available during the time it was open for signature by the states. Throughout the 90-day period after the MSA was signed, any tobacco product manufacturer could have reviewed the MSA's terms and discovered the payment exemption offered to SPMs who joined during that time.[30] Among other places, the MSA could (and still can) be found on the website of the National Association of Attorneys General ("NAAG").[31] The full text of the MSA was also published in Mealey's Litigation Report: Tobacco. The accompanying article in the Mealey's reporter explained that NPMs could either join the settlement and accept its obligations or subject themselves to the payment requirements under the Model Statute that would be enacted in each of the Settling States.

33. Major media outlets across the country – including the *New York Times*, *Washington Post*, *L.A. Times* and *Chicago Tribune* – reported on the MSA and its impact. Smaller regional newspapers in locales where the claimants resided at the time also featured news about the MSA, including the *Buffalo News* and the *Omaha World Herald*. Several stories reported on the relevance of the MSA for tobacco product manufacturers other than

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[28] Media Briefing with Attorneys General from Seven States, Federal News Service, Nov. 16, 1998, Exh. 15 to Stmt. of Claim.

[29] *Id*.

[30] *See* MSA § IX (i).

[31] MSA, *available at* http://www.naag.org/upload/1109185724_1032468605_cigmsa.pdf.

the four OPMs. For example, a contemporaneous *New York Times* article discussed the MSA's impact on "the little guys" and the general terms on which they could join the MSA and be exempt from payment until their sales exceeded 125% of 1997 levels.

34. Other newspapers across the country also published articles around the time of the signing of the MSA in November 1998. These articles identified the features in the agreement intended to ensure that smaller companies would not be able to undermine the purposes of the MSA. For example, they noted that the MSA included provisions for state legislation designed to "level the playing field" for OPMs and NPMs and for exemptions from payment for smaller companies that opted into the agreement to the extent that their market shares remained at or around current levels. Media coverage also contemporaneously revealed that smaller tobacco companies had agreed to sign on to the agreement.

35. News of the MSA was widely reported in Canada where Grand River is located. The *Hamilton Spectator* reported on the "mammoth legal settlement" and described its provisions and impact.[32] Contemporaneous reports in the major Toronto newspapers announced that negotiators had reached a deal and that most states were likely to join the MSA. And provincial officials in British Columbia and Manitoba, finding inspiration in the signing of the MSA in November 1998, emulated attorneys general in the U.S. states in designing their own legal actions to recover medical costs from tobacco companies.

36. Other foreign media outlets also reported on the landmark settlement. The *Financial Times* reported on the final stages of the negotiations in November 1998 leading up to the text of the agreement as signed by the states and the OPMs. The *Financial Times* coverage reported contemporaneously on the negotiators' concern that small tobacco

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[32] Hamilton is one of the major media markets closest in proximity to Ohsweken, where Grand River Enterprises is located. The *Hamilton Spectator* frequently reports news on Grand River and the Six Nations.

companies would undermine the MSA by taking advantage of the participating manufacturers' higher settlement costs and consideration of the possibility of charging fees to non-participating companies.

37. As state legislatures enacted their Escrow Statutes, the local media typically reported on that fact as well. Several state legislatures acted quickly to enact the Escrow Statutes, even before the 90-day window had closed for non-participating manufacturers to sign and gain a payment exemption. For example, newspaper coverage of the South Dakota legislature's consideration of its proposed statute during January of 1999 detailed the obligations of NPMs under the Escrow Statute and the potential that "foreign corporations that refuse to fund the escrow" could be banned from selling their products in the state.

38. Similarly, the *Seattle Times* reported in February 1999 on the progress of the House Bill that would enact the Escrow Statute in Washington State, conveying the "ultimatum" for NPMs to either "join or pay up." And the Augusta Chronicle reported on the approval of the Escrow Statute by lawmakers in Georgia in February 1999.

4. *State Enforcement of the Escrow Statutes*

39. After enacting Escrow Statutes, some states provided notification to NPMs of their payment and other obligations. Neither the MSA nor the Escrow Statutes, nor any other provision of law, required the states to provide such direct and individualized notice. Nonetheless, some states' authorities notified tobacco product manufacturers that were known to them of their obligations under the legislation.

40. For example, on April 25, 2000, the Missouri Department of Revenue mailed a letter to Grand River, reminding the company of its obligations under Missouri's Escrow Statute, which took effect on July 1, 1999. The letter described in detail the obligations to

establish an escrow account, certify in writing to Missouri officials that the account had been established, deposit the correct amount in the account each year (the method of calculating that amount was also explained), and annually certify in writing to Missouri officials that the deposits had been made. The letter also notified Grand River of the penalties for failure to comply, including fines of 15% per day up to a maximum of 300% of the amount improperly withheld in the case of a knowing violation and, in the case of a second knowing violation, the prohibition on sales in the state for up to two years.

