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

PARTICULARIZED STATEMENT OF CLAIM

A. NAMES AND ADDRESSES OF THE PARTIES

Claimants/ Investors	**Grand River Enterprises Six Nations, Ltd.** **2176 Chiefswood Road** **Ohsweken, Ontario, Canada**
	Jerry Montour & Kenneth Hill **c/o Grand River Enterprises Six Nations, Ltd.** **2176 Chiefswood Road** **Ohsweken, Canada**
	Arthur Montour, Jr. **c/o Native Wholesale Supply** **11037 Old Logan Drive** **Seneca Nation Territory** **Perrysburg, New York 14129**
Respondent/ Party	**Government of the of the United States of America** **Executive Director** **Office of the Legal Advisor** **United States Department of State** **Room 5519** **2201 C. Street NW.** **Washington, D.C.** **20520**

B. REFERENCE TO THE ARBITRATION CLAUSE OR THE SEPARATE ARBITRATION AGREEMENT THAT IS INVOKED

The Claimants invoke Section B of Chapter 11 of the NAFTA, and specifically Articles 1116, 1117, 1120 and 1122 of the NAFTA, as authority for the arbitration. Section B of Chapter 11 of the NAFTA sets out the provisions agreed concerning the settlement of disputes between a Party and an investor of another Party.

C. REFERENCE TO THE CONTRACT OUT OF OR IN RELATION TO WHICH THE DISPUTE ARISES

The dispute arises from measures adopted by over 46 States and territories of the United States of America ("USA"), which relate to the Claimants and their investment in the United States and for which they have suffered loss and damage, and continue to suffer loss and damage, as a result of their imposition upon them, contrary to the obligations owed by the USA under Section A of Chapter 11 of the NAFTA.

D. FACTS

Identity of the Investors and their Investment

1. Grand River Enterprises Six Nations, Ltd. ("Grand River") is a Canadian corporation organized under the laws of Canada on April 29, 1996.[1] Grand River has at all relevant times since its incorporation maintained a principal office and tobacco products production facility located on the Grand River Reserve, in Ohsweken, Ontario, Canada. Ohsweken comprises part of the territory of the Six Nations of North America (also known as the Iroquois Confederacy), whose land spans both sides of the border between Canada and the USA.

2. Grand River currently provides for the employment and income of over two hundred native Canadians and their families, in addition to numerous other non-native Canadian individuals in its employ. It is the largest employer on the Grand River reserve, and one of the largest native employers in Canada.

3. Jerry Montour and Kenneth Hill are aboriginal nationals of Canada, currently residing in Ontario, Canada.[2] Arthur Montour, Jr. is an aboriginal national of Canada, [3] who currently resides on the Seneca Nation Territory, in Northern New York, USA. Messrs. Montour, Hill and Montour are all members of First Nations tribes within the Six Nations Iroquois Confederacy.

4. Jerry Montour and Kenneth Hill are controlling shareholders of Grand River. Jerry Montour, who serves as Chief Executive Officer of the corporation and owns 30% of Grand River's common shares and Kenneth Hill, who serves as the

[1] See Exhibit 1.
[2] See Exhibit 2 and Exhibit 3, respectively.
[3] See Exhibit 4.

Senior Officer in charge of marketing and supply for Grand River Enterprises' non-domestic sales, owns 10% of Grand River's common shares.[4] Jerry Montour and Kenneth Hill previously did business as, and are also former partners in, the business ventures and associations described in further detail below.

5. Arthur Montour, Jr. is the sole named shareholder, and President, of both Native Tobacco Direct Company and Native Wholesale Supply Company, operating under charters granted by the Sac and Fox Nation of Oklahoma on January 13, 1999, and February 25, 2000, respectively.[5] Native Tobacco Direct and Native Wholesale Supply have at all times maintained a principal office and place of business on Six Nations land in Northern New York. Prior to owning Native Tobacco Direct Company and Native Wholesale Supply Company, Arthur Montour, Jr. did business individually and under the proprietorship name Native American Wholesale.

Description of Investors' Business and Investments

6. Jerry Montour, Kenneth Hill and Arthur Montour, Jr. ("Investors"), individually and as co-venturers in the businesses and enterprise described herein, have been engaged in the licensing, manufacture, packaging, production, importation and or sale of tobacco products sold in Canada and the United States, continuously since 1992.

7. Jerry Montour and Kenneth Hill began their business relationship in 1992, initially as partners in a co-venture that was engaged in the sale and distribution of premium brand tobacco products in the United States and Canada, principally on Six Nations territory claimed by these two countries.

8. In or about 1992, with their business expanding, Jerry Montour and Kenneth Hill recognized a particular need to associate with and engage other individuals to assist in the management and operation of their rapidly growing tobacco business. Thus, in 1992, Jerry Montour and Kenneth Hill invited Arthur Montour, Jr. to be a co-venturer in their tobacco distribution operation, with the specific purpose of serving the USA market. Arthur Montour, Jr. accepted the invitation and proceeded to work in association with Jerry Montour and Arthur Montour in the distribution of tobacco products, principally in the East Coast region of the USA. Jerry Montour and Kenneth Hill brought to this relationship access to capital and general business and managerial skills, while Arthur Montour, Jr. brought business contacts and distribution expertise, particularly throughout Six Nations land.

9. As their business and relationships progressed, Jerry Montour and Kenneth Hill became known in the industry both individually and as partners in unincorporated enterprises known as "Traditional Trading" and "Grand River Enterprises."

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[4] See Exhibit 5
[5] See Exhibit 6

Similarly, Arthur Montour, Jr. operated professionally in the USA both individually and under the trade name "Native American Wholesale." Resolutions adopted by the Brotherhood of Six Nations Council recognizing the Grand River Enterprises partnership are annexed as Exhibit 7.

10. Through an association and business arrangement perhaps more common to Native American social norms than the formalistic rituals of European ("Western") business practice, Messrs. Montour, Hill and Montour formed a business relationship focused initially on the distribution of tobacco products in North America. Which provided for the delegation of responsible territories based on seniority and capital investment. Jerry Montour and Kenneth Hill were the principal and senior parties to this venture, whose return on investment would be based on distribution in the USA and Canada, while Arthur Montour, Jr.'s return on investment would be derived from distribution activities in the USA.

11. As it did since its inception, the Investors' business continued to prosper subsequent to the participation of Arthur Montour, Jr., in part because they were able to utilize specific treaty rights granted to them by both the Canadian and the American Governments, which permitted them to freely engage in commerce throughout what would eventually become the North American Free Trade Area.[6] The Investors relied upon the solemn promise made to the Tribes of the Iroquois Confederacy by the USA that their members would be forever entitled to engage in commerce without interference and to cross the border between what would eventually become known as Canada and the USA "unmolested." These treaty rights allowed the Investors, operating individually and under the Traditional Trading, Grand River Enterprises, and Native American Wholesale trade names, to also enter into and service a niche market for affordably priced tobacco products in the discount segment of the market, upon which, as described below, these Investors were poised to capitalize, having dedicated many years of time and capital to it.

12. Jerry Montour, Kenneth Hill, and Arthur Montour, Jr.'s immediate and sustained success in their distribution business permitted these Investors to quickly move from a enterprise that was focused on sales, transportation and distribution of premium tobacco products manufactured by the four largest USA tobacco product manufacturers, to one that included the trademark, manufacture and brand-licensing of their own cigarette brands. Their success in these endeavors as well was not coincidental but, rather, the result of applied business acumen and networking with and among other members of the Six Nations. Thus, Jerry Montour and Kenneth Hill entered into a joint venture in 1992 with another member of the Six Nations Confederacy named Larry Skidders. Together with Skidders, these Investors financed the construction of a manufacturing facility on Six Nations territory, near Racket Point on the Akwesasne Reserve (which straddles land claimed by the Provinces of Ontario and Quebec, as well as the State of New York). Racket Point is located south of the Border between Canada

[6] See Exhibits 8-10.

and the USA.

13. The goal of constructing a manufacturing facility near Racket Point was to create a manufacturing facility for the production of the Investors' own brands. This prospect presented an opportunity for the Investors to expand, diversify and fully integrate their operations, while providing a source of job creation for the people of the Six Nations. Along with their other partners, the Investors understood that if they began production of cigarettes, rather than merely concentrating on sales and distribution of premium brands made by the major USA tobacco manufacturers ("the Majors"), they could provide a large number of jobs to their people, while also realizing a substantial return on their collective investment. In addition, it became apparent that the Investors could and would capitalize on Arthur Montour, Jr.'s distribution skills and contacts to distribute products that the Investors would manufacture in their own right.

14. The success of the manufacturing facility near Racket Point, and the ongoing success in the sale and distribution of the Majors' premium brands throughout Six Nations territory, led the Investors to undertake a production agreement with Star Tobacco, a non-Native company located in Virginia, to produce a much greater volumes of the Investors' own brands. These brands initially included: "DK's" and "Putters," both of which were sold on Six Nations territory, throughout the North American Free Trade Area.

15. Between 1991 and 1993, the Investors continued to expand their business and develop their brand and distribution strategies, relying on the production from both Star Tobacco and the facility near Racket Point. Business was so good that the Investors also started planning for the construction of a much larger production facility in 1992, which would be located on the Grand River Reserve, in Ohsweken, Ontario, Canada. Construction commenced on this flagship facility in 1993. This manufacturing arm would come to be called "Grand River Enterprises" by the Investors, and was formally accepted and approved by the Six Nations Band Council in 1994. See Resolution annexed as Exhibit "11".

16. Ohsweken is situated north of the border between Canada and the USA, strategically located on the Western side of Six Nations territory, relative to the Racket Point facility at Racket Point, which was located in the East. One of the primary reasons for choosing this particular location, apart from the availability of land on the Six Nations Reserve, was a recognition that the aboriginal people of this region were in particular need of economic development, given the high rates of unemployment and the lack of any other major employer on-Reserve.

17. The Grand River facility became operational towards the end of 1993 and into 1994. The addition of this capacity would make it possible for the Investors to complete the transition of their business to a wholly-integrated enterprise of tobacco manufacturing, sales and distribution which would provide a livelihood to hundreds of inhabitants of the Six Nations Territories.

18. With their fully integrated tobacco business growing quickly, the Investors were approached with another opportunity to expand their investments in 1996. Introduced by a lawyer who was familiar with both parties, the Investors struck a partnership with the Omaha Tribe, whose reserve is located within the State of Nebraska. In exchange for a promised royalty percentage from the Omaha Tribe, the Investors would invest their capital, managerial and technical expertise with the Omaha Tribe, and provide managerial and technical labor to the partnership in order to establish another cigarette manufacturing facility and build market share utilizing both the pre-existing DK brand and the new "Omaha" brand.

19. Along with other investors, Jerry Montour and Ken Hill established a company that they called Turtle Island, through which they would participate in their partnership with the Omaha Tribe. Turtle Island was to be entitled to 50% of the income from the Omaha venture. In honoring the obligations undertaken by Turtle Island in the partnership, Jerry Montour first visited the Omaha Tribe in late 1996 and moved there to live and work for most of 1997 and 1998.

20. The launch and production in Omaha played an important interim role for the Investors and in their plans to integrate and expand their tobacco operations. Initially, the Investors intended the Racket Point facility and the flagship factory in Ohsweken to satisfy their production needs. However, in or about 1993, after the death of Larry Skidders, the Investors' relationship with the Skidders' estate was deteriorating, and the Investors looked to the Omaha plant to fulfill, in part, their short and long term production needs.. After successfully launching production in Omaha, the Investors realized that the most efficient and practical application of their resources required that they direct and satisfy all of their production needs for the USA and Canadian markets out of the flagship facility in Ohsweken, with distribution centrally coordinated under Arthur Montour, Jr.'s direction in their facility located on-Reserve in Northern New York.

21. Thus, the Grand River facility ultimately became, and to this day remains, the Investors' exclusive production facility for market in both the USA and Canada, in addition to other markets worldwide.

22. The process of consolidating their investments and centrally locating production and distribution was ultimately completed in January 1999, when the Investors began to manufacture their brands exclusively at Grand River. They also agreed at that time to the incorporation of Native Tobacco Direct, and later Native Wholesale Supply, for the purpose of importing and selling those brands on Indian land in the USA. Through these enterprises, the Investors would continue to operate as they had for years, with Jerry Montour and Ken Hill handling the capital and manufacturing components of their business and Arthur Montour Jr. handling the distribution component.

23. As part of the consolidation process, the Investors agreed through a cross-

licensing relationship that Native Tobacco Direct (and, later, Native Wholesale Supply) would hold and beneficially own the intellectual property and distribution rights to, and Grand River Enterprises Six Nations, Ltd. would hold the exclusive right to manufacture, the Investors' American market brands, including the Seneca brand, which is and has been used in the USA continuously since 1999, by Native Tobacco Direct and Native Wholesale Supply Company.

24. Working through Native Tobacco Direct, Arthur Montour Jr. thus applied for, and subsequently received, federal registration for the Seneca trademark in the USA.[7] Ownership of the marks was later assigned to Native Wholesale Supply, a current importer and licensor of the marks. Since September 2002, a South Carolina-based company, Tobaccoville USA, Inc., has operated under a license agreed to by and among the Investors, as the exclusive licensee of the Investors' marks for off-reserve sales in the USA. Native Wholesale Supply has retained unto itself the exclusive rights to import and sell the Investors' products on Indian land in the USA.

25. In connection with the consolidation and integration described above, the Investors also caused an exclusive manufacturing agreement to be entered into between Grand River and Native Tobacco Direct on March 15, 1999, and subsequently Native Wholesale Supply, to memorialize this relationship. A separate licensing and manufacturing arrangement was entered into by and between the Investors and Tobaccoville USA, which remains in effect to the present day.

26. Products manufactured by Grand River, thus, have been and continue to be brought into the USA by Native Wholesale Supply and Tobaccoville USA. These products are then sold on Indian land in the USA by Native Wholesale Supply and on non-Indian land by Tobaccoville USA.

27. Having discontinued their relationship in the Turtle Island partnership and with the Skidders' estate, the Investors now derive their income solely from the enterprise relationship between, and the operations of, Grand River and Native Wholesale Supply. The income and profits from this partnership are shared among the Investors through an informal allocation process that essentially distributes profits to Jerry Montour and Kenneth Hill through Grand River, and to Arthur Montour, Jr. through Native Wholesale Supply. As the accompanying record makes clear, until the measures at issue in this arbitration were adopted and enforced, the Investors had profited, and were poised to continue profiting, from a successful enterprise and business plan that had been created, launched and implemented years before the measures were created.

28. As further explained below, however, the measures at issue have substantially interfered with the Investors' investments and have also discriminated against them to a crippling extent, for which the Investors seek and are entitled to

[7] See: Exhibit 12.

damages under Chapter 11 of the NAFTA.

Background to the Measures Forming the Basis of this Claim: The MSA

29. In November 1998, attorneys general and state officials representing forty-six States and six U.S. territories (the “MSA States”) entered into a master settlement agreement (“MSA”) with the four largest U.S.-based manufacturers of cigarettes, namely: Philip Morris Inc., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corp., and Lorillard Tobacco Company (collectively, the “Majors”).[8]

30. The MSA settled and resolved over forty lawsuits and claims that these State officials had filed against the Majors, beginning in or about May 1994.[9] In consideration for the States’ dismissal of the lawsuits, the Majors agreed under the MSA to make annual “settlement” payments to the MSA States totaling $206 billion over the first 25 years following the MSA’s execution, and $9 billion thereafter, annually, subject to certain contingencies, adjustments and offsets.

31. During the MSA’s negotiation in the summer and fall 1998, however, and unbeknownst to the Investors or their investments, the MSA States and Majors had occasion to discuss and did discuss and enter into agreements affecting the future of competition and trade in the cigarette industry within the Free Trade Area, particularly in the United States.

32. Specifically, during the negotiations and discussions leading up to the execution of the MSA, the Majors and the MSA States discussed the fact that the Majors would be raising the price of their tobacco products after the MSA’s execution to fund the MSA’s settlement payments.

33. In the context of those discussions, the Majors expressed a concern that they would lose market share to existing and potential competitors in the overall U.S. market, including the Investors and their investment entities, who would not need to raise prices or maintain higher price levels for their tobacco products subsequent to the MSA’s execution.

34. The reason that the Majors’ competitors would not need to raise their prices subsequent to the MSA is that these smaller competitors were never sued nor accused of any of the wrongdoing that gave rise to, and strengthened, the States’

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[8] See: Exhibit 13.

[9] The lawsuits sought primarily to recoup Medicaid expenses the States had incurred for the treatment of smoking-related illnesses of indigent smokers, including cancer and emphysema, and were premised principally on theories of conspiracy, fraud and deception. The States’ claims focused on allegations that the Majors targeted youth in their advertising; knew of, controlled, and failed to disclose research into the harmful effects of smoking; and knew nicotine in cigarettes was addictive and marketed their cigarettes with those addictive properties in mind. *Report to Senate U.S. Comm. on Commerce, Science & Trans.*, States’ Use of MSA Payments, GAO-01-851, at 8 (June 2001), See Exhibit 14.

claims against the Majors. Accordingly, competitors such as the Investors and their investments could not rightfully be subjected to the burdens and costs associated with the MSA's annual settlement payment scheme.

35. The Majors refused to agree to the MSA, however, unless the MSA's payment obligations were extended, by some form of mandatory legislation, to *all other* competitors whose cigarettes would be sold in the U.S. after the MSA's execution.

36. Consistent with these demands, the MSA's payment obligations were drafted to apply, and currently would apply, not only to the Majors but to all other competitors whose cigarettes are sold in the United States, despite the fact that these smaller competitors have never been, and may never be, sued or threatened with suit, nor accused of the wrongdoing that gave rise to the claims asserted against the Majors and settled under the MSA.

37. The device, artifice and contrivance employed by the Majors and the MSA States to make the MSA's "payment scheme" applicable to the Majors' competitors constitutes the principal gravamen of the Investors' claims. This scheme was designed, and would later be implemented by each State, to restrict the sale of smaller competitors' products to the point that these competitors would effectively be eliminated entirely from the marketplace.

38. As designed, the MSA's payment scheme was expressly made applicable to the Majors' competitors through two interrelated provisions of the MSA. First, the Majors and the MSA States included provisions in the MSA "permitting" other competitors (who were never sued nor accused of any wrongdoing) to nonetheless join the MSA as Subsequent Participating Manufacturers or "SPMs." MSA §IX(i).[10] Thus, under what are called the "Renegade Clause" provisions of the MSA, competitors of the Majors may join the MSA as SPMs and make *pro rata* settlement payments to the MSA States based on their annual sales volume *vis-à-vis* the Majors in the United States.

39. The second provision applicable to the Majors' competitors is model legislation annexed as Exhibit "T" to the MSA, which the drafting parties intended to be enacted (and which would later be enacted in each MSA State and territory) as an "Escrow Statute". Each Escrow Statute would require all tobacco product manufacturers that did not "join" the MSA as an SPM to establish a "Qualified Escrow Fund" for the benefit of the MSA States, into which the manufacturer would be required to deposit annually an amount equivalent to that which the manufacturer would have paid the States had it joined the MSA as an SPM.

40. In simplest terms, the Escrow Statutes incorporate the Renegade Clause's

[10] The Majors are defined as Original Participating Manufacturers or "OPMs" under the MSA.

payment requirements (with one exception)[11] and makes them applicable to all competitors that did not "join" the MSA, *i.e.*, non-participating manufacturers or "NPMs" as designated under the measures that would eventually be enacted to implement the MSA.

41. For the reasons explained below, none of the Investors nor their investment entities has joined the MSA as an SPM. Consequently, Grand River, Native Tobacco Direct and Native Wholesale Supply have been classified by the MSA States as NPMs under their Escrow Statutes and subjected to that legislation's payment requirements. The result of the implementation and eventual enforcement of these measures has been devastating to the Investors and their investments.

The Renegade Clause

42. Notwithstanding that the MSA was drafted by the Majors and the MSA States, and presented to the public as a settlement of lawsuits that were asserted only against the Majors, the MSA expressly provides that other manufacturers and competitors of the Majors may join the MSA as SPMs. MSA § IX(i).

43. Inducing manufacturers and competitors that had never been accused of, nor sued for, any wrongdoing to enter into a settlement agreement, however, required an incentive. That incentive came in the form of a payment exemption set forth in the MSA's Renegade Clause and, further, from the threat that electing not to join the MSA would subject an NPM to substantial, non-exempt payment obligations under the Escrow Statutes.[12]

44. Under the MSA's Renegade Clause, a tobacco product manufacturer (which includes a manufacturer or importer of record) that elects to join the MSA as an SPM must make *pro rata* annual "settlement" payments to the MSA States based on the SPM's comparative U.S. market share *vis-à-vis* the Majors' market share; MSA §IX(i)(1). This exempt status would later be accommodated in implementation by each MSA state through its respective legislative enactments.

45. The Renegade Clause contained an exemption, however, pursuant to which an SPM that agreed to sign on to the MSA within 90 days of its Execution Date

[11] The one exception, explained immediately *infra*, is that certain SPMs benefit from a payment exemption that is not similarly afforded to other SPMs nor NPMs.

[12] As North Dakota Attorney General Heidi Heitkamp and Washington Attorney General Christine Gregoire explained at the press conference announcing the MSA: "We are deeply concerned about so-called renegades or rogue manufacturers who are not subject to the [MSA] …. And so consequently, there are incentives built into this deal all around for us to bring as many [manufacturers] in as we can …. [W]e believe there is an incentive for [these manufacturers] to come in, to live consistently [with] the advertising and marketing restrictions that are placed here. We've tried to give them economic incentives." Press Conference of Attorneys General announcing MSA, *Federal News Service,* November 16, 1998 (hereafter "MSA Press Conference"). See: Exhibit 15.

(November 23, 1998) would not be required to make any MSA payments, provided its sales in any given year do not exceed the greater of 100% of its 1998 U.S. market share or 125% of its 1997 U.S. market share. MSA § IX(i)(1),(4).

46. In contrast to the early signing SPMs, any manufacturer that signed the MSA more than 90 days after the Execution Date was deemed to have 0% U.S. market share for both 1997 and 1998. Hence, based upon the arbitrary inclusion of a 90-day execution period and use of the years 1997 and 1998 as the only suitable baseline for participation in the U.S. market, any manufacturer that was deemed – post-implementation – to be an SPM, would be forced to make MSA payments based on every cigarette it sold. No exemption would be possible under the measures uniformly imposed by each state in the years to come.

47. None of the Investors nor their investments were privy to the MSA negotiations, nor were they ever notified of the 90-day deadline. Indeed, none of the Investors or their investments was ever notified that the MSA -- a settlement agreement between States and private third parties -- could be signed by any manufacturer other than those accused of wrongdoing or sued, *i.e.*, the Majors.

48. Yet, as the statements of the attorneys general that negotiated the MSA later made clear, the MSA States and Majors had been secretly negotiating before the MSA's execution with a select few of the Majors' competitors to join the MSA as SPMs within the 90-day deadline, so that they would receive the benefit of the foregoing exemption and favorable treatment under the MSA:

> *MSA Press Conference at 8* ("I'm delighted to say that just before I came in here today, we received a call and a fax from Commonwealth [Tobacco] … who was not sued by any of the states, but has decided they, too, will be a signatory to the agreement … *We're in negotiations with a number of other manufacturers*.") (emphasis added).

49. News reports at the time also gave no indication that on-Reserve sales of tobacco products could somehow be subjected to the measures which would eventually be imposed to implement the MSA's contemplated regime. Similarly, the then-Attorney General for the Seneca nation was never even contacted by the States Attorneys General to inform him that the MSA could possibly have anything to do with Aboriginal tobacco producers.[13]

50. In 1998, the Majors accounted for approximately 96% – 98% of the U.S. cigarette market. The intent and purpose of the Renegade Clause's exemption was to induce a group of smaller competitors (hereinafter "Exempt SPMs") to join the MSA under a grant that effectively safeguarded their existing market share, while simultaneously and effectively taking the share held by other competitors, including the Investors, for the benefit of these Exempt SPMs. The Exempt SPM's would thus be provided with the exclusive entitlement to the remaining

[13] See: Exhibit 16.

2% – 4% of the U.S. market and subsequent increases in market share beyond those levels – because they were the only ones invited to "join" the MSA during the 90-day exclusion period.

51. In other words, the clear intent and result of the Renegade Clause provisions of the MSA – which would be implemented uniformly in the years to come by each MSA State and territory – was not only the elimination of most price-competition for the Majors, but also the reservation of an exclusive slice of the U.S. market to a select club of smaller producers who were invited into this secret agreement by invitation only. These Exempt SPMs would not, and have not, been forced to make any payments to the MSA States under the measures that were eventually imposed to implement the MSA, so long as they did not increase their market share by greater than 100% of their 1998 market share, or 125% of their 1997 market share.

52. Officials from the MSA States never did reveal why or how they could permit such obvious discrimination to take place as between competitors who would eventually be labeled by their measures as either Exempt or Non-exempt SPMs. Even prior to the MSA's Execution Date in November 1998, the MSA States had apparently already negotiated and reached agreement with the Exempt SPMs to sign on to the MSA within 90 days of the Execution Date, and thus receive the benefit of the foregoing exemption from the MSA's payment requirements. No explanation was ever given as to why competitors such as the Investors and their investments were not deemed worthy of an invitation to what would – in implementation – become a highly-favored club.

53. To be clear, notice of the foregoing negotiations or an invitation to join as an Exempt SPM was never given to the Investors nor to their investments, and no explanation exists for the MSA States' failure to do so. In short, the Majors and the MSA States selected an exclusive group of smaller competitors with whom they would negotiate privately, and secretly, to extend this favorable treatment. The MSA States did so to the exclusion and considerable detriment of all other smaller competitors, including the Investors and their investments.

54. Moreover, the States were well aware that the tobacco products of other competitors, including the Investors and their investments, were sold in the United States. Yet, the MSA States did not invite nor give notice to these entities to participate in the MSA under the same favorable terms as those secretly offered to and negotiated with Exempt SPMs, including Ligget Corp. and Commonwealth Tobacco Company, which are U.S.-based manufacturers.[14]

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[14] In 1999, Exempt SPMs sold approximately 3.8% of all the cigarettes sold in the U.S. -- <u>16.6 billion cigarettes</u> -- without incurring any MSA payment obligations with respect to those sales. These SPMs also were, and continue to be, exempt from Escrow Statute payment obligations (discussed *infra*) with respect to those and equivalent future sales. In short, the Renegade Clause's annual exemption for these Exempt SPMs continues *pro rata* in perpetuity under the MSA

55. Without an exemption, if the Investors or their investments join the MSA, their payment obligation to the MSA States would amount to tens of millions of dollars annually. To illustrate, if Grand River and Native Wholesale Supply sold cigarettes in 1999 equivalent in amount to the market share devised and allocated to Exempt SPMs (3.8%), and they chose now to join the MSA, they would be required to make retroactive MSA payments for that year in the approximate amount of $158 million, despite the fact that Exempt SPMs were required to make *no* MSA payments for selling the same number of cigarettes in 1999.

56. Similarly, assuming current sales trends, if Grand River and Native Wholesale Supply now or hereafter "joined" the MSA, pursuant to the implementing measures now present in all of the MSA States and territories, they would incur liability for tens of millions of dollars in MSA payments for their 2002 and 2003 sales, *alone*, despite the fact that Exempt SPMs will have incurred $0 for selling the same number of cigarettes in 2002. In addition, if co-venturers Grand River and Native Wholesale Supply "join" the MSA today, under each States' existing implementing measures, they would be forced to pay, on average, approximately 12.5% more per carton annually than the Majors are entitled to pay (under the original terms of the MSA, as memorialized in the measures at issue in this Claim).

57. Thus, the Investors and their investment enterprises have been effectively precluded from "joining" the MSA on the same terms that have been made available to their competitors, as subsequently implemented by the laws of each State. Moreover, as demonstrated below, there is in fact no choice of whether to "join" the MSA. Because of the measures imposed by each state to implement the MSA's terms, abstinence is not an option. Under each MSA State and Territory's Escrow statute, the Investors and their investments are still required to make the equivalent, multi-million dollar payments annually in order to stay in business in each market – while Exempt SPMs are not required to make *any* payments for selling the same number of cigarettes.

The Escrow Statutes

58. The MSA contains, in Exhibit "T," model legislation that was drafted by the MSA's parties to be enacted in every MSA State and applicable to every tobacco product manufacturer whose cigarettes are sold in the MSA States. As detailed below, each of the 46 MSA States has enacted this model legislation, commonly referred to as an "Escrow Statue." These measures effectively gave force to the discriminatory and anticompetitive provisions of the MSA in each State.

59. The Escrow Statutes each require a tobacco product "manufacturer" whose cigarettes are sold in an MSA State to do one of two things. First, it may "join" the MSA as an SPM (without an exemption.) Alternatively, it may remain a "Non-Participating Manufacturer" or "NPM." As an NPM, the manufacturer

must establish and maintain a "Qualified Escrow Fund," *i.e.*, an escrow arrangement with a qualified financial institution, into which the manufacturer must make annual payments that are held for twenty-five years for the benefit of the MSA State.

60. To illustrate, for each carton of cigarettes manufactured and distributed by Investors and their investment enterprises that are sold in MSA States, the Escrow Statutes require them to place into a Qualified Escrow Fund by April 15th of the year following the year in which such sales are made: $1.88482 for cigarettes sold in 1999; $2.09424 for cigarettes sold in 2000; $2.7225 for cigarettes sold in 2001 and 2002; $3.35078 for cigarettes sold in 2003 through 2006; and $3.76964 for cigarettes sold in 2007 and thereafter. Each of the foregoing per carton amounts are further subject to cumulative inflation adjustments of no less than 3% per year, as calculated per the terms of the MSA.

61. The total amount an NPM must deposit and maintain in the Qualified Escrow Fund is capped by, and ultimately calculated based on, what it would have paid as an SPM under the MSA, *with no exemption*.

62. The purported purpose of each Escrow Statute is to create a fund that may be accessed by an MSA State to satisfy any judgment that it might receive in the event it successfully sues the NPM in the future. Such lawsuits must be for claims similar to those asserted against the Majors, and the NPM must be found by a court to have acted "culpably." The funds deposited may not be accessed by the NPM for twenty-five years after their deposit, except to the extent needed to satisfy such judgments.

63. Thus, despite having never been accused of any wrongdoing nor sued nor even alleged to have engaged in the kind of misconduct allegedly engaged in by the Majors, the MSA implementing measures of each state now require the Investors and their investments to deposit millions of dollars annually into qualified escrow fund to secure claims that presently do not exist, may never arise, and which currently have no legal basis. The claimants do not receive the benefit of a fair and equitable hearing (assessing their likely culpability – for which such payments are ostensibly to be made). They do not even hear any claim against them. They are simply ordered to make tens of millions of dollars in annual payments for the benefit of any MSA States in which they want to do business, to be held for twenty-five years in the unlikely event that any of these States launches a case and actually recovers a judgment against them for acting "culpably" (a term nowhere defined in any of the measures).

64. As indicated in the MSA, however, the Escrow Statutes' true purpose is to "effectively and fully neutralize the cost disadvantages that the [Majors and SPMs] experience *vis-à-vis* [NPMs] within each [MSA State] as a result of the provisions of [the MSA]." MSA IX(d)(2)(E).

65. The Escrow Statutes have this "neutralizing" effect because the escrow payments they require are prohibitive, *i.e.*, the per carton payments required under the Escrow Statutes are greater than the per carton profits of Investors or their investment enterprises.

66. Thus, the Investors and their investments are forced to raise prices if they wish to comply with the Escrow Statutes; they cannot maintain pre-MSA price levels for their cigarettes and stay in business. If they increase prices, however, their ability to offer significant price competition to the Majors and SPMs – especially the Exempt SPMs – is materially and adversely compromised. Moreover, their ability to compete against other Aboriginal tobacco companies, who – because they do not pay state taxes and their territories do not extend upon either side of the Canada-US border – are effectively "exempt" from the MSA measures (because they are apparently not enforced against them), has been even more seriously compromised.

67. The effect of compliance with these MSA-implementation measures, accordingly, is the complete destruction of the Investors' business and their investments. On the other hand, if an NPM does not make the payments required under a State's Escrow Statute, the NPM will be subjected to civil penalties and its products will be prohibited from being sold in the State. As described below, the effect of non-compliance, accordingly, is a complete prohibition against the operation of the Investors' business and their investments within the territory claimed by the USA, again resulting in its complete destruction.

The Contraband Laws

68. As detailed below, beginning in early 2002, the MSA States started to enact and adopt measures commonly called "complementary" legislation and regulations, also known collectively as the "Contraband Laws." They are defined herein as Contraband Laws because cigarettes manufactured by an NPM that has not complied with the Escrow Statutes are considered under those measures as being contraband. These laws were and are designed to provide a further, immediate means of neutralizing competition from NPMs, and they were drafted and proposed for legislation by the same parties who agreed to the MSA: the National Association of Attorneys General ("NAAG") and the Majors.[15]

69. Penalties under the Contraband Laws are severe and, unlike the Escrow Statutes, explicitly apply to distributors as well as "manufacturers". Violation of a Contraband Law subjects a distributor to civil monetary penalties and suspension or cancellation of its license to stamp cigarettes. Cigarettes that are stamped in

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[15] Under the Escrow Statutes, an NPM and others selling its cigarettes may be enjoined from selling cigarettes in an MSA State only after the NPM is found to have knowingly withheld escrow payments for two separate years. Under the Contraband Laws, however, there is an immediate prohibition against the stamping and sale of an NPM's cigarettes if the NPM is not in compliance with the State's Escrow Statute.

violation of a Contraband Law are also subject in some States to immediate seizure by state officials and a forfeiture action similar to those involving pre-conviction forfeiture crimes.

70. The Contraband Laws also provide that an NPM's products may not be sold in an MSA State unless the NPM appoints a representative statutory agent for service of process in the State. In addition, these laws provide for the public posting and publication of lists of NPMs who have not complied with the Escrow Statutes – in other words: a black list – indicating those manufacturers whose products can and cannot be sold in the State. If an NPM has not complied with an escrow statute, its products are "black listed," meaning they are posted on an attorney general's website and cannot be sold in the State. These lists are explicitly compiled by brand; not by manufacturer.

71. The table attached at Exhibit 17 lists the measures imposed by each individual state to implement the terms of the MSA's escrow obligations. The table attached at Exhibit 18 lists the measures imposed thus far by each individual state to promulgate their Contraband Law policies, as orchestrated by the National Association of State Attorneys General.

Additional State Measures Designed to Secure the MSA Cartel Price

72. In addition to promulgating their respective Escrow Statutes and Contraband Laws, various MSA States have also taken further steps to exclude the brands of NPMs from the marketplace, by imposing prohibitive fees on the distribution of NPM cigarettes sold in their territories.

73. On January 8, 2004, Michigan promulgated Act Nos. 285 and 286, which, in addition to the the escrow obligations imposed on NPMs, imposes a new "equity assessment" on NPMs whose cigarettes are sold in Michigan. This "equity assessment" must be "pre-paid" by March 1st of each year, at a rate of 175 mills per cigarette (i.e. ¢35 per 20-cigarette pack) for all cigarettes likely to be sold in the State (based upon the previous year's sales) or $10,000.00 (whichever is higher).[16]

74. Even non-MSA states, such as Minnesota, have begun imposing discriminatory measures based upon the same flawed and anti-competitive philosophy. The *Minnesota Cigarette Fee Act* imposes a non-tax levy of ¢35 per 20-cigarette pack on all "non-settlement" cigarettes brands made after June 30, 2003.[17] This fee is imposed upon distributors, such as Native Wholesale Supply, for any of the Investors' cigarettes sold in Minnesota – whether directly or indirectly (i.e. later in the stream of commerce).

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[16] See: Exhibit 19.

[17] Laws of Minnesota 2003, Ch. 127, Art. 14, Sec. 9, amending Sec. 297F of the Minnesota Statutes. See Exhibit 20.

MSA States' Actions Against the Investors and their Investments

75. When the MSA was concluded, none of the Investors had any reason to believe that they would or could be affected by it or whatever measures might be devised to implement it.[18] They had never been accused of the conduct that notoriously impugned the Majors, much less been sued by any State for the recovery of health care costs for any reason. Moreover, the conclusion of the MSA in and of itself and standing alone did not actually cause any kind of loss or damage to any of the investors.

76. Similarly, the mere enactment of the Escrow Statutes, did not cause any kind of loss or damage to any of the Investors. The first time that any of the investors realized that the measures enacted to implement the MSA could cause them loss or damage was in July 2002, when they were advised by counsel about the operation and effect of these measures which, at that time, the MSA States sought to enforce as against the Investors.

77. The first expenditure made by any of the Investors, in respect of any of the measures which form the basis of their claims, was that made when the law firm of Windels Marx Lane & Mittendorf, LLP was retained by Grand River to advise and defend against the extension of these measures to sales of the Investors' Seneca brand in the US market. Thus, the first monies which could be characterized as "damages" in these proceedings were paid by the Investors, through Grand River, in May 2002.

78. Over the past three years, many MSA States have undertaken enforcement and coordinated enforcement of the Escrow Statutes and Contraband Laws against the Investors and their investments.[19] On a state-by-state basis, each of these enforcement actions, together with the legislation being enforced, constitutes a "measure" which forms the basis of the claim. Specifically, the MSA States commenced lawsuits in the following States, of which the Investors were aware at the time of filing their initial notice of claim in this matter: Missouri, Nebraska, Oklahoma, North Carolina, South Carolina and Wisconsin.

79. Counsel for the Investors has further learned that multiple, other enforcement actions have apparently been filed against the Investors. The true extent, number and identity of these actions is known only by the Attorneys General of the MSA States, who, in many cases have apparently failed to serve process through required international protocols, or failed to serve appropriate parties. Faced with

[18] See Exhibits 17 and 18

[19] Each Escrow Statute provides that the State's Attorney General is authorized to bring a civil action on behalf of the State against an NPM if it fails to make required escrow payments, and seek a civil penalty of up to 300% of the amount required to paid into escrow in the case of a knowing violation. The Escrow Statutes also provide that each failure to make an annual escrow payment constitutes a separate violation, and, in the case of a second knowing violation, the NPM is to be prohibited from selling cigarettes to consumers within the applicable MSA State for a period not to exceed two years.

an overwhelming plethora of continually-emerging enforcement actions, the Investors have been forced to economize and prioritize their market access plans and enforcement of their legal rights. They simply could not afford to fully defend against every regulatory action being marshaled against them. Rather, the Investors have responded in two ways. First, they have filed and are prosecuting an antitrust action against multiple MSA States in the U.S. District Court, Southern District of New York, seeking injunctive relief to stop enforcement of these measures. Under the U.S. Constitution, the Investors cannot sue the MSA States for damages resulting from these measures. Thus, the Investors can only seek injunctive relief in the U.S. courts and must look to this tribunal for redress of the damages that they have sustained and continue to sustain. Unfortunately, the lawsuit in New York was dismissed as against all but the New York Attorney General. Essentially, the Court has ruled that, if the Investors wish to enjoin these measures against multiple Attorneys General, the Investors must bring forty-six (46) separate lawsuits in each individual state – a feat Grand River could never afford, manage or accomplish.