41. Star Tobacco Corporation of Virginia, with whom Grand River alleges it had a production agreement prior to the signing of the MSA, received similar notice of the Escrow Statutes shortly after their enactment.[33] The Office of State Tax Commissioner for North Dakota sent a letter on July 8, 1999 to numerous tobacco product manufacturers, including Star Tobacco, informing them that North Dakota had enacted legislation requiring NPMs to establish escrow accounts, deposit the appropriate amount into the accounts, and certify compliance in writing to the state. The letter also advised that similar statutes had been enacted elsewhere, including: Alaska, Arkansas, Delaware, the District of Columbia, Georgia, Hawaii, Idaho, Iowa, Maine, Maryland, Missouri, Montana, Nebraska, Nevada, New Jersey, New Mexico, Oklahoma, Rhode Island, South Carolina, Utah, Washington, and West Virginia.

42. Omaha Nation Tobacco, with which claimants Jerry Montour and Kenneth Hill allegedly worked, received direct notice of its obligations under the Escrow Statutes from the State of Nebraska at least as early as May 17, 2000. In a May 17, 2000 letter to Omaha Nation Tobacco, Nebraska's Office of the Attorney General cited and quoted from

[33] *See* Stmt. of Claim ¶ 14.

Nebraska's Escrow Statute, informed Omaha Nation Tobacco that the state had records of its company's cigarettes being sold in 1999, and demanded compliance with the obligation to place funds into escrow within 15 days.

43. After April 15, 2000, the first deadline for placing funds into escrow under Escrow Statutes enacted in 1999, Settling States were authorized to bring civil actions against NPMs for failure to comply. Typically, state authorities sent several additional notices to non-compliant NPMs prior to initiating enforcement proceedings. In some cases, states mistakenly sent notices to Native Tobacco Direct, unaware that Grand River – not Native Tobacco Direct – was the tobacco product manufacturer and, therefore, the responsible party under the Escrow Statutes.

44. Settling States initiated enforcement proceedings against Grand River as early as 2000 for failing to make escrow payments or certify compliance with the Escrow Statutes. Missouri, for example, brought its original Petition against Grand River on June 13, 2000. In federal court litigation in New York, Grand River admitted in its pleadings that it has known about the states' enforcement of the Escrow Statutes since at least January 2001.

45. Many other states subsequently initiated enforcement proceedings against Grand River for sales of its products in those states in 1999 and 2000. In those cases, the complaints alleged that Grand River "knowingly" violated the Escrow Statutes.

46. Iowa, for example, filed its Petition against Grand River on November 28, 2001 relating to sales of Grand River's tobacco products during part of 1999 and all of 2000. The Iowa Petition alludes to written notice provided to a large number of NPMs as early as July 8, 1999, notifying them of their obligations under Escrow Statutes implemented in many of the Settling States. Nebraska and South Dakota also brought actions against Grand River

in 2001 relating to sales in those states during the year 2000. Oklahoma filed its petition in 2002 relating to Grand River's sales in that state after July 1, 1999, and in 2000 and 2001. The Oklahoma petition alleges that all of Grand River's violations were "knowing," and refers to written notice sent on multiple occasions to Grand River's importer, Native Tobacco Direct, as well as to Grand River itself. Those states that initially sued Native Tobacco Direct substituted Grand River as the proper defendant upon learning that it was the tobacco product manufacturer.

47. In total, at least thirty civil enforcement actions have been brought against Grand River by states where its tobacco products were sold but where no funds had been placed in escrow as required by the Escrow Statutes. In most of these proceedings, Grand River failed to answer, resulting in court judgments ordering immediate compliance with the Escrow Statutes, payment of penalties, and, for second or subsequent knowing violations, a two-year prohibition on sales of cigarettes in those states. Grand River responded in a few of the state proceedings, including those in Nebraska, North Carolina, Oklahoma, and Tennessee, sometimes by answer, in other cases by belatedly complying or seeking a settlement to lift the injunction on sales entered as part of the default judgments. In a few other states, including Arkansas, Georgia, Kansas, Louisiana and South Carolina, Grand River has complied with the Escrow Statutes and its products may legally be sold in those states.

48. In Arkansas, Grand River failed to place funds into escrow for several years when its products were sold in the state. Grand River belatedly complied, agreeing to pay a $100,000 penalty and make escrow deposits while seeking and obtaining large releases based on its concentration of sales in that and a few nearby Settling States. Typically, the amount

released from escrow in the Settling States where Grand River has concentrated its sales represents the vast majority of the amount deposited. In April 2004, Grand River deposited $1,691,813.81 into its Arkansas escrow account based on its sales in 2003. Grand River received an immediate release from escrow of $1,461,535.30, leaving $230,278.51 as the amount Arkansas would have received from Grand River if it were a participant in the MSA.[34]

49. Grand River received copies of the complaints and petitions filed against it by the various states, putting it on notice of its obligations and liabilities under the Escrow Statutes. Several of the complaints and petitions attach receipts for registered or certified mail, affidavits of process servers, or other proof that they were actually received by Grand River. In the default judgments, the appropriate state courts made findings that Grand River had been properly served.