80. Second, recognizing that they cannot sit idly by while the Attorneys General crush their business altogether, the Investors have economically and strategically defended against various state actions, while settling others on a without-prejudice basis.

81. Thus far, the Investors have reached accords without prejudice with the following MSA States: Oklahoma, South Carolina (Tobaccoville USA is responsible party), North Carolina (Tobaccoville USA is responsible party), Louisiana, Arkansas, Georgia, Kansas, Tennessee and Nebraska..

82. To date, the Investors have paid approximately $5,000,000 dollars [USD] in escrow deposits and penalties to the MSA States, without prejudice and under a full reservation of their rights under U.S. law, in effort to resolve a fraction of these claims.

83. More importantly, as indicated above, the Investors and their investments are at risk of additional lawsuits and demands for tens of millions of dollars in escrow payments and penalties from other MSA States. Each demand comes with the imminent promise of complete exclusion from the market for each of the Investors: as manufacturers, as trademark-holders and as the distributors of the Seneca Brand in each State where these measures have been imposed.

84. The foregoing enforcement efforts have been coordinated and implemented through various committees and task forces of NAAG that are comprised of officials from the attorneys general offices of the MSA States and the personnel and attorneys employed by NAAG, who are paid from an enforcement fund that is funded separately under the MSA by the Majors.

85. The MSA States' enforcement actions and demands are based on the claim that

the Investors and their investments manufacture cigarettes that they "intend to be sold in the United States," irrespective of whether they "intend" their cigarettes to be sold in any particular MSA State.[20] Because enforcement officials have access to records of importation for the Investors' business, they have universally concluded that every single Seneca cigarette produced and sold by the Investors in the United States must be sold somewhere in the United States – despite the fact that approximately 50% of the Investors' business is concluded on-Reserve (where taxes are not paid, and therefore enforcement officials have no tax records as the do with all other Non-exempt NPM's).

86. As such, regardless of how much of their inventory will be sold on-Reservation – and therefore would not have been made subject to the payment of State excise taxes (the normal method used by states to base liability under their MSA measures) – the Investors are being held liable by the MSA States for all of their sales of the Seneca Brand.

87. In stark contrast to the way in which the Investors have been treated, as the proprietors of an Aboriginal tobacco business, a Tribe from Washington State has received a complete exemption from application of the same MSA-related measures causing loss and harm to the Investors.

88. In 2004, the Squaxin Band of Washington State started building a 25,000-square-foot tobacco manufacturing facility, which was completed in April 2005. It opened with an expected initial production run of as much as 100,000 10-pack cartons per month. The Squaxin investors began building a market by selling their brand, "Completes," using inventory manufactured under license by a non-Aboriginal facility.[21]

89. As memorialized in a compact entered into between the Squaxin and Washington State,[22] the State has acknowledged that it lacks jurisdiction to tax cigarettes sold on-Reserve. The same state of affairs exists in many states, such as New York, where officials have respected aboriginal sovereignty by either entering into a formal compact, thereby officially memorializing the issue, or by simply refraining from attempting to impose or collect such taxes on sales made on-Reserve.

90. The Squaxin sell cigarettes on-Reserve, both in Washington State and in other Aboriginal territories where a tax compact exist; but, pursuant to an agreement made between themselves and the State of Washington, none of these sales are

[20] Indeed, *even if Investors' products are sold only in one of the four non-MSA States*, they would be subject to an MSA State's Escrow Statute if the cigarettes are subsequently sold in that MSA State "whether directly or through a distributor, retailer or similar intermediary or intermediaries" -- irrespective of how such products find their way into the State, by whom they are sold, and even if Investors or their investment entities did not direct or take part in any sale in the State.

[21] See: Exhibit 21

[22] See: Exhibit 22.

considered to accrue liability under the states' MSA-related measures. Accordingly, the Squaxin have been effectively exempted from the application of any of the MSA-related measures in application throughout the country, for all sales made on-reserve.

91. Payment of State excise taxes constitutes the primary means whereby sales information is gathered by MSA states, in order to enforce their MSA-related measures. Assisted by administrators working for the Association of States Attorneys General, each state relies upon the tax stamp tally in order to determine an accurate sales figure on a state-by-state basis – which is required for them to individually apply their respective MSA-related measures. States also attempt to gather information directly from distributors, and as described above, they have resorted to regulatory sanctions to ensure such "cooperation".[23]

The State of Play for the Investors' Remaining Markets

92. At the present time, through extensive litigation and without-prejudice settlement of the MSA-related regulatory actions described above, Native Wholesale Supply has only been able to maintain sales from its offices in Six Nations territory, and from other Aboriginal territories.

93. The application of MSA-related measures in all but the States with which the Investors have entered into settlements has completely precluded the Investors' products from participating in them.

94. The sole non-Native importer of Investors' products, Tobaccoville USA, is a corporation with offices located in Hartsville, South Carolina. Tobaccoville USA has also reported similar difficulties in establishing markets for the Investors' products because of the application of MSA-related measures. Sales are currently only taking place to customers in the following seven states: South Carolina; North Carolina; Oklahoma; Arkansas; Georgia; Kansas and Tennessee.

95. The reason for markets disappearing in each of the states except those noted above is the application of MSA-related measures by each respective State Government.

E. THE ARGUMENT

I. THE REQUIREMENTS OF NAFTA CHAPTER 11 HAVE BEEN MET

1. Articles 1101, 1116 and 1117 constitute the jurisdiction-granting provisions of the NAFTA. They provide, in part:

Article 1101: Scope and Coverage

[23] "Transcription of a Presentation Given by Peter J. Levin, ESQ, Economic Counsel for the NAAG Tobacco Project at the Marriott Hotel in Chicago on July 13, 2001" at 10; see: Exhibit 23.

> 1. This Chapter applies to measures adopted or maintained by a Party relating to:
> (a) investors of another Party;
> (b) investments of investors of another Party in the territory of the Party; and
> (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party.
> …
>
> Article 1116: Claim by an Investor of a Party on Its Own Behalf
> 1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:
> (a) Section A or Article 1503(2) (State Enterprises), or
> (b) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A,
> and that the investor has incurred loss or damage by reason of, or arising out of, that breach.
> 2. 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.
>
> Article 1117: Claim by an Investor of a Party on Behalf of an Enterprise
> 1. An investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the other Party has breached an obligation under:
> (a) Section A or Article 1503(2) (State Enterprises), or
> (b) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A, and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach.
> 2. 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.
> ...
> 4. An investment may not make a claim under this Section.

2. Only an "investor of a Party" may bring a claim under NAFTA Articles 1116 or 1117. NAFTA Article 1139 states that "**investor of a Party** means a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment." As aboriginal nationals of Canada, and a Canadian-incorporated enterprise, each of the Claimants qualify as an "investor of a Party" under Articles 1116 and 1117 of the NAFTA.

3. Since the early 1990's, the three individual Investors have been carrying on business in the territory of the United States: i.e. the business of providing tobacco products to Americans. They have done so in comportment with the traditions of their aboriginal heritage, eschewing the more formalistic strictures of

the "Euro-Western" business world in favour of a more flexible and co-operative partnership. This partnership (hereinafter "the Partnership") falls within the definitions of "enterprise" contained within Articles 1139 and 201(1) of the NAFTA.

4. In 1996 and 1999, respectively, the Investors first established corporations through which to carry on their existing relationship. At that time, Grand River Enterprises Six Nations, Ltd. and Native Tobacco Direct Company (which was succeeded by Native Wholesale Supply Company), were created, the former in Canada and the latter on aboriginal territory contained within the United States.

5. As a Canadian corporate entity, Grand River's role in the Investors' ongoing partnership of manufacturing cigarettes for sale in the United States (both on and off Six Nations territory claimed by the United States), qualifies it as a participating Investor in investment. The Investors' collective business operations and assets, including intellectual property rights, constitute investments within the meaning of sub-paragraphs (a), (e), (f), (g) and (h) of NAFTA Article 1139.

6. Having established, owned and controlled Native Wholesale Supply on aboriginal territory claimed by the United States, and having registered marks used by the Partnership in the United States, Claimant Arthur Montour Jr. can additionally be said to maintain investments under the NAFTA, consistent with the definitions contained within sub-paragraphs (a), (b), (e), (f) and (g) of Article 1139.

7. NAFTA Article 1101 provides that Chapter 11 applies to "measures" adopted or maintained by a party relating to investors of another Party or investments of investors of another Party in the territory of the Party. NAFTA Article 201 defines "measure" as including "any law, regulation, procedure, requirement or practice." As a practice, the governmental decision to enforce an existing statute or regulation against an investor or investment thus constitutes a "measure" under the NAFTA.

8. It is well-established that measures implemented and enforced by sub-state governments may attract liability under the NAFTA generally and under Chapter 11 in particular. As stated in NAFTA Article 105, the NAFTA Parties have committed themselves and their sub-State entities to be bound by all of its obligations, unless specifically reserved elsewhere in the text of the Agreement:

> The Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments.

9. NAFTA Tribunals have thus far consistently determined that this obligation, as interpreted within the context of the customary international law on state responsibility, obliges NAFTA Parties to ultimately take financial responsibility for the measures imposed and enforced by their sub-State entities, should they be

found in breach of an obligation contained within Section A of NAFTA Chapter 11.[24]

10. The measures in this case include the existence and enforcement of three types of legislation, which have been, and continue to be, imposed by the vast majority of state-level governments:

(i) The Escrow Statutes;
(ii) The Contraband Laws; and
(iii) The Equity Assessment Laws.

11. In order for measures to be considered to ***relate to*** investors or their investments, it is necessary for a relationship of sufficient proximity to exist between the measures and the investor or its investments. The Tribunal in *Methanex Corp.* v. *U.S.A.* referred to this relationship of proximity as "legally significant connection" between the measure and the investor or its investments.[25]

12. Where a measure is aimed directly at the investor or investment, or if the measure can be seen as connected to the investment activities of the investor or its competitors, there is no controversy as to whether it relates to the investor or its investment.[26] In the present case, the legally significant connection is obvious: these measures have been designed, implemented and – most importantly – enforced in order to prevent the investors from carrying on their tobacco business as they had been operating it prior to the MSA was entered into by and among the Investors' competitors and forty-six U.S. States.

13. It is also necessary for an investor to have suffered a loss arising out of the treatment that it or its investment received that breached one of the relevant NAFTA provisions. In this case, the first loss suffered by the Investors which could be construed as compensable damage under the NAFTA and/or international law was the retainer paid by Grand River to counsel, in May 2002, to defend against the measures which were then presently being enforced against the Investors' business. As will be described in more detail below, the Investors have since suffered considerable losses for which they are presently seeking relief.

14. Finally, Articles 1116 and 1117 require that claims be brought in respect of breaches of the relevant NAFTA provisions by no later than three years after "the date on which the investor first acquired, or should have first acquired, knowledge

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[24] See, e.g.: *Metalclad Corp.* v. *Mexico*, Final Award, NAFTA/UNCITRAL Tribunal, 2 September 2000, at para. 73; *Raymond Loewen and The Loewen Group* v. *United States of America*, Final Award, ICSID Case. No. ARB(AF)/98/3, 25 June 2003, at para's. 40 & 42; and ADF *Group Inc.* v. *U.S.A*, Final Award, NAFTA/ICSID(AF) Tribunal, Case No. ARB(AF)/00/1, 9 January 2003, at note 125.
[25] *Methanex Corp.* v. *United States of America*, NAFTA/UNCITRAL Tribunal, Award on Competence and Jurisdiction, 7 August 2002, at para. 147.
[26] See, e.g., *S.D. Myers, Inc.* v. *Canada*, NAFTA/UNCITRAL Tribunal, Award on the Merits, 13 November 2000, at para's. 233-236.

of the alleged breach and knowledge that the investor has incurred loss or damage."

15. The first time that any of the Claimants became aware that any individual state intended to enforce its MSA laws against them was March 2002, when the Investors first became aware of the institution of an action to enforce these measures as against them. The first date upon which any of the Claimants suffered loss or damage within the meaning of Articles 1116 and 1117 of the NAFTA, was in May 2002, the day upon which counsel was retained to advise and defend the Investors with respect to these measures.

16. The investor launched this arbitration with the delivery of its Notice of Arbitration and Statement of Claim on March 12, 2004 – less that three years after it was made aware of the first enforcement action against it and less than three years from the date upon which it incurred loss or damage. Accordingly, the Investor launched its claim within the appropriate period of time required under the NAFTA.

II. INTERPRETATION

17. NAFTA Article 1131 provides that Tribunals established to hear investor's claims under Chapter 11 "shall decide the issues in dispute in accordance with [the NAFTA] and the applicable rules of international law." Tribunals have thus far concluded that, in terms of interpreting the NAFTA text, the applicable rules of international law are the customary international law rules of treaty interpretation.[27]

18. The customary international law rules of treaty interpretation have been codified in Article 31 of the *Vienna Convention on the Law of Treaties*, which states:

> 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
>
> 2. The context for the purpose of the interpretation of a treaty shall comprise in addition to the text, including its preamble and annexes:
>
> a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

[27] 23 May 1969, 1155 U.N.T.S. 331; 8 (1969) ILM 679. See, e.g. *United States – Standards for Reformulated Gasoline*, WT/DS2/AB/R, 20 May 1996, at 17; *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, 4 October 1996, at 9-12; and *Mondev International Ltd.* v. *U.S.A.*, ICSID No. ARB(AF)/99/2, Final Award, 11 October 2002, at para. 43; *Myers* Merits Award, at para's. 196-200; or *Ethyl Corp.* v. *Canada*, NAFTA/UNCITRAL Tribunal, Award on Jurisdiction, 24 June 1998, at para's. 25-29.

b) Any instrument which was made by one of more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

c) Any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

19. Article 31(1) of the *Vienna Convention* provides the golden rule of treaty interpretation. It requires a tribunal to focus upon the plain meaning of the text before it, while being mindful not only of its placement within the context of the treaty but also of the objects and purposes of that treaty. The textual focus will naturally predominate where the object and purposes of a treaty are not explicitly provided. This is not the case for the NAFTA, however, which provides tribunals with considerable guidance in this regard. The NAFTA provides both a list of its objectives and a prescription for how its text must be interpreted. Article 102 states:

Objectives

1. The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favoured-nation treatment and transparency, are to:

(a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
(b) promote conditions of fair competition in the free trade area;
(c) increase substantially investment opportunities in the territories of the Parties;
(d) provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;
(e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
(f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

> 2. The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law.

20. The very first panel established to hear a NAFTA dispute noted Article 102 in concluding as follows:

> The Panel also attaches importance to the trade liberalization background against which the agreements under consideration must be interpreted. Moreover, as a free trade agreement, the NAFTA has the specific objective of eliminating barriers to trade among the three contracting Parties. The principles and rules through which the objectives of the NAFTA are elaborated are identified in NAFTA Article 102(1) as including national treatment, most-favored nation treatment and transparency. Any interpretation adopted by the Panel must, therefore, promote rather than inhibit the NAFTA=s objectives.[28]

21. This approach was echoed by the Tribunal in *Metalclad Corp. v. Mexico*, where the Tribunal noted in its Award that the principle of transparency and the objective of substantially increasing investment opportunities in the North American Free Trade Area were both important elements of its interpretative analysis.[29]

22. Article 102(1) is very specific in the manner in which it lays out the appropriate context for interpretation of the NAFTA text. It not only set out the goals of substantially increasing investment opportunities and promoting "conditions of fair competition" in the free trade area. It also provides that these objectives are "elaborated more specifically through its principles and rules," which include: national treatment; most favoured nation treatment; and transparency.

23. These three "principles and rules" represent the bedrock standards and principles of international economic law, which can be found within countless treaty provisions and throughout the burgeoning jurisprudence of international tribunals, such as the dispute settlement bodies of the World Trade Organization and other Chapters of the NAFTA. It is accordingly appropriate for a tribunal to have recourse to other trade and investment treaties, as well as the wider jurisprudence of international economic law, in interpreting the NAFTA text in a manner that is consonant with its broadly liberalizing objectives.

24. It may also be necessary for a tribunal to have recourse to other sources of public international law, as the circumstances dictate, in order to accord the most appropriate interpretation and application of the treaty text as required. For example, human rights treaties and jurisprudence can prove to be a very suitable source for a tribunal's interpretative analysis on issues of expropriation.

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[28] *Canada – Tariffs on Certain US - Origin Agricultural Products*, CDA-95-2008-01, 2 December 1996, at 36. This was an arbitration panel established pursuant to NAFTA Article 2008.
[29] *Metalclad* Award, at para's. 70-71.

25. Similarly, human rights conventions and bilateral treaties entered into by the NAFTA Parties concerning the rights of aboriginals may assist the Tribunal in this case, given the identities of the Claimants and the nature of their investment in territory claimed by the United States. The principle of good faith, as memorialized in the preamble and Articles 26 and 31(1) of the *Vienna Convention*, similarly requires any interpretation of how NAFTA obligations are to be applied within the context of measures affecting aboriginals to take into account the obligations undertaken by a NAFTA Party with respect to aboriginals generally and aboriginal nations in particular.

26. Finally, as the *Metalclad* Tribunal also noted, the Parties have agreed to "ENSURE a predictable commercial framework for business planning and investment" in the preamble of the NAFTA. As the Tribunal in *S.D. Myers, Inc. v. Canada* stated, the preambular language of a treaty shall be construed as part of the context in which the treaty text is situated.

27. Accordingly, as demonstrated in its preamble, the drafters of the NAFTA clearly designed a treaty that would permit the Parties to create a truly liberalized free trade and investment zone. The substantive protections granted to individual investors under NAFTA Chapter 11 operate as a bulwark against those who would attempt to weaken or subvert those goals. The only interpretation of the plain meaning of the NAFTA text which would be in accordance with the international law principle that treaties must be interpreted in good faith[30] is one that maximizes the liberalizing objectives contained therein.

III. NATIONAL TREATMENT AND MOST-FAVOURED-NATION TREATMENT

28. Without justification, forty-six state governments have accorded different treatment to the Investors and their investment than that which they have provided to domestic investors and investments operating in like circumstances. Such conduct constitutes a *prima facie* breach of the national treatment standard, which is found in NAFTA Article 1102.

29. Article 1102 provides, in relevant part:

> 1. Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
>
> 2. Each Party shall accord to investments of investors of another Party treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

[30] A.D. McNair, *The Law of Treaties* (Oxford: Clarendon Press, 1986) at 465.

> 3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favourable than the most favourable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.

30. NAFTA Article 102(1) provides that "national treatment" is one of the "principles and rules" of the Agreement which must be used to "elaborate" the objectives of the NAFTA set out in Article 102(1). Those objectives include "the promotion of conditions of fair competition in the free trade area" and "to increase substantially investment opportunities in the territories of the Parties." Article 101(2) mandates that any interpretation and application of the NAFTA text must be undertaken "in light of" these objectives.

31. The national treatment standard appears in virtually all of the world's investment protection treaties.[31] The United Nations Conference on Trade and Development has defined the national treatment standard in investment treaties as follows:

> National Treatment can be described as a principle whereby a host country extends to foreign investors treatment that is at least as favourable as the treatment it accords to national investors in like circumstances. In this way the national treatment standards seek to ensure a degree of competitive equality between national and foreign investors.[32]

32. "National treatment" is also a term which has been used repeatedly throughout the NAFTA, although never defined. It needs no definition because its *usus loquendi*, i.e. its common use, is well known among international lawyers. As the *Feldman* Tribunal noted in its recent award concerning the interpretation of application of NAFTA Article 1102, national treatment is a "fundamental obligation" of the NAFTA, which bears analogies to its use in other international trade agreements, such as Article III of *GATT 1947*.[33]

33. The *Pope & Talbot* Tribunal came to a similar conclusion about the over-arching nature of the national treatment standard, as demonstrated by its extensive analysis of applicable WTO jurisprudence on the national treatment standard.[34] The *Pope & Talbot* Tribunal has articulated a lucent and compelling analysis of the application of Article 1102 which has been implicitly observed by every NAFTA tribunal of panel to date.[35] This analysis be broken into three basic elements:

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[31] United Nations Conference on Trade and Development, *National Treatment* (UN Publications, New York: 1999) at 1.
[32] United Nations Conference on Trade and Development, *National Treatment* (UN Publications, New York: 1999) at 1.
[33] *Marvin Feldman* v. *Mexico*, Final Award, Case No. ARB(AF)/99/1 at para. 165.
[34] See, e.g.: *Pope & Talbot, Inc.* v. *Canada*, NAFTA/UNCITRAL Tribunal, Final Merits Award, 10 April 2001, at para's. 45-63
[35] *Pope Talbot* Final Merits Award, at para's 31-81, and para. 78 in particular.

(1) Identification of the relevant subjects of the national treatment comparison;
(2) Consideration of the relative treatment received by each comparator; and
(3) Consideration of whether factors exist which could justify any difference in treatment so found.

34. The most-favoured-nation ("MFN") treatment obligation is conceptually distinct from the national treatment obligation in only one key issue: whereas the basis for a national treatment comparison is local-to-foreign, the basis for MFN treatment comparison is foreign-foreign. In other words, for national treatment, one compares the treatment accorded to a NAFTA investor to that which has been received by a local investor, whereas under the MFN standard, one compares the treatment received by a NAFTA investor to that which has been received by another foreign investor, on an individualized basis.

35. Otherwise, the MFN treatment standard is largely identical to the national treatment standard – with both obligations requiring a comparison of treatment received by the NAFTA investor or investment to that received by a third person (whether local or foreign) with the goal of ensuring the existence of fair and equitable conditions of competition.

The Identification of Appropriate Comparators

36. Articles 1102 and 1103 are comparative standards. The scope for comparison of the Claimant investor and the comparator (whether local or domestic) is based upon the treatment in question. For example, to consider the context of a classical MFN treatment claim, if an investor under one treaty is entitled to certain protections not offered in a second treaty, the investor can obtain the benefits of the second treaty by operation of a MFN treatment clause contained within the first treaty.[36]

37. In cases where the treatment in question is particular to a certain industry, the source of comparison will naturally be between investors operating within that industry (rather than all investors in the territory). The basis for any comparison is based upon the likeness of the comparators.

38. The *Pope & Talbot* Tribunal concluded that, "as a first step, the treatment accorded to a foreign owned investment protected by Article 1102(2) should be compared with that accorded domestic investments in the same business or economic sector…," although the Tribunal cautioned that this was but a first step. The same could equally be said for Article 1103. The *Pope & Talbot* Tribunal's rationale for establishing this first step can be found in the OECD *Declaration on National Treatment for Foreign-Controlled Enterprises*, which provides, in part:

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[36] *Emilio Agustin Maffezini* and *The Kingdom of Spain*, Case No. ARB/97/7, January 25, 2000, *Decision of the Tribunal on Objections to Jurisdiction*, at para. 56.

> As regards the expression "in like situations," the comparison between foreign-controlled enterprises established in a Member country and domestic enterprises in that Member country is valid only if it is made between firms operating in the same sector.[37]

39. While not always noted explicitly, this first step can be seen in the reasons for decision of all other NAFTA tribunals. For example, in the *Feldman* case, the Tribunal started with a determination that the "applicable universe" of comparable investors and investments was made up of those businesses engaged in the purchase and reselling of cigarettes, rather than a wider group which would have included manufacturers, because the comparison was agreed as between the parties. The measure at issue in the *Feldman* case was a rebate on export taxes.[38]

40. In *US – Cross Border Trucking Services*, the Panel readily compared any trucking businesses operating, or desirous of operating, between points in the United States, regardless of business size or the particular type of service provided.[39] The measure at issue was a prohibition on most Mexican-owned carriers operating in all but a tiny fraction of the United States market.

41. The *ADF* Tribunal determined that the point of comparison for it under Article 1102(2) was between steel products held by the investor (a steel fabricator) versus steel products held by domestic investors, with respect to their potential use in a highway project.[40] By necessary implication, the Tribunal's comparison focused on firms operating in the steel fabrication business as its "universe" of comparable investors under Article 1102(1).

42. And finally, in *S.D. Myers, Inc.* v. *Canada*, the Tribunal held that the appropriate basis for comparison – involving a measure which banned the export of PCB wastes from Canada in order to disadvantage the investor whose destruction facilities were located outside of Canada – was between the competitors for a share of the Canadian PCB waste destruction market.[41] It did so over the objections of Canada, which argued that the investor could only compare itself with PCB waste brokers because it did not completely destroy PCB wastes in Canada. This argument was rejected on the strength of the evidence, which clearly showed that it was Canada's native PCB waste destruction firms who were most active in lobbying the Minister to impose an export ban and thereby keep Myers from entering the Canadian market, rather than any waste brokers (most of whom would welcome the work that increased competition could have brought).

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[37] Organization for Economic Co-operation and Development, *National Treatment for Foreign-Controlled Enterprises* (OECD, Paris: 1993) at 22. Mexico is an OECD Member country. As a consequence of Membership, Mexico is obliged to adhere to OECD declarations such as this one, pursuant to Article 5(b) of the 1960 *Convention on the Organization for Economic Co-operation and Development.*
[38] *Feldman* Award, at para's. 171-172.
[39] *United States – In the Matter of Cross Border Trucking Services*, 252-257 & 291-294
[40] ADF Award, at 155.
[41] *S.D. Myers, Inc.* v. *Canada*, Merits Award, NAFTA/UNCITRAL Tribunal, 13 November 2000, at 251.

43. This approach to the comparison required by Articles 1102 or 1103 can also be seen in the WTO *aquis,* where numerous panels have commented on the goal of the national treatment standard as being to promote and protect the conditions of competition as between individual economic actors. The following excerpts are illustrative of this theme in WTO national treatment jurisprudence:

> The words "treatment no less favourable" in paragraph 4 call for effective equality of opportunities for imported products in respect of the application of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products. This clearly sets a minimum permissible standard as a basis… the purpose of Article III:2, dealing with internal taxes and other internal charges, is to protect "expectation on the competitive relationship between imported and domestic products.[42]
>
> The broad and functional purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures… Toward this end, Article III obliges members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products… Moreover, it is irrelevant that the "trade effects" of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products.[43]
>
> The "no less favourite treatment obligation" in Article III:4 has been consistently interpreted as a requirement to ensure effective equality of competitive opportunities between imported products and domestic products. In this respect, it has been held that, since a fundamental objective of Article III is the protection of expectations on the competitive relationship between imported and domestic products, a measure can be found to be inconsistence with Article III:4 because of its potential discriminatory impact on imported products. The requirements of Article III:4 is addressed to "relative competitive opportunities created by the government in the market, not to actual choices made by enterprises in that market."[44]

44. The lessons from the WTO jurisprudence are clear – the object of the national treatment or MFN treatment comparison is to safeguard the competitive opportunities of an investor who claims its protection vis-à-vis its local competitors. Accordingly, the starting point for any national treatment comparison is to ensure that an appropriate "universe" of appropriate comparators is identified – based upon a definition which best protects the business activities of the investor in question. This universe can normally be drawn from the evidence of the private actors at issue, concerning with whom they believe they are in competition.

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[42] *United States – Section 337 of the Tariff Act of 1930*, 36 (1989) B.I.S.D. 345 at para's. 5.11-5.13.
[43] *Japan – Taxes on Alcoholic Beverages*, WT/DS58/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, 4 October 1996 at 6. See, also: *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, 18 January 1999 at para. 119.
[44] *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R. WT/DS142/R, 31 January 2000, at para 10.78.

45. Where the measure is national in scope, but the nature of the business is either more localized, or there are more or less than a few easily identifiable competitors, the comparison can be based on an economic analysis of the industry within which the investor is situated. In other words, it is not necessary to demonstrate that the comparators are actually in direct competition with each other in any specific region. The analysis can be accomplished on a sectoral level. As the *Myers* Tribunal noted in its award:

> The concept of "like circumstances" invites an examination of whether a non-national investor complaining of less favorable treatment is in the same "sector" as the national investor. The Tribunal takes the view that the word "sector" has a wide connotation that includes the concepts of "economic sector" and "business sector."
>
> From the business perspective, it is clear that SDMI and Myers Canada were in "like circumstances" with Canadian operators such as Chem-Security and Cintec. They all were engaged in providing PCB waste remediation services...[45]

Treatment No Less Favorable

46. Under Article 1102, the Investors and their investment are entitled to the best level of treatment available to ***any*** other domestic investor or investment operating in like circumstances. The same is true for treatment available to other foreign investors and their investments under Article 1103. These comparisons are not limited to an evaluation of whether the treatment being received is substantially similar. It focuses on the result of the treatment being received. As the *Myers* Tribunal noted:

> Intent is important, but protectionist intent is not necessarily decisive on its own. The existence of an intent to favor nationals over non-nationals would not give rise to a breach of [Article 1102] if the measures in question were to produce no adverse effect on the non-national complainant. The word "treatment" suggests that practical impact is required to produce a breach of Article 1102, not merely a motive or intent that is a violation of Chapter 11.[46]

47. A focus on the effects of treatment can also be found in GATT and WTO jurisprudence:

> One the one hand, contracting parties may apply to imported products different formal legal requirements if doing so would accord imported products more favorable treatment. On the other hand, it also has to be recognized that there may be cases where application of formally identical provisions would in practice accord less favorable treatment to imported products and a contracting party might thus have to apply different legal provisions to imported products to ensure that the treatment accorded them is in fact no less favorable… In such cases, it has to be assessed whether or not such differences in the legal

[45] *Myers* Merits Award, at para's 250-251.
[46] *Myers* Merits Award, at para. 254.

> provisions applicable do or do not accord to imported products less favorable treatment.[47]

And the *Pope & Talbot* Tribunal has noted:

> Canada contends that these [various WTO] cases are distinguishable because they involve *de jure*, rather than *de facto*, discrimination. We have already seen that it is not always clear whether a measure is a *de jure* or *de facto* case, but even if it were, Canada has presented no reasons to justify treating the two forms of disadvantage differently. Indeed, the recognition that national treatment can be denied through *de facto* measures has always been based on an unwillingness to allow circumvention of that right by skillful or evasive drafting. Applying Canada's proposed more onerous rules to *de facto* cases [which would require proof that foreigners, as a group, were proportionately disadvantaged in application of a measure] could quickly undermine that principle. That result would be inconsistent with the investment objectives of [the] NAFTA, in particular Article 102(1)(b) and (c), to promote conditions of fair competition and to increase substantially investment opportunities.[48]

48. The test of "treatment no less favorable" is therefore not a global comparison of treatment received, on the whole, by groups of domestic or foreign investors or investments. It is particular to the experience of the claimant. It does not matter if every other foreign investor is receiving treatment which is effectively identical to that which is provided to all domestic investors. It does not matter if there are other domestic investors who are also receiving less favorable treatment. The comparison is between the treatment being received by the claimant and the best treatment being received by a domestic investor operating in like circumstances. For example, in *United States – Section 337* interpreted the national treatment standard as follows:

> The Panel did not consider relevant the fact that many of the state provisions at issue in this dispute provide the same treatment to products of other states of the United States as that provided to foreign products. The national treatment provisions require contracting parties to accord to imported products treatment no less favorable than that accorded to any like domestic product, whatever the domestic origin. Article III consequently requires national treatment of imported products no less favorable than that accorded to the most-favored domestic products.[49]

49. Another application of this principle of comparison can be found in the WTO case of *Canada - Certain Automotive Measures*, which involved the application of the MFN treatment obligation. Canada argued that since its measure provided some luxury cars and some automotive distributors from Japan, the United States and the European Union with the best possible treatment, it was not open to the European Communities or Japan to complain that other luxury cars and auto-distributors were not provided with that same quality of treatment. As long as

[47] *U.S. – Section 337*, at para's. 5.13-5.14.
[48] *Pope & Talbot* Final Merits Award, at para. 70.
[49] *United States – Measures Affecting Alcoholic Beverages*, Panel Report, DS23/R, 19 June 1992, at para. 5.17.

somebody or something from Japan or the European Communities was receiving the best treatment, Canada reasoned, there could be no finding of discrimination in favor of anybody, or anything, from those countries. In rejecting this argument, the Panel determined that by not offering the best treatment available to all goods and all service providers from Japan or Europe, rather than just a closed list of goods and service providers, Canada breached its obligations to accord "treatment no less favorable" under both the GATS and GATT.[50]

50. As the *Pope & Talbot* Tribunal noted (in response to Canada's argument that a single investor could not possibly claim entitlement to receive the most favorable treatment being received by any domestic competitor or competitors):

> Canada has suggested no reason why the NAFTA Parties would have undertaken such an approach or any evidence of an intention to do so, and the Tribunal can see none. The Tribunal believes that the language of Article 1102(3) was intended simply to make clear that the obligation of a state or province to provide investments of foreign investors with the best treatment it accords *any* investment of its country, not just the best treatment it accords to investments of *its* investors. Since, as noted, the treatment of states and provinces in Article 1102(3) is expressly an elucidation of the requirement placed on the NAFTA Parties by Articles 1102(1) and (2), that interpretation lends support to the conclusion that, like states and provinces, national governments cannot comply with [the] NAFTA by according foreign investments less than the most favorable treatment they accord to their own investments.
>
> … The Tribunal thus concludes that "no less favorable" means equivalent to, not better or worse than, the best treatment accorded to the comparator.[51]

51. It is also unnecessary to prove that the reason for any difference in treatment received by an investor or its investment was due to its nationality (i.e. its not being domestic). As the *Feldman* Tribunal has explained:

> It is clear that the concept of national treatment as embodied in [the] NAFTA and similar agreements is designed to prevent discrimination on the basis of nationality, or "by reason of nationality" … However, it is not self-evident, as the Respondent argues, that any departure from national treatment must be *explicitly* shown to be a result of the investor's nationality. There is no such language in Article 1102. Rather, Article 1102 by its terms suggests that it is sufficient to show less favorable treatment for the foreign investor than for domestic investors in like circumstances.[52]

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[50] *Canada – Automotive Industry*, Panel Report, at para. 10.262. The Appellate Body overturned the Panel's finding with respect to service providers as not being based on sufficient evidence that service providers, as opposed to the goods they distributed, were actually disadvantaged by the measure. The Appellate Body stressed, however, that it was not rejecting the Panel's "treatment" analysis, only its reliance on insufficient evidence with respect to the GATS violation. See: *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R & WT/DS142/AB/R, 31 May 2000, at para's. 175-184.
[51] *Pope & Talbot* Final Merits Award, at para's. 41 & 42.
[52] *Feldman* Award, at 181.

Like Circumstances

52. Once a *prima facie* breach of either Article 1102 or Article 1103 has been proved by the claimant, the analysis turns to the question of whether the difference in treatment could be rationally explained as justifiable in the circumstances.

53. To the Panel in *U.S. Trucking Services*, this third prong of the non-discrimination test was as a *de facto* exception – focusing on the phrase "treatment in like circumstances." Much like the old adage about apples and oranges, the Panel wrote that differences in treatment could be justified if the comparators did not deserve to receive the same treatment. However, the Tribunal cautioned that it's "like circumstances exception" must be construed narrowly so as not to strip the national treatment obligation of any true meaning.[53]

54. While it did not label its analysis under this third prong of the national treatment test as an "exception," the *Pope & Talbot* Tribunal came to a similar conclusion:

> 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 or *de facto,* between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of [the] NAFTA.
>
> In one respect, this approach echoes the suggestion by Canada that Article 1102 prohibits treatment that discriminates on the basis of the foreign investment's nationality. The other NAFTA Parties have taken the same position. However, the Tribunal believes that the approach proposed by the NAFTA Parties would tend to excuse discrimination that is not facially directed at foreign owned investments. A formulation focusing on the like circumstances question, on the other hand, will require addressing *any* difference in treatment, demanding that it be justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic or other foreign owned investments. That is, once a difference in treatment between a domestic and a foreign-owned investment is discerned, the question becomes, are they in like circumstances? It is in answering that question that the issue of discrimination may arise.[54]

55. Once the Investor has made out its *prima facie* claim that it has received less favorable treatment than any of its domestic competitors (under Article 1102) or any of its foreign competitors (under Article 1103), it is accordingly for the Respondent to justify such treatment as reasonable and justifiable in the circumstances. Such an approach is consistent with the general principles of international law and the applicable rules of evidence in customary international law. As a Majority of the Tribunal in *Feldman* noted:

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[53] *United States – In the Matter of Cross-Border Trucking Services*, Panel Report, USA-MEX-98-2008-01, 6 February 2001, at 258-260.

[54] *Pope & Talbot* Final Merits Award, at para's. 78-79.

> On the question of burden of proof, the majority finds the following statement of the international law standard helpful, as stated by the Appellate Body of the WTO:
>
>> … various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or respondent, is responsible for providing proof thereof. Also, it is a generally accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a claim or defense. *If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.* (Emphasis supplied.)
>
> Here, the Claimant in our view has established a presumption and a *prima facie* case that the Claimant has been treated in a different and less favorable manner than several Mexican owned cigarette resellers, and the Respondent has failed to introduce any credible evidence into the record to rebut that presumption.[55]

56. The *Feldman* case involved a simple non-discrimination fact pattern. The investor was denied tax rebates that were enjoyed by domestic investors whose investments were operating in like circumstances. The investor was subjected to thorough audits at a time when domestic investors were left largely unmolested. While Mexico contended that none of the comparators actually should have received the rebates under the applicable domestic laws, the fact was that the rebates were received. A Majority of the Tribunal accordingly concluded that this obvious difference in treatment constituted a *prima facie* breach of Article 1102. It further concluded that Mexico failed to provide any evidence which could justify this difference in treatment.[56] The *Feldman* Tribunal also concluded that the audit activity which solely targeted the investor, rather than being applied evenly to all industry members, also violated Article 1102.[57]

57. The *Myers* Tribunal noted that the "overall legal context" of the NAFTA can be used to explain when apparently discriminatory treatment is actually justified under the circumstances.[58] Both the *Myers* Tribunal and the *US – Trucking* Panel focused on how environmental protection was woven into the context of the NAFTA to conclude that it could be a factor which could explain differences in treatment. In neither case, however, did these Tribunals determine that a *bona*

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[55] *Feldman* Award, at 177. The accompanying note provides: "*United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, Adopted 23 May 1997, WT/DS33/AB/R, p. 14. Accordingly, *Asian Agricultural Products Limited* v. *Republic of Sri Lanka*, ICSID Reports, pp. 246, 272, 1990. ("In case a party adduces some evidence which prima facie supports his allegation, the burden of proof shifts to his opponent.").

[56] *Feldman* Award, at para's. 173-176.

[57] *Feldman* Award, at para. 174. The *Pope & Talbot* Tribunal concluded that similarly selective, and arbitrary, auditing constituted a breach of Article 1105 in the case before it.