5. *Complementary Legislation*

50. Despite early enforcement by some states of their Escrow Statutes, many NPMs continued to sell cigarettes without complying with the Escrow Statutes. In particular, compliance lagged for NPMs located in foreign countries. NPMs also devised schemes to evade compliance, or concentrated their sales in a small number of states to maximize the refund under the Allocable Share release provision.

51. To address these evasion tactics and enforcement difficulties, states enacted statutes, later referred to as "Complementary Legislation." New York was among the first states to implement a form of Complementary Legislation with its statute taking effect in December 2001. New York's statute, in addition to reinforcing the pre-existing obligations

[34] Notably, Grand River acknowledged in a filing in the case it brought against the Arkansas attorney general that it had previously been aware of the obligations imposed by the Escrow Statutes, but had excused itself from compliance, believing that the Escrow Statutes were not applicable to it.

on tobacco product manufacturers, also prohibits stamping agents from affixing tax stamps on brands manufactured by NPMs that have not complied with their escrow obligations.

52. As of January 2003, fifteen states had enacted similar legislation. This legislation generally prohibits tax stamping of tobacco products that are not in compliance with a state's Escrow Statute, requires certification that a tobacco product manufacturer is either a participating manufacturer or in full compliance with the Escrow Statute, and requires an attorney general or revenue department for the state to maintain a list of tobacco product manufacturers that are in compliance with state laws.

53. The effectiveness of these states' Complementary Legislation in promoting compliance with the Escrow Statutes prompted the NAAG Tobacco Project to create a working group and develop model Complementary Legislation for other states to implement. A majority of the Settling States implemented Complementary Legislation in 2003 along the lines of the NAAG model, if they had not previously enacted their own form of Complementary Legislation.

54. The Complementary Legislation is designed to ensure that cigarette manufacturers do not evade the Escrow Statutes. Pursuant to the Escrow Statutes, an enforcement action is triggered if, by April 15, an NPM has not made escrow payments on its previous year's sales. The model Complementary Legislation ensures that no tobacco products are sold in the state unless they are listed in a directory of products that are manufactured by either a participating manufacturer or an NPM that has complied with the Escrow Statute by establishing and making payments into an escrow account.

55. The tobacco product manufacturer's payment obligations and the penalties for violation under the Complementary Legislation are essentially the same obligations and

penalties that already existed under the states' Escrow Statutes, although under some states' Complementary Legislation, escrow deposits are required quarterly rather than annually. The additional obligations in the model Complementary Legislation are in the nature of administrative and reporting requirements, e.g., certifying compliance and engaging an agent for service of process.

56. The Complementary Legislation formalizes the obligations and penalties for stamping agents and state-licensed distributors, upon whom the states rely for ensuring that no tobacco products are stamped or sold that are not listed in the directory maintained by the state of products manufactured by complying manufacturers (and upon whom they had already relied for obtaining data as to the number of cigarettes sold by brand). Any cigarettes sold in violation of a state's Complementary Legislation that follows the NAAG model are subject to forfeiture and seizure as contraband.

57. Neither Native Wholesale Supply Company nor Native Tobacco Direct Company is, or ever has been, authorized as a stamping agent for the State of New York, where both of those companies are located.

C. Additional State Measures

58. A few states have adopted additional measures to ensure sufficient burden sharing by NPMs. Michigan, for example, enacted an equity assessment provision into its tobacco tax law, effective January 8, 2004. This tax measure requires an NPM to pay an "equity assessment" per cigarette sold in the state.[35] This tax – and others like it – is imposed and functions as an excise tax on tobacco products. Similar provisions exist in other states including Utah, Alaska and Minnesota (which is not a signatory to the MSA).

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[35] *See* Tobacco Products Tax Act, § 205.426d(4) ("The purpose of the equity assessment is to fund enforcement and administration of [the Escrow Statute] and this act.").

D. Impact of the MSA and Related Measures

59. Since the implementation of the MSA, the Escrow Statutes, and the Complementary Legislation, the United States has made great strides in addressing the tobacco crisis. States have received more than $41 billion in payments from the participating manufacturers to offset health care costs resulting from use of the products manufactured by these companies. These payments have been put to a variety of uses, including health-related and tobacco-control programs.[36] Cigarette consumption has declined by nearly 20% since the MSA was signed, and youth smoking has declined even further. The percentage of high school seniors who reported smoking during the prior 30 days decreased from 35.1% in 1998 to 25.0% in 2004, the percentage of high school seniors who smoke every day decreased from 22.4% to 15.6% in the same period, and the percentage of eighth graders who reported ever having smoked declined from 45.7% to 28.4%.

60. The OPMs have raised the prices of their tobacco products to cover the settlement costs. The collective U.S. market share of NPMs like Grand River has grown since the MSA took effect from 0.37% in 1997 to 8.1% in 2003. The OPMs' market share declined over the same period, from 97.1% in 1997 to 84.6% in 2003, due to growth in the market shares of both NPMs and SPMs. Grand River has never stated the number of cigarettes it sold in the United States prior to the MSA (if any).[37] However, according to claimants, Grand River's total U.S. sales in 2004 were approximately 2.2 billion units (cigarettes).[38] The total number of cigarettes sold in the United States in 2004, including

[36] GAO Report at 6.