[58] *Myers* Merits Award, at para. 250. See, also: *Pope & Talbot* Final Merits Award, at para. 76.

fide environmental policy justification for was proved. For the *Myers* Tribunal, there were clearly less discriminatory measures available to Canada if it was really motivated by environmental concerns.[59] A similar conclusion seems implicit in the *US – Trucking* Panel Report.

58. The *Pope & Talbot* Tribunal entered into a thorough analysis of the measures and the justifications for their imposition before ultimately concluding that they were a reasonable response to political and economic realities which threatened the investor's industry as a whole. The measure was an incredibly complicated export quota regime that allocated entitlement to export lumber – without the payment of an escalating scale of fees – based upon numerous factors, including the exporter's performance in past years. The measure was imposed pursuant to an agreement between the Canadian and American governments which lifted the threat of US-imposed anti-dumping duties being imposed against industry members (including the investor).

59. The *Pope & Talbot* Tribunal ultimately determined that while the investor had received less favorable treatment than otherwise comparable investors, there had always been a good reason for it. For example, because the investor was not in the process of expanding its facilities at the relevant times, it was not eligible to receive the portion of quota set aside for "new entrants" under the regime (even though the effect of the "new entrants" policy appeared to be a shift of quota from producers in British Columbia to producers in Quebec – thus disadvantaging the investor).

60. In each NAFTA case in which a *prima facie* claim of non-discrimination has been made out, the tribunal has turned to the respondent to justify its actions – regardless of whether they were discriminatory on their face (such as in *US - Trucking*) or discriminatory in result or application (such as in *Feldman*, *Myers* and *Pope & Talbot*). To safeguard the liberalizing objectives of the NAFTA, this "like circumstances exception" must be construed narrowly. And any appreciation of the overall legal context of the NAFTA, in search for justification for an apparently discriminatory measure, must begin with an acknowledgement of the objectives contained within Article 102(1): to promote conditions of ***fair competition*** and substantially increase investment opportunities in the North American Free Trade Zone.

IV. THE LAW OF NON DISCRIMINATION APPLIED TO THE FACTS OF THIS CLAIM

61. Forty-six MSA States, plus Minnesota, have imposed measures breaching the obligation of the United States to provide "treatment no less favourable" to the Investors and to their investment, vis-à-vis their competitors in the United States tobacco market. These measures fall into three categories:

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[59] *Myers* Merits Award, at para. 255.

(a) Escrow Statutes;
(b) Contraband Laws; and
(c) Equity Statutes.

The Escrow Statutes and Contraband Laws

62. As indicated above, Escrow Statutes have been implemented in all 46 of the States that agreed to the MSA with Big Tobacco. Since March 2002, , at least six states have officially commenced enforcement actions against the Investors under their Escrow Statutes. These measures memorialize and enforce the anti-competitive promises made by the National Association of State Attorneys General ("NAAG") to Big Tobacco, as part of the settlement of their private legal disputes. There is no secret: through the NAAG and in their own capacities, each State has blatantly admitted that the goal of these measures is to remove any price advantage enjoyed by smaller tobacco companies vis-à-vis Big Tobacco.

63. As one of the primary implements of the MSA, these Escrow Statutes do not impose the same burden upon all participants in the United States tobacco market. Rather, they memorialized the secret deal struck between Big Tobacco and the NAAG, whereby a select group of smaller companies were invited to participate in the new regime in exchange for a grandfathering of their market share on a no-fee basis.

64. This special deal was never offered to the Investors, nor to their investment. No effort was apparently made to even contact any legal officials representing members of the Six Nations Confederacy, such as the Attorney General for the Seneca nation. Having never been accused of wrongdoing by a State Attorney General, much less sued for the kind of conduct that attracted liability for Big Tobacco, the Investors and their investment had no idea that either the MSA or its implementing measures could be applied to them. Moreover, being aboriginals running an aboriginal tobacco business, the Investors had no reason to imagine that they could be subjected to measure that seemingly had nothing to do with them.

65. Accordingly, it was not until years after the MSA was concluded that the Investors even learned that a special deal was cut for small companies affiliated with Big Tobacco, or that a 90-day window was theoretically provided whereby other small manufactures could theoretically "join" the settlement. Why would the Investors choose to join a private settlement between non-aboriginal, multinational corporations accused of all manner of wrongdoings in dozens of state law suits, and any State attorney general?

66. To be clear, the MSA – in and of itself – could not constitute a "measure" under the NAFTA. It is a private agreement between parties to law suits. The MSA did not begin to take on the character of a "measure" until such time as the State Governments who were parties to it decided to implement its terms through

legislation. In turn, the MSA – as implemented by these measures – did not become a measure relating to the Investors and their investment until such time as enforcement programs were adopted by each State Government, under its MSA-related legislation, that targeted the manufacture, sale and distribution of tobacco products by the Claimants in their respective jurisdictions.

67. Until the point at which the MSA regime established in each state was directed at the Claimants and their U.S. tobacco business, there was no significant legal relationship between the measures and the Investors or their investment. As soon as enforcement began, however, the regime and all of its discriminatory and anticompetitive elements constituted a breach of NAFTA Articles 1102 and 1103, in so far as they instantly conferred more favorable treatment to the producers who enjoyed a partial exemption under the regime and withheld the same from the Investors and their investment.

68. As many State Governments have elected to implement and enforce Contraband Laws, which severely punish distributors of products deemed to be non-compliant, the effect of this regime – albeit implemented on a state-by-state basis – is to strengthen and embolden its reach to a national level.

69. The MSA regime, as implemented and enforced individually in each state, constitutes a prima facie breach of both Article 1102 and Article 1103 because it provides an exemption from payment obligations to both domestic and foreign-owned tobacco businesses, while providing no exemption whatsoever to the Investors or their investment. For example, Liggett Corp. is a business incorporated in the USA, whereas Japan Tobacco, International is a business incorporated in Japan. Both of these companies enjoy a grandfathered exemption under the MSA regime, as implemented by each State's Escrow Statutes.

70. The basis for calculating the size of each respective exemption, as enforced uniformly in all 46 states through their complementary Escrow Statutes, is an arbitrarily-determined period of historical market share enjoyed by each individual recipient. The effect of this grandfathered exemption from the MSA-regime is stark: companies in receipt of the exemption are not obliged to pay the hundreds of millions of dollars to the respective State Governments, or into their escrow accounts, as those without the exemption must (or have their products banned from sale at the distribution level). The Investors fall into the latter category, despite the fact that they too are small-scale players participating in the exact same market for discount tobacco products.

71. No better a demonstration of the arbitrariness inherent in how the MSA States have collectively selected winners and losers in the marketplace can be provided than the case of the Squaxin Band of Washington State. As described above, the Band recently started marketing its own brand of discount cigarettes on-reserve, eventually constructing a manufacturing facility to employ its people and increase its share of the United States discount tobacco market, selling in the same states in

which the Investors have had an established presence, such as Washington State and Oklahoma.

72. By way of amicable negotiations with State officials, the Squaxin Band is effectively exempted from the enforcement of any Escrow Statutes nation-wide because the State recognizes the tax-exempt status of its on-Reserve sales. As most states rely upon excise tax records for their enforcement of their MSA-related measures, such tax-exempt status ensures that this direct competitor of the Investors in the same segment of the United States tobacco market is exempted from any of the onerous Escrow Statute obligations being visited upon the Claimants.

73. The Squaxin Band was received this *de facto* national exemption from enforcement of any State's MSA-related measures despite the fact that it was not even in business when the companies that currently enjoy exemption (on the premise of having been invited to "join" the MSA within 90 days of its existence) qualified for their exemption. To be clear, the basis upon which these companies supposedly enjoy an exemption in perpetuity was their market share in 1997 and 1998, and their good fortune in having been invited to "join" the MSA while it was being negotiated. Despite being a new entrant into the market, the Squaxin Band appears to have received even more favourable treatment. Rather than being grandfathered at a level of market share enjoyed during an historical, two-year period, it receives an unlimited exemption for all sales made on-Reserve.

74. Through their investment, the Investors sell the majority of their product on-Reserve. However, because Six Nations territory stretches across a border imposed upon the Iroquois peoples by two European powers, the MSA states have a special way of tracking what they apparently assume are cigarettes that should be subject to their anti-competitive and discriminatory regime. Rather than relying on tax records – because the vast majority of the Investors' on-Reserve sales are not taxed by any State (just like those of the Squaxin) – State officials have instead chosen to rely upon the Claimants' customs importation documents to arbitrarily establish what they believe to represent the total number of cigarettes sold by the Claimants in their respective territories. They have done so despite the fact that a majority of those products are sold on-Reserve, taking logistical advantage of the fact that the Claimants' manufacturing facility is situated in territory claimed by Canada.

75. Under the umbrella of MSA-related measures, both Escrow Statutes and Contraband laws, two types of more favorable treatment are being provided to tobacco enterprises operating in like circumstances with the Investors and their investment. The very existence of these more favorable conditions reciprocally demonstrates the arbitrariness with which the 46 MSA States have collectively imposed and enforced their measures. One set of smaller, discount-brand tobacco companies has been granted a perpetual grand-fathered exemption for their volume of sales over an historical period; while another aboriginal tobacco

enterprise with its own, new discount brand has been given a thoroughgoing *de facto* exemption for all of its on-Reserve sales.

76. Without explanation, the Claimants have received neither such exemption. As a result, they have incurred tens of millions of dollars in damages and stand to be pushed to the brink of insolvency going forward. There is no valid reason for why a tobacco business that was never even accused by the MSA states of any sort of wrongdoing, much less sued, should be forced to bare the brunt of the same "settlement" conditions accepted freely by Big Tobacco, while other similarly-situated enterprises receive exemptions.

The Equity Assessment Measures

77. The Minnesota and Michigan Equity Assessment Statutes constitute an additional ground for compensation under Articles 1102 and 1103 of the NAFTA.

78. Under these measures, one class of participant in the tobacco market – those making, selling or distributing "non settlement" cigarettes – are forced to pay an additional fee equivalent to ¢35 per 20-cigarette pack for all cigarettes deemed to have entered the stream of commerce in the particular state, regardless of whether they entered by means of resale. Those making cigarettes subject to the MSA are not forced to pay the levy.

79. Obviously under these measure less favorable treatment is being provided to businesses such as the Investors and their investment, vis-à-vis Big Tobacco and their surrogates (who were secretly invited to "join" the settlement in exchange for a grandfathering of their market share). There is no justification for such conduct, which effectively punishes the Investors by adding an additional cost of doing business, above and beyond the cost of compliance with Escrow Statutes and the Contraband Laws.

V. THE MINIMUM STANDARD OF TREATMENT REQUIRED UNDER INTERNATIONAL LAW

80. Acting collectively, the forty-six state governments that agreed to the MSA and implemented it through the enactment and enforcement of MSA-related measures have failed to provide the Investors and their investment with the kind of treatment that is required of the NAFTA Parties under the Agreement and under customary international law. These states have instead acted in a manner that violates international standards, such as fair and equitable treatment and full protection and security, to which the Investors were entitled under NAFTA Article 1105.

81. NAFTA Article 1105 provides, in relevant part:

> 1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

82. Pursuant to NAFTA Article 1131(1), this Tribunal shall decide the issues in dispute in accordance with the NAFTA and "the applicable rules of international law." NAFTA Article 1105(1) specifically requires Parties to provide treatment that is "in accordance with international law." For the purposes of interpreting NAFTA Article 1105(1), "the applicable rules of international law" include any international law obligations designed to protect and/or promote the interests of private actors, such as investors or their investments. The applicable rules in this case also include the international human rights treaties that bind the United States generally with respect to its treatment of aboriginals and the international treaties it has entered into that specifically contemplate its treatment of the peoples of the Six Nations Confederacy.

83. The *Myers* Tribunal implicitly recognized the Article 1131(1) requirement to consider the ***applicable*** rules of international law with its interpretation of Article 1105(1). The Tribunal noted that the provision expressed "an overall concept," whereby the phrases "full protection and security" and "fair and equitable treatment" were to be read in conjunction with the introductory phrase: "treatment in accordance with international law." The Tribunal stated:

> The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international prospective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities within their own borders. The determination must also take into account any specific rules of international law that are applicable to the case.
>
> In some cases, the breach of a rule of international law by a host Party may not be decisive in determining that a foreign investor has been denied "fair and equitable treatment", but the fact that a host Party has breached a rule of international law that is specifically deigned to protect investors will tend to weigh heavily in favor of finding a breach of Article 1105.[60]

84. The Tribunal in *Mondev* v. *U.S.A.* came to the same conclusion as did the Myers Tribunal.[61] It did so after the NAFTA Free Trade Commission issued a statement on the interpretation of 1105 which provided as follows:

> **B. Minimum Standard of Treatment in Accordance with International Law**

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[60] *Myers* Award on the Merits, at para's. 263-264.
[61] *Mondev* Award, at para. 120.

> 1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
>
> 2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
>
> 3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

85. NAFTA Article 1131(2) provides that interpretations issued by the Commission "shall be binding" upon Chapter 11 tribunals. In the opinion of the *Mondev* Tribunal – which counted both Professor Crawford and Judge Schwebel among its members – the Commission's statement had two primary effects. First, the statement confirmed that the standard of treatment recalled in Article 1105 is a customary international law standard which would be required of the NAFTA Parties even in the absence of its codification through Article 1105. Second, the Tribunal confirmed that an investor cannot succeed in a claim under Article 1105 merely by proving that a NAFTA Party has breached an obligation contained within another treaty.[62]

86. With regard to the first issue, the *Mondev* Tribunal noted that all three NAFTA Parties were in agreement that Article 1105 conclusively recognized the existence of a customary international law minimum standard of treatment for foreign investors and their investments. They also were in agreement that the standard was an evolutionary one, whose content would be determined by recourse to modern international law standards. The Tribunal noted:

> Thus, the question is not that of a failure to show *opinio juris* or to amass sufficient evidence demonstrating it. The question rather is: what is the content of customary international law providing for fair and equitable treatment and full protection and security in investment treaties?[63]

87. The *ADF* Tribunal agreed with the Mondev approach to the customary international law standard contained within Article 1105, as mandated by the Commission. It provided the following approach to determining the appropriate content of that customarily-mandated standard:

> We understand the *Mondev* Tribunal to be saying – and we would respectfully agree with it – that any general requirement to accord "fair and equitable treatment" and "full protection and security" must be based upon State practice

[62] *Mondev* Award, at para. 121. This does not mean, however, that the existence of another international treaty obligation is irrelevant to interpretation of the content of the Article 1105 standard in any given case (for example: as evidence of State practice).
[63] *Mondev* Award, at para. 111-113 and 121-124.

> and judicial or arbitral caselaw or other sources of customary or general international law.[64]

88. It is also important to note that the *ADF* Tribunal explicitly chose not to accept the US argument – which was supported by the two other NAFTA Parties – that "a specific rule of international law relating to foreign investors and their investments" must be proved (on the basis of providing evidence of both *opinio juris* and State practice) for an investor to succeed in an Article 1105 claim. The same arguments were made before, but clearly not accepted by, the *Mondev* Tribunal. Instead, the *ADF* Tribunal stated the following:

> The Investor, of course, in the end has the burden of sustaining its charge of inconsistency with Article 1105(1). That burden has not been discharged here and hence, as a strict technical matter, the Respondent does not have to prove that current customary international law concerning standards of treatment consists only of discrete, specific rules applicable to limited contexts. It does not appear inappropriate, however, to note that it is not necessary to assume that the customary international law on the treatment of aliens and their property, including investments, is bereft of more general principles or requirements, with normative consequences, in respect of investments, derived from – in the language of Mondev – "established sources of international law."[65]

89. Accordingly, to succeed in a claim for a breach of Article 1105, the investor will not need to prove the breach of some narrowly defined or historic rule of customary international law. It is the very existence of the minimum standard which has achieved the status of custom. To understand the content of this international law standard, one must provide proof – to be drawn from any one of the sources of international law set out in Article 38(1) of the *Statute of the Court of International Justice*. This proof will be used by a tribunal to consider how the terms "fair and equitable treatment and full protection and security" should be construed in light of the facts of any particular case.

90. While the minimum standard remains a constant requirement of customary international law, the international law proof to be used in one "minimum standard" case may not be relevant in another. For this case, two complementary international law doctrines can provide assistance to the Tribunal in its evaluation of whether the forty-six MSA states have either collectively or individually acted in a manner inconsistent with the United States' international law obligations, as memorialized under NAFTA Article 1105(1):

(1) The doctrine of denial of justice; and
(2) The principle of good faith.

Denial of Justice

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[64] *ADF* Award, at para. 184.
[65] *ADF* Award, at para. 185.

91. As was confirmed in the *Loewen* Award,[66] the doctrine of denial of justice has a long history in customary international law and mixed-claims jurisprudence. This history extends beyond holding the acts of the domestic courts to the test of international law.

92. One of the best encapsulations of the doctrine of denial of justice can be found than in the views contained within the 1961 *Harvard Draft Convention on Responsibility of States for Damage Done on Their Territory to the Person or Property of Foreigners*, which provides, in Article 7, that:

> The denial to an alien by a tribunal or an administrative authority of a fair hearing in a proceeding involving the determination of his civil rights or obligations or of any criminal charges against him is wrongful if a decision or judgment is rendered against him or he is accorded an inadequate recovery. In determining the fairness of any hearing, it is relevant to consider whether it was held before an independent tribunal and whether the alien was denied:
> (a) specific information in advance of the hearing of any claim or charge against him;
> (b) adequate time to prepare his case;
> (c) full opportunity to know the substance and source of any evidence against him and to contest its validity;
> (d) full opportunity to have compulsory process for obtaining witnesses and evidence;
> (e) full opportunity to have legal representation of his own choice;
> (f) free or assisted legal representation on the same basis as nationals of the State concerned or on the basis recognized by the principal legal systems of the world, whichever standard is higher;
> (g) the services of a competent interpreter during the proceedings if he cannot fully understand or speak the language used in the tribunal;
> (h) full opportunity to communicate with a representative of the government of the State entitled to extend its diplomatic protection to him;
> (i) full opportunity to have such a representative present at any judicial or administrative proceeding in accordance with the rules of procedure of the tribunal or administrative agency;
> (j) disposition of his case with reasonable dispatch at all stages of the proceedings; or
> (k) any other procedural right conferred by a treaty or recognized by the principal legal systems of the world.[67]

93. The *Harvard Draft* specifies that denials of justice may be perpetrated by "a tribunal or an administrative authority" that is charged with maintaining a proceeding "involving the determination of [a foreigner's] civil rights or obligations." The right to hold property has been explicitly recognized by the United States through its ratification of the NAFTA, which provides for protection of a wide range of property interests included in the definition of "investment" under Article 1138.

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[66] *Loewen* Final Award, at para's. 129 & 133.
[67] LB. Sohn & R.R. Baxter, "Responsibility of States for Injuries to the Economic Interests of Aliens" 55 (1961) *American Journal of International Law* 545 at 550.

94. Accordingly, any administrative proceeding maintained by an administrative authority must respect an investor's property rights, in a manner which is consistent with "international law, including fair and equitable treatment and full protection and security." The doctrine of denial of justice assists this Tribunal in determining the content of this international law standard, involving both substantive and procedural denials of justice.

95. With the progress of time, the doctrine of denial of justice has evolved in a manner consistent with both international and domestic administrative law developments. The past hundred years has seen an exponential increase in the role of the State in economic and risk regulation. This development has necessarily extended the scope of how government decisions impact upon the rights and interests of individual actors. International law has evolved to meet these developments. On a procedural level, the doctrine of denial of justice has been complemented by the rapid growth in protections afforded under various human rights treaties. On a substantive level, the doctrine has been enhanced by the development of international economic law treaties which prohibit the arbitrary or discriminatory treatment of foreigners or their investments.

96. Professor Garcia Amador's work on the minimum standard of treatment of aliens is widely regarded as an authoritative statement of customary international law standard as it existed thirty years ago. With respect to denials of justice, Professor Amador included numerous judicial, quasi-judicial and administrative or regulatory bodies within the scope of a denial of justice claim, noting:

> A decision or judgment of a tribunal or an administrative authority rendered in a proceeding involving the determination of the civil rights or obligations of an alien or of any criminal charges against him, and either denying him recovery in whole or in part or granting recovery against him or imposing a penalty, whether civil or criminal, upon him is wrongful:
>
> a) if it is a clear and discriminatory violation of the that law the State concerned;
>
> b) if it unreasonably departs from the principles of justice recognized by the principal legal systems of the world; or
>
> c) if it otherwise involves a violation by the State of a treaty.[68]

97. Similarly, although he was writing at a time predating the rise of the administrative state, Professor Freeman nonetheless noted that States may dispense regulatory functions in different ways, whether through courts or other bodies. In so doing, he noted:

> It is not the *label* of the institution that matters, but the quality of the justice which it dispenses. If the procedure followed offers the same or as effective safeguards as that or ordinary courts; and if there is no question as to

[68] V.F. Garcia-Amador, L.B. Sohn & R.R. Baxter, *Recent Codification of the Law of State Responsibility for Injuries to Aliens* (1974) at 196.

> governmental control or absence of impartiality, no complaint may be made as to [the "exceptional character" of an administrative tribunal].[69]
>
> At the present era of international relations, the submission of these cases to the scrutiny of an impartial body is the only sound assurance of an objective determination of the rights of aliens.[70]

98. In fact, as early as the opening decades of the 20th century, it was firmly established in the jurisprudence of mixed claims commissions that a denial of justice could be found in the administrative/regulatory decisions of the state, notwithstanding the existence of an exhaustion of local remedies rule.[71]

99. Of course, the NAFTA Parties have effectively annulled the application of the "exhaustion of local remedies" rule by providing investors with the choice of pursuing a claim for damages before a NAFTA Tribunal or a domestic tribunal, while permitting them to maintain domestic petitions for extra-ordinary relief pursuant Article 1121. Accordingly, unless the first and primary source of a NAFTA claim is the decision of a domestic court,[72] it will not be necessary to demonstrate that a claimant has exhausted its domestic legal remedies before seeking relief from a NAFTA tribunal.[73]

100. The conclusion that denials of justice extend far beyond the domestic courtroom, besides being based on arbitral jurisprudence and the nullification of the exhaustion of local remedies rule for NAFTA claims, can also be based upon general principles of State responsibility. As Professor Bin Cheng noted about the actions of government officials, "whatever his rank, his act *qua* an official is an act of the Government and hence of the State."[74] Professor Cheng's view is supported by the tribunal in the *Moses* case, which concluded:

> An officer or person in authority represents *pro tanto* his government, which in an international sense is the aggregate of all officers and men in authority.[75]

Procedural Denials of Justice

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[69] Alwyn Freeman, *The International Responsibility of States for Denial of Justice* (Kraus Reprint Co., New York: 1970) at 304.
[70] Freeman, at 545.
[71] William Marion Gibson, *Aliens and the Law* (University of North Carolina Press, Durham: 1940) at 10; A. H. Feller, *The Mexican Claims Commission* (MacMillan, New York: 1935) at 133.
[72] The *Loewen* Tribunal has clarified that the principle of finality will require a claimant to exhaust its appeals when the primary source of its complaint is the act of a court, rather than the acts of an administrator. This result is to be distinguished from the exhaustion of local remedies rule, as it goes to the nature of a court decision as a "measure" under the NAFTA. In application of the finality principle, a lower court's decision does not constitute a "measure" under Article 1101 until appeals in respect of that decision have been exhausted. See: *Loewen* Award, at para's. 143, 146, 148 and 156.
[73] See, e.g.: *Feldman* Award, at para. 140.
[74] Bin Cheng, *The General Principles of Law* (Stevens & Sons, London: 1953) at 196.
[75] *Moses* v. *Mexico*, US-Mexico Claims Commission (1868), *Moore's Digest*, 3127 at 3129.

101. The doctrine of denial of justice is composed of two categories: denials of procedural justice and denials of substantive justice. This distinction was best described in the celebrated *Cotesworth & Powell* judgement, which provided:

> The first occurs when the tribunals refuse to hear a complaint, or to the established forms of procedure, or when undue an inexcusable delays occur in rendering a judgement. The second takes place when sentences are pronounced and executed in open violation of the law, or which are manifestly iniquitous.[76]

102. Drawing upon centuries of international jurisprudence, numerous commentators have formulated expressions of how to recognize when procedural denials of justice may have occurred. For example, Professor Schachter has noted how the obligation of the host state includes the maintenance of “competent and independent tribunal” for the determination of a foreign investor’s rights.[77] Decades earlier, Professor Roth wrote that:

> International law grants the alien procedural rights in his State of residence as a primary protection against the violation of his substantive rights. These procedural rights amount to freedom of access to court, the right to fair, non-discriminatory and unbiased hearing, the right to a just decision rendered in full compliance with the laws of the State within a reasonable time.[78]

103. The kinds of activities which will constitute a denial of procedural justice would include, for example, an effective refusal to hear an interested party;[79] or “a continued absence of seriousness on the part of [the decision-maker].”[80] Professor Borchard, who authored the first *Harvard Draft*, summarized the content of the prohibition against procedural denials of justice as follows:

> On the procedural side, we are perhaps in less doubt of the content of the standard, although we must still be satisfied with general principles. Fair courts, readily open to aliens, administering justice honestly, impartially, without bias or political control, seem essentials of international due process. While the details of procedure necessarily vary considerably from country to country, certain essential elements of fair trial and objective justice are required of all systems. It is probably less difficult to apply than to define these principles, and we have in their application the aid of innumerable precedents from international practice. In spite of the legislative effort strictly to narrow the conception of denial of justice and the privilege of diplomatic interposition, few foreign countries have been willing to abandon their nationals to the arbitrariness of corrupt courts or administrative bodies.[81]

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[76] Moore’s 2057, at 2083.
[77] Oscar Schachter, *International Law in Theory and Practice* (Kluwer, New York: 1991) at 312.
[78] Andreas Hans Roth, *The Minimum Standard of International Law Applied to Aliens* (University of Geneva: 1949) at 185.
[79] *Cotesworth & Powell*, at 2083.
[80] *United States (Chattin) v. United Mexican States*, 22 (1928) American Journal of International Law 677 (Mexico-US General Claims Commission); cited by at Roth at 183.
[81] Edwin Borchard, “The ‘Minimum Standard’ of the Treatment of Aliens” 38 (1940) *Michigan Law Review* 445 at 460.

104. Borchard's use of the term "due process" is telling, not only because it appears in NAFTA Article 1110 with explicit reference to the application of Article 1105 in terms of the expropriation of an investment, but also because it has appeared in numerous draft conventions on the protection of foreign property and in many bilateral investment treaties.[82] In connotes a fundamental respect for the Rule of Law, which must be present in the decision-making processes under review.

105. In his comparative study of due process and procedural fairness in the United States, in the United Kingdom and Commonwealth countries (such as Canada) and in the European Union, Professor Galligan has noted that the concepts of "due process" (as understood in the U.S. context) and "procedural fairness" (as understood in the common law process of the U.K. and Commonwealth countries) clearly "cover the same ground," with "the core idea" being "common to both … that certain procedures are needed to give effect to the ends of justice within legal decisions."[83]

106. Professor Galligan states that the idea of procedural fairness is a general principle which applies across the spectrum of administrative processes in the common law of Commonwealth countries, "with its precise content to be determined in each context."[84] He similarly notes a conception of a sliding scale for the application of procedural principles, under the rubric of due process, in the U.S. context.[85] He recounts the kinds of due process (or procedural) safeguards which will be relevant in an administrative context as including: "the giving of notice, an oral hearing, an impartial adjudicator, the calling of witnesses and cross examination, the right to counsel, the compiling of a record, the basing of a decision on the record, and the giving of reasons."[86]

107. In the European context, Professor Galligan notes how Article 6(1) of the *European Convention on Human Rights* stipulates that individuals are "entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law." He concludes that the "impartiality" mentioned above has connotations similar to those of English law and emphasizes the need to dispel the appearance of bias as well as actual bias."[87]

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[82] In his treatise on the subject of these draft conventions, Professor Schwarzenberger hypothesized that with the inclusion of the term "due process of law" that the drafters of such codifying instruments as the *Abs-Shawcross Convention* and the *OECD Draft Convention* were attempting to acknowledge the role of the minimum standard in consideration of the lawfulness of a taking, as such a principle embodies elements of the Rule of Law. However, he suggested that they would have done better to state more precisely what they had in mind. See: Georg Schwarzenberger, *Foreign Investments and International Law* (Stevens & Sons, London: 1969) at 119 and 172.

[83] D.J. Galligan, *Due Process and Fair Procedures: A Study of Administrative Procedures* (Clarendon, Oxford: 1996) at 170.

[84] Galligan at 186.

[85] Galligan at 198.

[86] Galligan at 208.

[87] Galligan at 220-221.

108. The concepts of due process and procedural fairness can also be found within modern international economic law. For example, Article X:3 of the GATT, which the WTO Appellate Body has explicitly recognized as granting a minimum standard of procedural fairness which all WTO Member States (including Mexico) must obey,[88] provides:

> (a) Each contracting party shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.
>
> (b) Each contracting party shall maintain, or institute as soon as practicable, judicial, arbitral or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review and correction of administrative action relating to customs matters. Such tribunals or procedures shall be independent of the agencies entrusted with administrative enforcement and their decisions shall be implemented by, and shall govern the practice of, such agencies unless an appeal is lodged with a court or tribunal of superior jurisdiction within the time prescribed for appeals to be lodged by importers; Provided that the central administration of such agency may take steps to obtain a review of the matter in another proceeding if there is good cause to believe that the decision is inconsistent with established principles of law or the actual facts.

109. In order to relate the content of the minimum standards contained in GATT Article X:3 to the content of the international law standard memorialised in Article 1105 it is essential to demonstrate how the obligation has been undertaken by a State in the interests of private actors, such as investors and their investments. The WTO Panel in the *US – Section 301* case explained the connection between the obligations contained with multilateral trade agreements, such as the GATT, and individual economic actors in the following manner:

> Trade is conducted most often and increasingly by private operators. It is through improved conditions for these private operators that Members benefit from WTO disciplines. The denial of benefits to a Member which flows from a breach is often indirect and results from the impact of the breach on the market place and the activities of individuals within it. Sections 301-310 themselves recognize this nexus. One of the principal triggers for US action to vindicate US rights under covered agreements is the impact alleged breaches have had on, and the complaint emanating from, individual economic operators…
>
> In treaties which concern only the relations between States, State responsibility is incurred only when an actual violation takes place. By contrast, in a treaty the benefits of which depend in part on the activity of individual operators the legislation itself may be construed as a breach, since the mere existence of legislation could have an appreciable "chilling effect" on the economic activities of individuals.
>
> Thus, Article III:2 of GATT 1947, for example, would not, on its face, seem to prohibit legislation independently from its application to specific products. However, in light of the object and purpose of the GATT, it was read in GATT jurisprudence as a promise by contracting parties not only that they would

[88] *United States – Import Prohibition on Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, 12 October 1998, at para. 183.

> abstain from actually imposing discriminatory taxes, but also that they would not enact legislation with that effect.[89]

110. While it is not possible for an investor to use the NAFTA to submit a claim for breach of GATT Article X:3 on its own behalf, the content of the minimum standard contained within this obligation is certainly relevant in determining the content of the customary international law standard contained within Article 1105.

111. Similarly, while it is not possible for an investor to submit a claim for a breach of NAFTA Articles 1804 or 1805, it is certainly appropriate for this Tribunal to consider these obligations as part of the treaty context within which the meaning of the phrase "treatment in accordance with international law, including fair and equitable treatment and full protection and security" can be discerned (and the content of the NAFTA minimum standard can thus be identified).[90] NAFTA Articles 1804 and 1805 provide:

> **Article 1804: Administrative Proceedings**
>
> With a view to administering in a consistent, impartial and reasonable manner all measures of general application affecting matters covered by this Agreement, each Party shall ensure that in its administrative proceedings applying measures referred to in Article 1802 to particular persons, goods or services of another Party in specific cases that:
>
> (a) wherever possible, persons of another Party that are directly affected by a proceeding are provided reasonable notice, in accordance with domestic procedures, when a proceeding is initiated, including a description of the nature of the proceeding, a statement of the legal authority under which the proceeding is initiated and a general description of any issues in controversy;
>
> (b) such persons are afforded a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action, when time, the nature of the proceeding and the public interest permit; and
>
> (c) its procedures are in accordance with domestic law.

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[89] *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, 22 December 1999, at para's. 7.77 & 7.81-7.82.

[90] This was the approach taken by the Tribunal in *Metalclad*. A similar interpretive approach was also adopted by the *ADF* Tribunal in determining the meaning of "procurement" under Chapter 11 (with reference to its construction in Chapter 10). Mexico will doubtlessly point out that the reasons of the Metalclad Tribunal concerning this issue were looked upon with disfavour by a judge sitting on the local bench in Vancouver, British Columbia (which was the *situs* of the Metalclad arbitration). It is perhaps axiomatic to note, however, that the decisions of domestic tribunals concerning the interpretation of international law are in no way binding on international tribunals. See, e.g.: *Moore's Digest* at 694. The Investor is confident that once this Tribunal has had the opportunity to consider both the reasons of this learned local judge, which can be found at: http://www.international-economic-law.org/Metalclad/metalclad_judrev.pdf, and those of the Metalclad Tribunal (which was chaired by Sir Eli Lauterpacht), it will favour the reasons of the latter over the former.

Article 1805: Review and Appeal

> 1. Each Party shall establish or maintain judicial, quasi-judicial or administrative tribunals or procedures for the purpose of the prompt review and, where warranted, correction of final administrative actions regarding matters covered by this Agreement. Such tribunals shall be impartial and independent of the office or authority entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter.
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> 2. Each Party shall ensure that, in any such tribunals or procedures, the parties to the proceeding are provided with the right to:
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> (a) a reasonable opportunity to support or defend their respective positions; and
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> (b) a decision based on the evidence and submissions of record or, where required by domestic law, the record compiled by the administrative authority.
>
> 3. Each Party shall ensure, subject to appeal or further review as provided in its domestic law, that such decisions shall be implemented by, and shall govern the practice of, the offices or authorities with respect to the administrative action at issue.

112. Numerous NAFTA tribunals have recently confirmed that a denial of due process rights constitutes a breach of Article 1105. For example, the *Loewen* Tribunal identified serious deficiencies in the manner in which a civil claim was prosecuted against the investment as evidence of a failure to respect the due process rights required under Article 1105.[91] Similarly, the *ADF* Tribunal stated that if it were to make a finding in favor of the investor in spite of sufficient evidence on the record, such actions could constitute a denial of due process required under international law.[92]

113. In citing the same judgment of the International Court of Justice, both the *Mondev* Tribunal and the *Pope & Talbot* Tribunal have noted that failures to provide sufficient due process to an investor (in any government decision-making context) may evidence the kind of arbitrariness that falls below international law standards.[93] In this regard, the *Mondev* Tribunal stated:

> In the *ELSI* case, a Chamber of the Court described as arbitrary conduct that which displays "a wilful disregard of due process of law, … which shocks, or at least surprises, a sense of judicial propriety". It is true that the question there was whether certain administrative conduct was "arbitrary", contrary to the provisions of an FCN treaty. Nonetheless (and without otherwise commenting on the soundness of the decision itself) the Tribunal regards the Chamber's criterion as useful also in the context of denial of justice, and it has been applied in that context, as the Claimant pointed out. The Tribunal would stress that the

[91] *Loewen* Final Award, at para's. 87 and 119.
[92] *ADF* Award, at para. 143.
[93] *Pope & Talbot* Damages Award, at para's. 63-65.

> word "surprises" does not occur in isolation. The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome, bearing in mind on the one hand that international tribunals are not courts of appeal, and on the other hand that Chapter 11 of NAFTA (like other treaties for the protection of investments) is intended to provide a real measure of protection. In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment. This is admittedly a somewhat open-ended standard, but it may be that in practice no more precise formula can be offered to cover the range of possibilities.[94]

114. Given the authority of arbitral jurisprudence, the work of the most noted publicists, and the current content of international economic law instruments, it is possible to provide a list of basic principles of procedural fairness, the denial of which may result in a finding that a NAFTA Party has breached the standards contained within Article 1105 and customary international law generally. These principles would apply to all manner of judicial, quasi-judicial or administrative decision-makers, with the latter being provided with the greatest degree of deference.[95] For administrative decision-makers, such principles include:

(a) The provision of notice of a decision-making process that could materially affect the rights or interests of an investor or investment;
(b) The opportunity to be made aware of, and freely contribute to the assembly of, all of the evidence at issue;
(c) The opportunity to make one's case before an independent and impartial official;
(d) The promise of fair treatment by the decision-maker, including a prohibition on unnecessary or inappropriate *ex parte* communications; and
(e) The compilation of a record of proceedings and the issuance of satisfactory reasons for decision which are based upon that record.

Substantive Denials of Justice

115. It is a well-established principle of international law that a claim may be founded upon substantive denials of justice, separate and apart from any serious defects of procedural law. Early in the last century, Professor Borchard wrote that: "As a rule, unjustified discrimination will be found an ingredient in sustainable claims [for substantive denials of justice]."[96] Desvernine also cited Borchard for the maxim that "a grossly unfair or notoriously unjust decision may be and has been

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[94] *Mondev* Final Award, at para. 127.
[95] Domestic courts are deserving of the highest level of deference in this regard because they are designed to provide the greatest degree of institutionalized protection to individuals in order to safeguard their rights and liberties.
[96] Borchard, at 458.

considered as equivalent to a denial of justice." Noting the case of *Bronner* v. *Mexico*, he indicated that an adjudicative decision can be found "so unfair" as to constitute a denial of justice (in that case, involving a finding of fact that invoices evidenced fraud when they clearly did not).[97]

116. Writing during the same period, Professor Frederick Dunn presciently noted that the customary international law minimum standard of treatment of aliens is:

> … ultimately concerned with the possibility of maintaining a unified economic and social order for the conduct of international trade and intercourse among independent political units of diverse cultures and stages of civilization, different legal and economic systems, and varying degrees of physical power and prestige… [98]
>
> Unquestionably, the very existence of the institution [of mixed claims commissions which provide redress for denial of justice] operates as a strong inducement to governments and their officials to be more careful in their treatment of foreigners than might otherwise be the case.[99]

117. Sir Robert Jennings and Sir Arthur Watts have come to a similar conclusion about arbitrariness and the minimum standard of treatment of foreign investors:

> An alien must in particular not be wronged in person or property by officials or courts of a state. Thus the police must not arrest him without cause, administrative officials must not treat him arbitrarily and courts must treat him justly and in accordance with the law.[100]

118. The hallmark of a substantive denial of justice can be found in the arbitrariness of the decision in question. A decision is arbitrary, and accordingly a substantive denial of justice, if it is "manifestly unjust or one-sided."[101] There are numerous arbitral decisions which consider applicability of customary minimum standards of treatment in terms of the arbitrariness of the government actions in question. For example, in the *BP Oil* case, the sole arbitrator found that the State's actions violated public international law because its taking of the investor's property "was made for purely political reasons and arbitrary and discriminatory in character."[102]

119. Professor Mann has also confirmed that "…arbitrary, discriminatory or abusive treatment is contrary to customary international law…"[103] and the *Mondev*

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[97] Desvernine, *Claims Against Mexico* (New York: Private Edition, 1921) at 79-80.
[98] Frederick S. Dunn, *The Diplomatic Protection of Americans in Mexico* (Kraus Reprint, New York:1971) at 1.
[99] Dunn, at 426.
[100] *Oppenheim's International Law*, 9th ed., Vol. 1 – Peace, Parts 2-4 at 910-911.
[101] This is the formulation of a substantive denial of justice provided by Vattel, *Le Droit des Gens* (1758) Book II, Chapter 18, at para. 350; translated by C.J. Fenwick in: J.B. Scott, ed., *Classics of International Law* (Washington, Carnegie Institution: 1916).
[102] *British Petroleum Exploration Co*. v. *Libyan Arab Republic*, Final Award of Arbitrator Lagergren, 53 (1973) *International Law Reports* 297 at 329.
[103] *F.A. Mann*, "British Treaties for the Promotion and Protection of Investments" 52 [1981] *British Yearbook of International Law* 241 at 243.