[37] Grand River's distributors, Native Wholesale Supply and Native Tobacco Direct did not exist until after the MSA. *See* Certificates of Incorporation, Exh. 6 to Stmt. of Claim.

[38] LECG, Preliminary Calculation of Losses ¶ 11, Exh. 24 to Stmt. of Claim.

imports, was approximately 400.8 billion, making Grand River's market share approximately 0.55%, greater than the total combined market share for all NPMs prior to the MSA.

61. Several tobacco product manufacturers, including Grand River, have challenged the constitutionality of the MSA in U.S. courts. In each of these cases, the court has concluded that the MSA is constitutional, specifically holding that it does not violate due process, equal protection, the Commerce Clause, the Compact Clause, or the First Amendment.

62. In 2002, Grand River commenced a legal action against the attorneys general of more than thirty states in federal district court in New York. Grand River seeks injunctive and declaratory relief and alleges that the states' acts to implement the MSA (including the Escrow Statutes, Complementary Legislation, and enforcement proceedings) are unconstitutional, violate antitrust laws, are preempted by federal law, and constitute a violation of the Civil Rights Act. On September 29, 2003, the federal district court dismissed the claims in their entirety. The court subsequently granted, in part, a motion for reconsideration as to Grand River's claim alleging that federal antitrust law preempts New York's Complementary Legislation. That claim is now pending in district court. Grand River appealed dismissal of its other claims, and the district court's finding that it lacked personal jurisdiction as to all attorneys general except New York's. That appeal is currently pending before the Court of Appeals for the Second Circuit.

III. POINTS AT ISSUE

63. The MSA and the state actions to implement and enforce it do not breach any of the obligations in Chapter Eleven. The MSA was a legitimate effort to address a public health problem. None of its provisions discriminate on the basis of nationality, violate the

customary international law minimum standard of treatment or amount to an expropriation of claimants' alleged investments.

64. Below, the United States first presents the jurisdictional grounds on which the Tribunal should dismiss the claims without reaching the merits. It then outlines its defenses on the merits of the claims under each of the relevant provisions of Chapter Eleven.

A. Jurisdiction

1. *Failure to Submit Claims In Time Under Articles 1116(2) and 1117(2) (Limitations Period)*

65. The United States objects to the jurisdiction of the Tribunal on the ground that the claims are barred by the time limitations for submitting a claim to arbitration, prescribed by NAFTA Articles 1116(2) and 1117(2).

66. Article 1116(2) provides that "An investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage."

67. Article 1117(2) provides that "An investor may not make a claim on behalf of an enterprise described in paragraph 1 if more than three years have elapsed from the date on which the enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the enterprise has incurred loss or damage."

68. The claimants and the enterprises knew, or should have known, of the alleged breaches of NAFTA Chapter Eleven and any resulting loss or damage more than three years prior to filing their claims. Claimants submitted their claims to arbitration on March 10, 2004. Claimants knew or should have known of all of the alleged breaches and any resulting loss or damage before March 10, 2001.

69. The MSA – including the attached Model Statute – was signed on November 23, 1998. As noted above, the MSA was the largest civil settlement in U.S. history. Contemporaneous press conferences and media reports put the entire tobacco industry on notice of the terms, including the opportunity for companies to join as Grandfathered SPMs.

70. To the extent that claimants allege that they incurred loss or damage as a result of the MSA because it bestowed an exemption from payment only on manufacturers that joined within 90 days, that claim is time-barred. That alleged loss or damage was incurred as soon as the 90-day period expired, or no later than February 23, 1999.[39]

71. Claimants should be deemed to have known of any alleged breach and accompanying loss or damage arising out of the Escrow Statutes shortly after the MSA became publicly available in November 1998. In any event, claimants must be deemed to have known of any alleged breach and resulting damage stemming from the Escrow Statutes no later than the time those Escrow Statutes were enacted into law in each of the states where they do business.

72. As contemplated by the terms of the MSA, all of the Settling States enacted Escrow Statutes following the Model Statute attached to the MSA. Every Settling State where Grand River purports to sell its cigarettes had enacted its Escrow Statute more than three years before claimants submitted their claims to arbitration.[40]

[39] Claimants propose, as one means of quantifying their alleged loss or damage, the value of the SPM exemption from escrow payments on a per cigarette basis using valuations of SPMs that have been the subject of corporate acquisitions since the MSA was enacted. *See* LECG, Preliminary Calculation of Losses at 2, Exh. 24 to Stmt. of Claim. This contradicts claimants' repeated statements that they do not challenge the MSA as a measure in this arbitration. *See* Stmt. of Claim ¶¶ 10, 61, 66 ("Argument").

[40] The only Settling States where the Escrow Statutes became effective after March 10, 2001 are two distant territories where Grand River does not purport to have ever made or wished to make any sales of its tobacco products: Guam (effective date March 14, 2001) and Northern Mariana Islands (effective date April 20, 2001). Notably, neither of these territories' Escrow Statutes appears on claimants' list of such laws. *See* Exh. 17 to Stmt. of Claim.

73. Claimants' asserted lack of actual knowledge – implausible as it is – is irrelevant because they are legally responsible for knowing and complying with applicable law in the states where they chose to direct their products into the stream of commerce. It is a well-accepted maxim that ignorance of the law is no excuse. Thus, claimants should be presumed to have knowledge of the Escrow Statutes as early as 1998 and certainly no later than the date of enactment of those statutes in the states where Grand River's products are sold.[41]

74. In any event, Grand River had actual knowledge of the Escrow Statutes more than three years prior to submitting its claim to arbitration. Many states sent direct notice to tobacco product manufacturers known to have sales in their territory regarding the obligations under the Escrow Statutes, though they were not required to do so. Grand River and companies doing business with it at the time were among those receiving direct notice of the Escrow Statutes.

75. The Complementary Legislation challenged by claimants merely added enforcement measures to the payment obligations and penalties that had already been in place under the MSA and Escrow Statutes. Thus, no loss or damage independent from that already allegedly incurred by virtue of the MSA and Escrow Statutes arises from the Complementary Legislation. Grand River knew or should have known about its payment obligations and ensuing penalties – which are the same under the Complementary Legislation as under the Escrow Statutes – more than three years prior to submitting its claims to arbitration.

[41] In the alternative, the latest Grand River could possibly be deemed to have had knowledge that it had incurred loss or damage is when payments became due on April 15, 2000. A majority of the Settling States had enacted their Escrow Statutes in 1999. In any of those states where Grand River's products were sold in 1999, liability for failing to make payments into escrow arose on April 15, 2000. Even this latest possible date is more than three years before claimants submitted their claim to arbitration.

76. Accordingly, the claims are out of time and the Tribunal has no jurisdiction to consider those claims.

2. *Failure to Qualify Under Article 1101(1) (Scope and Coverage)*

77. The United States objects to the jurisdiction of the Tribunal on the grounds that all but one of the claimants lack any ownership interest in any alleged investment in the United States, and the measures at issue do not relate to the only claimant alleging ownership or control of U.S. investments, as required by Article 1101(1) of the NAFTA. Article 1101(1) confines the scope and coverage of Chapter Eleven to, in relevant part, "measures adopted or maintained by a Party relating to: (a) investors of another Party; and (b) investments of investors of another Party in the territory of the Party . . . ."

78. Article 1101(1) thus requires that the investments of investors of a Party be in the territory of another Party (in this case, the United States) and that the measures at issue relate to those investments. Investment is defined in Article 1139 to include "an enterprise." Article 201 defines "enterprise of a Party" as an enterprise "constituted or organized under the law of a Party." Thus, where the alleged investment is an enterprise, the enterprise must be constituted under the law of that other Party (in this case, the United States) to qualify as an investment.

79. Neither Grand River, nor Jerry Montour, nor Kenneth Hill qualifies as an investor who may submit claims under NAFTA Chapter Eleven. The Statement of Claim does not identify as the subject of the claim any investment in the United States in which any of those claimants has, or has sought to have, any ownership interest. Rather, Grand River and its shareholders, Jerry Montour and Kenneth Hill, are engaged in the business of exporting their tobacco products to the United States for subsequent sale by other entities.

None of these three claimants has any ownership interest in any of the allegedly U.S. enterprises identified by claimants.

80. The alleged "flexible and co-operative partnership"[42] that the claimants purport to have formed with entities in the United States for purposes of distributing their tobacco products in the United States does not constitute an investment or an enterprise of a Party. That "partnership" has not been constituted or organized under the law of the United States. Nor are Grand River, Jerry Montour or Kenneth Hill investors by virtue of their tribal or family ties with other individuals or entities located in the United States. Because these three claimants do not purport to own or control any investments in the United States, the Tribunal, in accordance with Article 1101(1), lacks jurisdiction to hear their claims.

81. The measures at issue also do not "relate to" Arthur Montour, Jr., as required by Article 1101(1). Arthur Montour, Jr. is allegedly the "sole named shareholder and President of both Native Tobacco Direct Company and Native Wholesale Supply Company."[43] Both of these entities are located in the United States. Native Wholesale Supply Company and Native Tobacco Direct Company also both appear to have been incorporated by the Sac and Fox Nation.[44]

82. The Escrow Statutes, however, require tobacco product manufacturers – like Grand River – to establish and make payments into escrow accounts. Arthur Montour, Jr. and his purported U.S. companies do not manufacture tobacco products. Rather, these entities apparently import tobacco products from Canada and sell those products in the

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[42] Stmt. of Claim ¶ 3 ("Argument").

[43] Stmt. of Claim ¶ 5.

[44] *See* Certificates of Incorporation of the Office of the Secretary, Sac and Fox Nation, for Native Tobacco Direct and Native Wholesale Supply, Exh. 6 to Stmt. of Claim. The United States Government recognizes the Sac and Fox Nation and its authority to incorporate companies like these two enterprises. Accordingly, if properly incorporated, they are enterprises organized under the law of a Party.