Tribunal has cautioned that "[to] the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without acting in bad faith."[104] The *Loewen* Tribunal has agreed, stating that proof of discriminatory intent or bad faith are not necessary to establish a breach of fair and equitable treatment under international law.[105]

120. Professor Schwarzenberger shared a similar view on when the arbitrariness of government conduct falls below international minimum standards:

> Arbitrariness in any form is – or ought to be – abhorrent to *homo juridicus*. His whole professional outlook is dominated by the attitude that, in the eyes of the law, equal situations require equal remedies.
>
> Yet, anybody who is acquainted with the techniques by which judicial precedents are applied and distinguished is aware of the element of subjectivity which is inseparable from deciding even on a judicial level what situations are supposed to be equal.
>
> In the fields of quasi-judicial, administrative or political decisions, it is even more difficult to verify the arbitrary exercise of discretion. The wider the scope of discretion, the easier it is to find plausible arguments to hide irrelevant or objectionable reasons behind such reasons. If discretion is exercised within as wide a framework of territorial jurisdiction, only the most potent abuses of sovereignty could possibly be caught by any prohibition of the arbitrary use of sovereign right.[106]

121. The principle of protection against arbitrary State acts can also be found in the practice of the United Nations bodies. For example, the UN Human Rights Commission concluded that a membership allocation scheme for seats in a legislative press gallery impinged upon the claimant's right to have access to information because the "operation and application" of the scheme could not be "shown as necessary and proportionate to the [legislative] goal in question and not arbitrary."[107]

122. For its part, the United Nations General Assembly has issued a *Declaration on the Human Rights of Individuals Who Are Not Nationals of the Country in Which They Live*, which provides in Article 9 that:

> No alien shall be arbitrarily deprived of his or her lawfully acquired assets.[108]

123. The WTO Appellate Body has twice considered what constitutes "arbitrary discrimination" in terms of the application of an otherwise justifiable government

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[104] *Mondev* Award, at para. 116.
[105] *Loewen* Award, at para. 132.
[106] Georg Schwarzenberger, *International Law and Order* (1971), at pp. 100-101.
[107] United Nations, Human Rights Committee, Communication No. 633/1995: Canada 05/05/99, CCPR/C/65/D/633/1995 at para.13.6.
[108] A/RES/40/144, 13 December 1985.

measure. In *US – Shrimp*, the Appellate Body determined that the regulatory process in question was non-transparent, did not provide the opportunity for a fair hearing of the issues, or an effective administrative means of review or appeal. Because the effect of these procedural weaknesses was to advantage some private actors over other ones, the measure was found to have been applied in a manner that resulted in arbitrary discrimination.[109]

124. In *US – Reformulated Gasoline*, the Appellate Body made a similar finding, where the measure was applied in a manner that inexplicably disadvantaged the goods manufactured by firms in certain countries over those from other countries.[110]

125. Thus, it would appear that whether one focuses upon the procedural aspects of an investor's treatment, or the substantive result, the teachings of the doctrine of "denial of justice" provide this Tribunal with an objective standard of "fair and equitable" treatment against which to judge the treatment received by an investment, regardless of whether than level of treatment is no better than what local competitors receive. Both the procedural principles contained within this doctrine, and the substantive prohibition of arbitrary results, have been received into the modern practice of states and jurisprudence of international tribunals.[111]

Good Faith

126. As an elemental principle in the ordering of relations between states, the principle of good faith provides the glue that holds the international order together. Section 711 of the *Third Restatement of the Foreign Relations Law of the United States* establishes the principle of good faith in state responsibility provides that "a state is responsible under international law for injury to a national of another state caused by an official act or omission that violates… a personal right that, under international law, a state is obligated to respect for individuals of foreign nationality."[112]

127. As the International Court of Justice noted in the *Anglo-Norwegian Fisheries* case:

> The principle of good faith requires that every right be exercised honestly and loyally. Any fictitious exercise of a right for the purpose of evading either a rule

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[109] *US - Shrimp*, at 177-183
[110] *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, 20 May 1996, at pp. 22-25.
[111] See, e.g., the *Myers* Award, at para. 260.
[112] Commentary (e) to Section 711 confirms that this provision refers both to the interests of individuals and to "a juridical person of foreign nationality also enjoy some protection, for instance, against denials of procedural justice" and that "for a juridical person, such violations would normally result in economic injury and fall within clause (c)," which provides that responsibility attaches for acts that unreasonably interfere with "a right to property of other economic interest that, under international law, a state is obligated to respect for persons, natural or judicial, of foreign nationality, as provided in section 712."

> of law or a contractual obligation will not be tolerated. Such an exercise constitutes an abuse of the right, prohibited by law.[113]

128. In its Merits Award, the ICSID Tribunal in *AMCO Asia* v. *Indonesia* determined that good faith is a general principle upon which an investor could found its claim, concluding that an investor should be entitled: "to realize the investment, to operate it with a reasonable expectation to make profit and to have the benefit of the incentives provided by law" without suffering the arbitrary exercise of a right which would prevent such enjoyment.[114]

129. In commenting on the import of the *Anglo-Norwegian Fisheries* case, Professor Cheng noted:

> The exercise of a right – or a supposed right, since the right no longer exists – for the sole purpose of causing injury to another in thus prohibited. Every right is the legal protection of a legitimate interest. An alleged exercise of a right not in furtherance of such interest, but with the malicious purpose of injuring others can no longer claim protection of the law.[115]
>
> The principle of good faith requires every right to be exercised honestly and loyally. Any fictitious exercise of a right for the purpose of evading either a rule of law or a contractual obligation will not be tolerated. Such an exercise constitutes an abuse of the right, prohibited by law.[116]

VI. THE LAW OF THE MINIMUM STANDARD OF TREATMENT APPLIED TO THE FACTS OF THIS CLAIM

130. The Investors are not 'normal' claimants; they are aboriginal nationals of Canada who are entitled, under international law, to expect a specific level of treatment from the United States and its instrumentalities of State. Such legitimate expectations are rooted in the treaties to which the United States long ago committed itself.

131. NAFTA Article 1105(1) requires the United States to provide treatment in accordance with international law to investors, in order to satisfy the minimum standard of treatment that it concurrently owes under customary international law. This is a **minimum** standard of treatment (i.e. a standard below which no treatment shall fall); rather and a **minimal** standard of treatment. The content of that standard varies depending upon the nature of the treatment in question and the circumstances in which such treatment should be provided, although the text of Article 1105(1) makes it clear that the Parties understood that the content would include fair and equitable treatment and full protection and security for an investment.

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[113] *Anglo-Norwegian Fisheries Case* (1951) ICJ Reports 116 at 142.
[114] *AMCO Asia* v. *Indonesia*, 1 ICSID Reports, 377 at 490 & 493. See, also: the Sapphire Award (1963) 35 ILR 136 at 181.
[115] Cheng, at 122.
[116] Cheng, at 123.

132. In this case, the content of the applicable standard of treatment must include a recognition of the special rights and interests of the Claimants, as aboriginal nationals of Canada, as articulated and protected under international law.

133. More particularly, as members of the Six Nations Confederacy, the Investors should have been able to rely, in good faith, on the United States honouring the specific terms of the 1794 *Treaty of Amity, Commerce and Navigation between the United States and Great Britain* (the "*Jay Treaty*"),[117] which for over 200 years have promised the Iroquois specific rights of free trade across the border established between the United States and what is now known as Canada, which purported to divide Six Nations territory between the two so-called countries.

134. Partially in recognition of the fact that Six Nations territory was bisected by their agreement, the parties to the *Jay Treaty* included specific mention of aboriginal nationals in Article 3, to which they bound themselves as follows:

> It is agreed that it shall at all times be free . . . to the Indians dwelling on either side of the said boundary line, freely to pass and repass by land or inland navigation, into the respective territories and countries of the two parties, on the continent of America . . . and freely to carry on trade and commerce with each other. . . . [N]or shall the Indians passing or repassing with their own proper goods and effect of whatever nature, pay for the same any impost or duty whatever. But goods in bales, or other large packages, unusual among Indians, shall not be considered as goods belonging bona fide to Indians.

135. This commitment was affirmed by the United States after the War of 1812 in Article 9 of the *Treaty of Ghent*[118] and has long since been affirmed by decisions of its own Federal Court system. For example, in *Diablo v. McCandless* it was held that the boundary line established under the *Jay Treaty* "was clearly not intended to, and just as clearly did not, affect the Indians."[119]

136. The Investors also benefit from the evolving norms of customary international law protecting the rights of indigenous peoples, as expressed in the norms found in various instruments for the protection of international human rights. For example, Article XVIII of the Proposed Inter-American Declaration on the Rights of Indigenous Peoples[120] provides:

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[117] *Treaty of Amity, Commerce, and Navigation, Between His Britannic Majesty and the United States of America*, November 19, 1794, U.S.-U.K., T.S. No. 105.
[118] *Treaty of Peace and Amity, Between His Britannic Majesty and the United States of America*, Art. 9, December 24, 1814, U.S.-U.K., T.S. No. 109
[119] Diablo v. McCandless, 18 F.2d 282 (E.D. Penn., 1927) at 283.
[120] Approved by the Inter-American Commission on Human Rights on February 26, 1997, at its 1333rd session, 95th regular session. O.A.S. Doc. OEA/Ser.L/V/II.95, Doc. 7, rev. (1996).

1. Indigenous peoples have the right to the legal recognition of their varied and specific forms and modalities of their control, ownership, use and enjoyment of territories and property.
2. Indigenous peoples have the right to the recognition of their property and ownership rights with respect to lands, territories and resources 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…

137. And Article 21 of the Draft *United Nations Declaration on the Rights of Indigenous Peoples* states:

> Indigenous peoples have the right to maintain and develop their political, economic and social systems, to be secure in the enjoyment of their own means of subsistence and development, and to engage freely in all their traditional and other economic activities. Indigenous peoples who have been deprived of their means of subsistence and development are entitled to just and fair compensation.[121]

138. And various provisions of ILO *Convention (No. 169) Concerning Indigenous and Tribal Peoples in Independent Countries* provides:

> Article 14
> 1. The rights of ownership and possession of the peoples concerned over the lands which they traditionally occupy shall be recognized…
> 2. Government shall take steps as necessary to identify the lands which the peoples concerned traditionally occupy, and to guarantee effective protection of their rights of ownership and possession….
>
> Article 32
> Governments shall take appropriate measures, including by means of international agreements, to facilitate contacts and co-operation between indigenous and tribunal peoples across borders, including activities in the economic, social, cultural, spiritual and environmental fields.[122]

139. These international instruments are illustrative of a quickening or crystallization that has been taking place in customary international law with respect to protection of the rights of indigenous peoples, both collectively and as individuals. Respect for the rights of aboriginals to engage in investment activities based upon historical rights to territory and historical patterns of commerce has largely achieved consensus as an international norm of protection for aboriginal groups and individuals.

140. Within the context of this case, these international norms elaborate exactly what it means for the Investors, as aboriginal nationals of Canada, to receive "fair and

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[121] U.N. Working Group on Indigenous Populations at its eleventh session, Geneva, July 1993. Adopted by the U.N. Subcommission on Prevention of Discrimination and Protection of Minorities by its resolution 1994/45, August 26, 1994. U.N. Doc. E/CN.4/1995/2, E/CN.4/Sub.2/1994/56, at 105 (1994).

[122]

equitable treatment" from the United States and its instrumentalities. It means that if they have invested in the traditional Indian business of growing, manufacturing and selling tobacco products on their sovereign territory, regardless of whether that territory spans the Canada-United States border, they are not only entitled to protection for that investment – as functionally and geographically constituted – but also for special consideration that recognizes how their right and ability to generate such economic activity fosters much needed employment in their aboriginal community.

141. Far from providing the Investors with the kind of special consideration that is owed to them under evolving norms of customary international law, the 46 MSA States have actually taken advantage of the fact that the Investors' manufacturing operations are located across a border to more strictly enforce their measures against the investment. The have done so by using the customs documents generated by the movement of these goods to quantify what each State deems to be the amount eventually marketed and distributed within its jurisdiction.

142. Such conduct constitutes a breach of the promises contained within the 1794 *Jay Treaty* not to interfere with the economic affairs of the peoples of the Six Nations, as it involves the frontier established by Great Britain and the United States. In addition to constituting a breach of the customary international law norms protecting aboriginals in the use of their historical territories to generate economic activity, such conduct constitutes an *abus du doit*, in that it violates the principle of good faith in honoring a State's treaty obligations.

143. Of course, the underlying breach of Article 1105(1) is much simpler than a complete failure to take into account the United States' treaty commitments with respect to the Six Nations Confederacy or honor emerging customary international norms that protect indigenous peoples and their commercial activities. It is rooted in the bedrock norms of what some systems refer to as "natural justice" and others call "due process." In order to treat an investor in a fair and equitable manner, that person must be entitled to her day in court; to hear the case against him; and to have a meaningful opportunity to reply. In adopting a practice of extending their enforcement of MSA-related measures against the Investors and their investment, the MSA States have flagrantly violated these fundamental norms.

144. To be clear, none of the Investors, nor the investment, nor any of the companies they have established over the years to make it function, have ever been accused of the kind of conduct that resulted in the negotiation of the MSA. They were not the source of any tort claim for the recovery of health care expenses and they were never accused of having taken any of the steps alleged to have been taken by Big Tobacco in furtherance of their business interests. Despite this reality, all 46 MSA States – and the State of Minnesota with respect to its Equity Assessment law – have chosen to subject the Investors and their investment to crippling economic penalties that threaten the very existence of their undertaking.

145. In addition, the process by which the enforcement measures, which are at issue in this claim, came to relate to the Investors and their investment was also completely lacking in transparency. No notice was given to the Claimants or the Attorney General of the Seneca Nation, at the time the MSA was negotiated and processes apparently established for its implement, indicating that the business of the Investors could ever be directly affected by this private agreement between State Governments and Big Tobacco. The surreptitious manner in which smaller, discount manufacturers were invited to "join" the MSA, in return for multi-million dollar exemptions in perpetuity, similarly fell below minimum standards of transparency.

146. When a State promises to accord "fair and equitable treatment" in a modern investment protection or mulitlateral trade treaty, it is providing an undertaking – backed by the principle of good faith – that it will provide a stable and predictable business environment for foreign investors. It promises that in its regulatory activities, including those of its instrumentalities, will be exercised in good faith observance of all applicable international law norms, and accordingly be free from arbitrariness and parochial favoritism. This understanding is deomonstrated by the recent Bilateral Treaty Tribunal sitting in *Técnicas Medioambientales v. Mexico*:

> "The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. <u>The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations</u>. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved there under, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any pre-existing decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation. In fact, failure by the host State to comply with such pattern of conduct with respect to the foreign investor or its investments affects the investor's ability to measure the treatment and protection awarded by the host State and to determine

> whether the actions of the host State conform to the fair and equitable treatment principle."[123] [Emphasis Added]

147. Similarly, in referring with approval to the *Metalclad* and the *Técnicas Medioambientales* decisions, the Tribunal in *Occidental Exploration* recently explained that:

> The relevant question for international law in this discussion is not whether there is an obligation to refund VAT, which is the point on which the parties have argue most intensely, but rather, whether the legal and business framework meets the requirements of stability and predictability under international law. It was earlier concluded that there is not a VAT refund obligation under international law, except in the specific case of the Andean Community law, which provides for the option of either compensation or refund, but there is certainly an obligation not to alter the legal and business environment in which the investment has been made. In this case, it is the latter question that triggers a treatment that is not fair and equitable."[124] [Emphasis Added]

148. It was bad enough for the MSA States to one day conclude that extra revenues could be generated by adopting an enforcement practice against the Investors and their investment under existing MSA-related measures, because of the unique territorial circumstances of their business model. However, in having carved out special, back-room deals for smaller, discounters connected to Big Tobacco – deals which would be memorialized nationally in their implementation measures – the 46 MSA States demonstrated an utter disrespect for the special circumstances of the Investors as aboriginal nationals of Canada, and for the international rule of law generally. Such arbitrary and non-transparent conduct clearly falls below the minimum standard of treatment required of the United States and its instrumentalities under customary international law and Article 1105(1).

VII. EXPROPRIATION

149. NAFTA Article 1110 provides for the payment of full, fair and effective compensation for any expropriation, regardless of whether such a taking is lawful under international law. This is because Article 1110(1) provides that, under all circumstances, regardless of whether the taking is for a public purpose, non-discriminatory or otherwise in accordance with the minimum standard of treatment, compensation must be paid in accordance with the other paragraphs of this provision.

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[123] *Técncias Medioambientales, TECMED S.A.* v. *Mexico*, ICSID CASE No. ARB (AF)/00/2 (29 May 2003) at para. 354 (see: http://www.worldbank.org/icsid/cases/laudo-051903%20-English.pdf).
[124] *Occidental Exploration, op. cite.* at para. 191.