United States. The Escrow Statutes do not impose payment obligations on retailers, like Arthur Montour, Jr., Native Wholesale Supply Company, or Native Tobacco Direct Company. These measures, therefore, do not relate to Arthur Montour, Jr. or the companies he allegedly owns and controls.

83. The Complementary Legislation serves the purpose of implementing and enforcing the provisions of the MSA and Model Statute. Accordingly, it also does not "relate to" Arthur Montour, Jr. New York, where Native Wholesale Supply and Native Tobacco Direct are located, has crafted its Complementary Legislation to apply only to stamping agents in the state, not to distributors or importers.[45] Neither Native Wholesale Supply nor Native Tobacco Direct is, or ever has been, an authorized stamping agent in the state of New York.

84. NAFTA Chapter Eleven, therefore, does not apply to claimants because Grand River, Jerry Montour, and Kenneth Hill have no investments in the territory of the United States and the measures at issue have no legally significant connection to Arthur Montour, Jr. or to his purported investments.

3. *Failure to Demonstrate Requisite Nationality Under Article 1101(1)(a) (Scope and Coverage)*

85. The United States reserves the right to object to the jurisdiction of the Tribunal to hear claims by Arthur Montour, Jr., who has not submitted adequate proof that he is an investor of another Party, as required by Article 1101(1)(a).

86. Arthur Montour, Jr. is a long-time resident of the United States with a U.S. Social Security number. Unlike claimants Jerry Montour and Kenneth Hill, he has not

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[45] *See* N.Y. Tax Law 60, Art. 20, 480-b.

submitted proof of his Canadian nationality.[46] To the extent that Arthur Montour, Jr. either (1) fails to prove that he has retained Canadian nationality at all times from the date of any alleged violations through the date of resolution of his claim; or, (2) if a dual national, fails to prove that his dominant and effective nationality is Canadian, the United States reserves the right to raise an objection to jurisdiction based on his failure to satisfy Article 1101(1)'s nationality requirement.

4. *Failure to Comply with NAFTA Article 2103(6) (Tax Filter)*

87. The United States objects to the jurisdiction of the Tribunal to hear claims under Articles 1105(1) and 1110 relating to any taxation measures, including the equity assessment provision in Michigan and similar provisions in Minnesota and other states.

88. NAFTA Article 2103(1) provides that "nothing in this Agreement shall apply to taxation measures." The subsequent sub-paragraphs in Article 2103 set forth certain exceptions to the inapplicability of the NAFTA to taxation measures, including for Articles 1102 and 1103. Article 2103(6) requires that before a claim may be submitted challenging a taxation measure as an expropriation, the claimant must "refer the issue of whether the measure is not an expropriation for a determination to the appropriate competent authorities."

89. Claimants have challenged Michigan Act 285 and Minnesota's Cigarette Fee Act, both of which are taxation measures.[47]

90. In accordance with Article 2103, claimants may not invoke Article 1105(1) with regard to a tax measure. In accordance with Article 2103(6), claimants may not invoke

[46] *Compare* Exh. 2 to Stmt. of Claim (copies of certificate of Indian Status and Canadian passport for Jerry Montour) *and* Exh. 3 to Stmt. of Claim (same for Kenneth Hill) *with* Exh. 4 to Stmt. of Claim (Mar. 16, 2005 letter "To Whom It May Concern" asserting that Arthur Montour was born in Montreal and is a member of the Kahnawake Band of Indians).

[47] Michigan Compiled Laws § 205.426d; Minnesota Statutes § 297F.24.

Article 1110 unless they take the prerequisite step of referring the issue of whether the taxation measure is an expropriation to the appropriate competent authorities. Claimants have failed to refer the matter to those competent authorities in the United States and Canada. Accordingly, the Tribunal does not have jurisdiction to hear claims under Articles 1105(1) or 1110 related to Michigan Act 285, Minnesota's Cigarette Fee Act, or any other similar tax.

5. *Failure to Comply with NAFTA Article 1119 (Notice of Intent) and Article 1120 (Submission of a Claim)*

91. The United States objects to the jurisdiction of the Tribunal to hear any claims for which no written notice of the intent to submit the claims was delivered to the United States. The United States also objects to the jurisdiction of the Tribunal to hear any claims submitted before six months had elapsed after the events giving rise to the claim.

92. Article 1119 requires the investor to "deliver to the disputing Party written notice of its intention to submit a claim to arbitration at least 90 days before the claim is submitted." Article 1120 allows a claim to be submitted to arbitration "provided that six months have elapsed since the events giving rise to a claim."

93. Claimants included in their Notice of Arbitration claims with regard to Michigan Act No. 285. This claim was absent from the Notice of Intent previously delivered to the United States. Claimants also added an additional state measure – Minnesota's Cigarette Fee Act – to their Statement of Claim that did not appear in either their Notice of Intent or their Notice of Arbitration. In addition, Minnesota is not a party to the MSA. The Notice of Arbitration and Notice of Intent challenged only measures taken by Settling States and provided no notice to the United States that other states' actions were also being challenged.

94. Michigan Act No. 285, codified at Section 205.426d of the Michigan Compiled Laws, took effect January 8, 2004. Claimants submitted their claims to arbitration on March 10, 2004 – less than six months after the Michigan Act giving rise to their claim took effect.

95. Accordingly, claimants have not complied with Articles 1119 and 1120 as to these claims and the Tribunal is without jurisdiction to hear them.

96. For the foregoing reasons, the Tribunal should determine as a preliminary matter that it lacks jurisdiction to hear the claims presented in the Statement of Claim and dismiss the claims in their entirety. The United States presents below a summary of its merits-based defenses.

B. Merits

1. *Article 1102*

97. Article 1102 provides that a NAFTA Party must "accord to investors of another Party [and their investments] treatment no less favorable than that it accords, in like circumstances, to its own investors [and their investments] with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."[48]

98. Claimants' Article 1102 claim fails because claimants and their alleged investments have not been accorded treatment less favorable than U.S. investors or U.S.-owned investments in like circumstances.

[48] NAFTA Art. 1102(1) & (2).

99. All of the state legislation implementing the MSA distinguishes among tobacco product manufacturers on the basis of whether and when they agree to join the MSA, not on the basis of nationality.

100. There are both U.S.-owned and foreign-owned (including Canadian-owned) tobacco product manufacturers that joined the MSA within the 90-day period, entitling them to an exemption from making payments under the MSA or Escrow Statutes. Likewise, there are both U.S.-owned and foreign-owned tobacco product manufacturers that – like Grand River – have not joined the MSA, maintaining their NPM status.

101. Grand River is not "in like circumstances" with the Grandfathered SPMs who joined the MSA within 90 days after it was signed and, therefore, is not entitled to the same treatment those SPMs receive.

102. Nor can Grand River identify any U.S. or U.S.-owned comparator that receives treatment more favorable than that accorded to it with regard to on-reservation sales of tobacco products. Several states in the U.S. exempt cigarette sales between tribal entities and individuals on Indian reservations in their territory from state excise tax laws that ordinarily require the payment of taxes and the stamping of packs (indicating taxes have been paid) for all sales of tobacco products. Because the Escrow Statutes define number of "Units Sold" based on excise taxes collected on packs bearing an excise tax stamp, they do not require escrow payments for sales as to which excise tax and stamping laws do not apply. Thus, on-reservation sales by foreign tribal entities that are not taxed receive the same treatment under the Escrow Statutes as non-taxed on-reservation sales by U.S. tribal entities.

103. Finally, Grand River also receives treatment no less favorable than domestic NPMs with regard to application of the additional tax measures imposed by states such as

Michigan. These taxes (whether nominally referred to as "assessments" or "fees") are intended to cover the additional administrative burdens placed on the states by applying the Escrow Statutes and Complementary Legislation to NPMs. They apply to all NPMs alike, whether the NPMs are U.S.-owned or Canadian-owned. As a result, these taxation measures do not violate Article 1102.

104. Accordingly, claimants' Article 1102 claims are without merit and should be dismissed.

2. *Article 1103*

105. Article 1103 provides that "Each Party shall accord to investors of another Party [and their investments] treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party [and their investments] . . . ."

106. Claimants' Article 1103 claim fails for the same reasons that their Article 1102 claim fails. The MSA and related measures do not distinguish among foreign-owned manufacturers of tobacco products based on nationality. The Escrow Statutes require that all tobacco manufacturers with tobacco products sold in the territory of the United States either join the MSA or place funds into escrow, regardless of the nationality of the manufacturer's owners or controlling shareholders. Claimants are not in like circumstances with foreign-owned Grandfathered SPMs and, therefore, they are not entitled to the same treatment accorded those manufacturers. Rather, claimants are in like circumstances with other foreign-owned NPMs who are accorded like treatment.

107. The taxes imposed by Michigan, Minnesota and other states likewise do not accord treatment to other foreign, non-Canadian NPMs that is more favorable than the treatment accorded to Grand River.

108. Claimants receive the same treatment as other foreign tobacco product manufacturers who did not join the MSA within 90 days after it was signed. Therefore, they are not denied most-favored-nation treatment and their Article 1103 claim should be dismissed.

3. *Article 1105(1)*

109. Article 1105(1) provides that "[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." The NAFTA Free Trade Commission's July 31, 2001 Interpretation of Article 1105(1), which is binding on this Tribunal, confirms that Article 1105(1) prescribes the customary international law minimum standard of treatment to be afforded to investors of another Party. That Interpretation further provides that the concepts of fair and equitable treatment and full protection and security do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens, and that a determination that there has been a breach of another provision of the NAFTA or of a separate international agreement does not establish that there has been a breach of Article 1105(1).

110. Claimants are incorrect to suggest that the minimum standard of treatment somehow differs with respect to aboriginal nationals of Canada. Claimants are not entitled to "special consideration" or a higher minimum standard because of their avowed purpose of providing employment for their aboriginal community.[49] The minimum standard is a standard that applies to all aliens regardless of their aboriginal status.

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[49] *See* Stmt. of Claim ¶¶ 132, 140 ("Argument").

111. Claimants' Article 1105(1) claim fails because they have not identified any principle of customary international law that has been violated in this case.

112. The purported rights under international agreements and instruments other than NAFTA Chapter Eleven cannot form the basis for finding a violation of Article 1105(1).

113. Claimants' invocation of the doctrine of denial of justice does not support their Article 1105(1) claim. While the doctrine of denial of justice is a recognized part of the customary international law minimum standard of treatment, that doctrine primarily addresses adjudicatory proceedings and has no bearing on this case. Claimants challenge three categories of legislative measures: the Escrow Statutes, the Complementary Legislation and the Equity Assessment Laws.[50] The customary international law minimum standard of treatment does not require legislatures to provide individual and direct notice and an opportunity to be heard to every entity that may possibly be impacted by legislation. Moreover, to the extent claimants continue to rely on the MSA as the cause of their loss or damage, it is not a denial of justice for states to enter into private settlements of lawsuits without directly notifying nonparties who might be subsequently impacted by legislative implementation of the settlement terms. In any event, public notice of the MSA and its terms was provided.

114. Nor can claimants' allegations that the measures violate principles of good faith and transparency establish an Article 1105(1) claim. The international law principle of good faith governs the creation and performance of legal obligations; it is not, in and of itself, a source of obligations where none would otherwise exist.

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[50] *See id*. ¶¶ 10, 61; *see also id.* ¶ 66.

115. Nor can an alleged lack of transparency in the promulgation of legislative measures constitute a violation of customary international law's minimum standard of treatment. Customary international law imposes no constraints on the process by which legislative measures of general application, such as the measures at issue, are adopted. In any event, the MSA, Escrow Statutes, and related measures have all been administered and applied in a manner that complies with fundamental notions of fairness, good faith, and transparency.

116. Finally, claimants' allegations that requiring them to make payments into escrow violates Article 1105(1) lack merit. The escrow payments ensure that any future judgments rendered to compensate for harm caused by claimants' inherently dangerous products can be satisfied. It is common State practice to require payments in the form of a bond, escrow, or otherwise, from persons engaged in activities that are potentially dangerous to their populace as a prior condition for engaging in those activities. Such requirements do not violate the minimum standard of treatment.

117. Accordingly, claimants' Article 1105(1) claim should be dismissed.

4. *Article 1110*

118. Article 1110 provides that "[n]o Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment" except where certain conditions are met, including payment of compensation.

119. With respect to Grand River, Jerry Montour and Kenneth Hill, claimants' expropriation claim fails for at least five reasons. *First*, in order to constitute a violation of Article 1110, the challenged measure must amount to an expropriation of "an investment of

an investor of another Party *in its territory*." Grand River, Jerry Montour and Kenneth Hill have no investments in the territory of the United States.

120. *Second*, a measure cannot constitute an expropriation unless it interferes with a property right or interest in an investment. Neither sales of Grand River's products in the United States, nor its market share qualify as a property right capable of being taken under Article 1110.

121. *Third*, any claim that Grand River's business has been expropriated by the measures is without merit. Grand River has the right to continue to sell its products in all states where it complies with applicable law.

122. *Fourth*, the escrow payments required of Grand River do not give rise to a claim for expropriation. Grand River retains title to and earns interest on all funds that it has placed in escrow. It is common State practice to require entities engaged in dangerous activities to post a bond or place funds into escrow prior to conducting business in the jurisdiction. Such requirements are not expropriatory.

123. *Finally*, none of the penalties imposed on Grand River as a result of its failure to abide by the provisions of the Escrow Statutes and Complementary Legislation constitutes an expropriation. These penalties include forfeiture and similar actions, which international law recognizes as distinct from and not tantamount to expropriation. International law permits the type of penalties imposed by the Escrow Statutes and Complementary Legislation, without any requirement of compensation.

124. Arthur Montour's expropriation claim also fails. There is no allegation that any property belonging to him or the enterprises he allegedly owns or controls has been taken. The only assets specifically mentioned in the Statement of Claim are the trademarks

registered to Native Wholesale Supply.[51] Native Wholesale Supply, however, retains possession and use of those trademarks.

125. Accordingly, claimants' Article 1110 claims should be dismissed.

IV. REMEDY SOUGHT

126. The United States denies that claimants are entitled to any relief. The United States requests that the Tribunal decide its jurisdiction as a preliminary matter. In the event that this Tribunal finds jurisdiction to hear any of these claims, the United States requests that damages be decided in a separate phase from the merits.

127. The United States respectfully requests that this Tribunal render an award in favor of the United States and against claimants, dismissing their claims in their entirety and with prejudice. The United States further requests that, pursuant to Article 40 of the UNCITRAL Arbitration Rules, claimants be required to bear all costs of the arbitration, including the United States' costs of legal assistance and representation.

Respectfully submitted,

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[51] *See* Exh. 12 to Stmt. of Claim (trademarks for Seneca, first used 6-1-1999).