150. Article 1110 states, in relevant part:

> 1. No 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 ("expropriation"), except:
> (a) for a public purpose;
> (b) on a non-discriminatory basis;
> (c) in accordance with due process of law and Article 1105(1); ***and***
> (d) on payment of compensation in accordance with paragraphs 2 through 6.
>
> 2. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.
>
> 3. Compensation shall be paid without delay and be fully realizable.
>
> 4. If payment is made in a G7 currency, compensation shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment.
>
> 5. If a Party elects to pay in a currency other than a G7 currency, the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing on that date, and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.
>
> 6. On payment, compensation shall be freely transferable as provided in Article 1109.
>
> ***Emphasis added.***

151. Five NAFTA tribunals have considered the meaning of this provision, and have together provided a clear view of how it should be interpreted and applied. The first significant award was made by the *Pope & Talbot* Tribunal, which began by determining that the object of an expropriation under Article 1110 is the "investment of an investor of a NAFTA Party." This term is defined under Article 1138, and includes any of tangible or intangible property interests included therein. It is not limited to any particular form of property, such as an interest in land, and is intimately tied to the nature of the business in question.[125]

152. Next, the *Pope & Talbot* Tribunal confirmed that the kinds of interference envisaged in NAFTA Article 1110 (including direct nationalization, indirect expropriation and measures tantamount to expropriation) do not depart from that which is available under customary international law.[126] It also concluded that

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[125] *Pope & Talbot, Inc.* v. *Canada*, Interim Merits Award, NAFTA/UNCITRAL Tribunal, 26 June 2000, at para's. 95 & 96-98.
[126] *Pope & Talbot* Interim Merits Award, at 96 & 103-104.

merely because a State claims that its actions are not overtly discriminatory and are justified as an exercise of its "police" (or regulatory) power, does not mean that compensation does not need to be paid under Article 1110(1). In doing so, the Tribunal noted:

> Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against [uncompensated] expropriation.[127]

153. Finally, the Tribunal provided an excellent articulation of the current test of what kind of interference constitutes a taking under modern international law, in stating:

> While it may sometimes be uncertain whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been "taken" from the owner. Thus the *Harvard Draft* defines the standard as requiring interference that would justify the inference that the owner will not be able to use, enjoy or dispose of the property…" The *Restatement*, in addressing the question of whether regulation may be considered expropriation, speaks of "action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property." Indeed, at the hearing, the Investor's counsel conceded, correctly, that under international law, expropriation requires a "substantial deprivation."[128]

154. The Tribunal in *Myers* concluded that an expropriation "usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary." In the case before it, the *Myers* Tribunal determined that the measure only delayed Myers' entry into the Canadian market for 14 months, rather than completely frustrating it.[129] Accordingly there was no expropriation.

155. By contrast, in *Wena Hotels*, the Tribunal noted that being deprived of access to its investment for only one year was sufficient to have deprived the investor of its enjoyment of the investment in a manner which was more than "ephemeral."[130] The hotel had been appropriated by a State-sponsored tourist agency, and although control was eventually relinquished, the condition of the facilities upon return was poor.

156. The "merely ephemeral" standard can be found in the oft-quoted Iran-US Claims Tribunal case, Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA, which the *Wena Hotels* Tribunal cited at paragraph 98 of its award:

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[127] *Pope & Talbot* Interim Merits Award, at 99.
[128] *Pope & Talbot* Interim Merits Award, at 102.
[129] *Myers* Merits Award, at 283 & 287.
[130] *Wena Hotels* Award, at para. 99.

> [W]hile assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner has been deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral.[131]

157. After reviewing the expropriation findings including in these NAFTA cases, Professor Loewenfeld has adroitly observed about BIT practice (in which he includes the NAFTA Chapter 11 jurisprudence):

> It seems clear from the cases here excerpted and others that expropriation as governed by the BITs is defined by the deprivation to the investor, not by the gain to the host state. Thus destruction of the investor's property may come within the definition of expropriation if the actions are attributable to the host state, even if the state does not acquire the property in question. Further, intangible rights, such as the right to import or export a given product or to participate in a given industry, may be subject to the constraints on expropriation set out in the BITs. However, a regulation of temporary duration, or a regulation that reduces the profitability of an investment but does not shut it down completely and leaves the investor in control, will generally not be seen as expropriation, even when it gives rise to liability on the part of the host state for violation of national treatment and fair and equitable treatment clauses.[132]

158. The *CME* Tribunal has also similarly held:

> The expropriation claim is sustained despite the fact that the Media Council did not expropriate CME by express measures of expropriation. De facto expropriations or indirect expropriations, i.e. measures that do not involve an overt taking but that effectively neutralize the benefit of the property of the foreign owner, are subject to expropriation claims. This is undisputed under international law (G. Sacerdoti page 382 as cited above, referring to numerous precedents such as the German Interests In Polish Upper Silesia case, 1926, PCIJ, Series A, No. 7, reprinted in M. Hudson, ed., I World Court Reports 475 (1934); see also Southern Pacific Properties (Middle East) Ltd. v. Egypt, ICSID Case No. ARB/84/3 (1992), 32 I.L.M. 993, 1993, dealing also with the expropriation of contractual rights of the operating company).[133]

The *CME* Tribunal also cited, with approval, the reasoning of the *Metalclad* Tribunal that an expropriation under Article 1110:

> … included not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with 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.[134]

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[131] *Tippets, Abbett, McCarthy, Stratton* v. *TAMS-AFFA Consenting Engineers of Iran et al*., Iran-U.S. Claims Tribunal, Award No. 141-7-2, June 22, 1984, at para. 225.
[132] Andreas F. Lowenfeld, *International Economic Law* (Oxford, Cambridge: 2002) at 479-480.
[133] *CME* Award, at para. 604.
[134] *CME* Award, at para. 606, citing the *Metalclad* Award at para. 103.

159. The *Metalclad* Tribunal was presented with a situation where the investor was led to believe that it had all the necessary federal and state authorizations to operate its newly constructed facility – only to be prevented from doing so through political intrigue and the questionable legal tactics of local and state officials. It was also presented with a bold “ecological decree” issued by the governor during his last days in office which was admittedly designed to ensure that the facility was never operated. The Tribunal accordingly found that the business of the investor had been taken without the payment of appropriate compensation, contrary to NAFTA Article 1110, on both counts.[135]

160. With respect to the expropriatory impact of the so-called ecological decree, the *Metalclad* Tribunal also noted that it did not need to consider the motivation or intent behind its imposition. While Article 1110(1) provides that an expropriation can be undertaken “for a public purpose” it also provides that, in any case, prompt, adequate and effective compensation shall be paid.

161. The *Feldman* Tribunal has also found that:

> If there is a finding of expropriation, compensation is required, *even if* the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1).[136]

However the Tribunal has also noted that not all regulatory actions which indirectly confiscate a business are compensable takings under the customary international law of expropriation, as expressed in Article 1110.

162. In order to discern the line between legitimate acts of governmental regulation and compensable takings under international law, the *Feldman* Tribunal found assistance in commentary (g) to Section 712 of the *Third U.S. Restatement on International Law*, which provides:

> A state is responsible as for an expropriation of property under Subsection (1) when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien’s property or its removal from the state’s territory... A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory....[137]

163. Finding support in the notes of the *Restatement*’s authors, the *Feldman* Tribunal resolved that the determination of whether an expropriation has taken place must be performed on a case-by-case basis, in view of the totality of the facts. For the *Feldman* Tribunal the key factor appeared to be the same one found by the *Pope*

[135] *Metalclad* Award, at para’s. 102-112.
[136] *Feldman* Award, at 98.
[137] *Feldman* Award, at 105.

& Talbot Tribunal – that because the investment enterprises of each investor were still "in business" and under the control of their respective investors, the interference with these investments had simply not been ***substantial*** enough to constitute a taking under international law.[138]

164. Nonetheless, the *Feldman* Tribunal also noted that:

> … not all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of exiting laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110.

165. Besides the obvious question of whether there exists "a substantial interference with the investment," the *Restatement* commentary mentioned above can also provide some direction as to how to decide whether the interference in question constitutes a compensable taking under international law. One should consider the overall "reasonableness" of the taking, including the manner of its imposition, and whether there were any discriminatory results. As the *Feldman* Tribunal suggests: the more arbitrary or discriminatory the measure which takes an investor's business without providing compensation, the more likely that there is a breach of Article 1110.[139]

166. Another factor is whether the taking is general or specific in application. The *Feldman* Tribunal was presented with the impact of a tax measure of general application, rather than a regulatory activity which was directed at any particular enterprise or individual. Also, the *Feldman* Tribunal was presented with an investor that did not take advantage of administrative procedures which would have provided considerable certainty as to whether the business activity in which it was engaged was properly subject to the tax treatment that the investor sought to receive.[140]

167. Accordingly, the general rule for consideration of whether government action constitutes a compensable taking, under Article 1110, is based upon an objective analysis of the facts of each case, with an emphasis on determining whether there exists some sort of "substantial" and unreasonable (or perhaps unjustifiable) interference with the business of the investment in question.

VIII. THE LAW OF EXPROPRIATION APPLIED TO THE FACTS OF THIS CLAIM

168. As a result of the adoption of enforcement practices that have extended the scope of MSA-related measures to include the business of the Investors, the Investors have been forced to make very difficult strategic decisions about the markets in which they would remain and the markets that they would be forced to surrender.

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[138] *Pope & Talbot* Interim Merits Award, at 103-104; *Feldman* Award, at 102, 106 & 111.
[139] *Feldman* Award, at 99.
[140] *Feldman* Award, at 134.

Faced with simultaneous enforcement actions in dozens of states, and up against an opponent in each with unlimited financial and legal resources, it has been necessary for the Investors to choose their domestic legal battles carefully. They simply could not afford to either bring themselves into "compliance" with an arbitrarily and discriminatorily applied regime in each state, or fight each state on its own "turf."

169. As a result, the Investors have been forced to abandon state markets in which they either had a presence, or plans for expansion. To be sure, from a business perspective the market for tobacco products is nation-wide with regional differentiation. It is only because of the fact that implementation of the MSA took place on a state-by-state basis, and that enforcement of any one MSA-related measure falls within the jurisdiction of an individual state, that it is possible to speak of being excluded from a "state market."

170. Because of the measures at issue in this case, the Investors have been completely excluded from participating in a number of State markets, including Virginia, Alabama, Kansas, Ohio, North Dakota, Wisconsin and Michigan. Because the measures at issue are taken at the state level, by definition the scope of the investment taken is also limited to the market of the individual state in question. The "investment" so taken was the market share existing at the time of the taking, including the potential for growth that is inherent in all valuations for a purchaser at fair market value.

171. As both the *Myers* and *Pope & Talbot* Tribunals understood, market share constitutes an intangible form property that is recognized as an investment under Article 1139 of the NAFTA. It is capable of being taken, and accordingly its loss is capable of being valued. To date, no compensation has been offered to any of the Investors by any of the aforementioned States whose enforcement practices have resulted in the complete preclusion of the Investors from their respective markets.

IX. DAMAGES

172. NAFTA Chapter 11 does not contain detailed provisions on the quantification of damages outside of the scope of Article 1110, which provides some guidance on the valuation of takings that is consistent with the *status quo ante* in customary international law generally. As such, in cases where a tribunal concludes that an investor has been deprived of its rights to enjoy a proprietary or business interest which constitutes an "investment" under Article 1139, compensation must reflect the fair market value of that investment immediately prior to its taking. Where a tribunal concludes that any other breach of NAFTA Chapter 11 has occurred, it must have recourse to the "applicable rules of international law" to determine the appropriate quantum of compensation to be paid.

173. The starting point for any discussion of the appropriate principles to be employed in compensation of a foreign investor for the illegal treatment of its investment can be found in the decision of the Permanent Court of Justice in the *Chorzow Factory* case.[141] In this case, the Permanent Court was concerned with the appropriate damages to be ordered in compensation for an unlawful expropriation, stating:

> "The essential principle contained in the actual notion of an illegal act … is that reparation must, as far as possible, wipe-out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind, or payment in place of it – such are the principles which should serve to determine the amount of compensation for an act contrary to international law.[142]

138. And in the Norwegian Shipowners' case, the principle was established that full restitution will normally include compensation for lost profits on the grounds that:

> Just compensation implies a complete restitution of the status quo ante, based, not upon future gains of the United States or other powers, but upon the loss of profits of the Norwegian owners as compared with the other owners of similar property.[143]

139. With these statements, the Permanent Court reaffirmed the principle that the goal for any international judge or arbitrator is to act to put a claimant back into the same position that it would have been "but for" the occurrence of the international wrongful act.[144]

140. This approach has been endorsed by many investment tribunals. For example, the ICSID Tribunal in *Amco Asia Corp.* v. *Indonesia* noted that the reasoning adopted in the *Chorzow Factory* case constitutes the fundamental precedent on the law of compensation in international claims.[145]

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141 *Factory at Chorzow*, Merits, 1928 P.C.I.J. Set. A, No. 17, at 47.

142 *Ibid*, at 47.

143 Norwegian Shipowners' Claims (Nor. v. U.S.), 1 R.I.A.A. 307 at 338 (Perm. Ct. Arb. 1922). Accordingly the compensation awarded for the seizure of ships under construction in US dockyards by US authorities, and the concordant assumption of the Norwegians' rights in the contracts for their construction, included the high value of shipping contracts in the open market as of the date of requisition, rather than the end of the First World War, when economic circumstances had irrevocably changed.

144 *See* also *S.D. Myers*, First Partial Award, *op. cite.* at para. 315 "This Tribunal has recognized that the *Chorzow Factory* case supports the principle that '*compensation should undo the material harm inflicted by a breach of an international obligation*'".

145 *Amco Asia Corp.* v. *Indonesia*, Merits Award, 1 ICSID Rep. 377, at 500.

141. While the vast majority of jurisprudence on compensation in mixed claims Tribunals involves expropriation, several cases have addressed the issue in the context of national treatment violations.

142. In *Feldman* v. *Mexico*,[146] the Tribunal found that Mexico had violated its national treatment obligations under Article 1102 of NAFTA by failing to grant the claimant tax rebates upon the exportation of cigarettes while rebates of the same taxes were granted to at least three other companies in like circumstances. The Tribunal, therefore, had to assess damages as a result of that breach, and stated:

> … It follows that, in cases of discrimination that constitute a breach of Article 1102, what is owed by the responding Party is the amount of loss or damage that is adequately connected to the breach. In the absence of discrimination that also constitutes indirect expropriation or is tantamount to expropriation, a claimant would not be entitled to the full market value of the investment which is granted by NAFTA Article 1110. Thus, if loss or damages is the requirement for the submission of a claim, it arguably follows that the Tribunal may direct compensation in the amount of the loss or damage actually incurred.
>
> To date, only two other NAFTA Tribunals, in S.D. Myers and Pope & Talbot, have found a compensable violation, of Article 1102 and 1105 (respectively). The damages phase of S.D. Myers has not been completed. However, in outlining its intended approach to damages, the Tribunal concluded that in the absence of a special provision, the drafters of the NAFTA intended to leave it open to Tribunals to determine a measure of compensation appropriate to the specific circumstances of the case, taking into account the principles of both international law and the provisions of NAFTA.[147]

143. The *Feldman* Tribunal added:

> It is obvious that in both of these earlier cases, which as here involved non-expropriation violations of Chapter 11, the Tribunals exercised considerable discretion in fashioning what they believed to be reasonable approaches to damages consistent with the requirements of NAFTA.[148]

144. The *Feldman* Tribunal went on to calculate the amount of tax rebates that the Claimants would have been entitled to (with the exclusion of refunds that were time barred under NAFTA) and then calculated interest on those tax rebates according to the Mexican law in force for the rebates requested to the date of the decision and, in the event that the Respondent did not pay the amount requested immediately, interest was to continue being calculated in the same manner until

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146 *Feldman op. cite.*

147 *Ibid,* at paras. 194 to 195.

148 *Feldman* Award, at para. 179.

the payment was made.[149] The Tribunal applied the Mexican government bond interest rates.

145. In its First Partial Award, the *Myers* Tribunal had made a number of observations concerning the principles that should be adopted in making the assessment of compensation for the breach of its national treatment obligation of NAFTA Article 1102. Among them:

> The Tribunal has already suggested that whatever precise approach is taken it should reflect the general principle of international law that compensation should undo the material harm inflicted by a breach of an international obligation.[150]

146. In its damages award, the *Myers* Tribunal opted for a measure of compensation based on the lost net income stream of the investment. The Tribunal stated:

> The quantification of loss of future profits claims can present special challenges. On the one hand, a claimant who has succeeded on liability must establish the quantum of his claims to the relevant standard of proof; and, to be awarded, the sums in question must be neither speculative nor too remote. On the other hand, fairness to the claimant requires that the court or tribunal should approach the task both realistically and rationally. The challenges become more acute in start up situations where there is little or no relevant track record. The Tribunal has taken due notice of SDMI's successful experience of seizing market opportunities in the USA, but at the same time acknowledges that the Canadian market has certain distinctive features.
>
> As stated above, the Tribunal has determined that the appropriate primary measure of compensation is the value of SDMI's lost net income stream.[151]

147. In *Occidental Exploration*, the Tribunal found that Ecuador had breached its obligation to treat investments and associated activities "on a basis no less favourable than that accorded in like situations to investments or associated activities of its own nationals or companies, or of nationals or companies of any third country, whichever is more favourable."[152]

148. In that case, the less favourable treatment involved a failure to pay value-added tax ("VAT") refunds to the investment. The Tribunal awarded damages on the basis of the VAT refunds that the Claimants ought to have received as follows:

> The Tribunal holds in this respect that the Claimant is entitled to the refund of VAT requested, again because no alternative mechanism was

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[149] *Feldman* Award, at para's. 203 et s.
[150] *S.D. Myers,* First Partial Award, at para. 315.
[151] *S.D. Myers,* Second Partial Award, at paras. 173-174.
[152] *Occidental Exploration*, at paras. 176 et s.

> included in the contract. In so far as VAT was paid and its refund not requested, the Tribunal holds that the Claimant is also entitled to this amount as the argument that any application for refund would have been futile is convincing. This entitlement to VAT includes the amount paid on goods, services and reasonable pre-production costs, particularly in connection with assistance to indigenous communities living within the Contract area.[153]

149. Interest on the damage award was calculated on the basis of the amount of interest that would have been payable for late tax obligations as follows:

> The Tribunal also holds that interests shall be paid in connection with the amount of compensation indicated through December 31, 2003. OEPC believes this interest to be that which the SRI applies for delay or late payment of tax obligations, in accordance with Article 20 and 21 of the Tax Law, which results in the amount of U.S. $7,082,561. In this regard, the Tribunal notes that in as much as it is granting compensation for Treaty breaches, those provisions are not directly applicable. The Tribunal believes, considering all of the circumstances of this case, that appropriate interest through December 31, 2003 would be one half of the sum requested, or U.S. $3,541,280.[154]

150. This Tribunal may also be guided by the customary international law on state responsibility, in particular, because a breach of the United States' NAFTA obligations constitutes an internationally wrongful act that "entail the international responsibility of [the United States]".[155]

151. As noted earlier, under international law, the standard of compensation for an international wrongful act is based on "full reparation", that is, reparation that wipes out all the consequences of the illegal act and re-establishes the situation which would, in all probability, have existed if the illegal act had not been committed.[156]

152. The general principles supporting full reparation are economically and eloquently expressed in the following articles of the International Law Commission's *Articles on Responsibility of States for International Wrongful Acts*:

> Article 31
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> Reparation
>
> 1. The responsible State is under an obligation to make full reparation for the injury caused by the internationally wrongful act.

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153 *Ibid* at para. 205.

154 *Ibid* at para 211.

155 International Law Commission *Articles on Responsibility of States for Internationally Wrongful Acts*, Articles 1 and 2.

156 *Chorzow Factory* (Indemnity) Case (1927), P.C.I.J. Set. A., No. 12 (Interim Measures; James Crawford, the *International Law Commissions Article on State Responsibility – Introduction, Text and Commentaries*, Cambridge, Cambridge University Press, 2002, at pages 201 ff (Article 31).

> 2. Injury includes any damage, whether material or moral, caused by the internationally wrongful act of a State.
>
> …
>
> Article 34
>
> Forms of Reparation
>
> Full reparation for the injury caused by the internationally wrongful act shall take the form of restitution, compensation and satisfaction, either singly or in combination, in accordance with the provisions of this chapter.
>
> Article 35
>
> Restitution
>
> A State responsible for an internationally wrongful act is under an obligation to make restitution, that is, to re-establish the situation which existed before the wrongful act was committed, provided and to the extent that restitution:
>
> (a) is not materially impossible;
>
> (b) does not involve a burden out of all proportion to the benefit deriving from restitution instead of compensation.
>
> Article 36
>
> Compensation
>
> 1. The State responsible for an internationally wrongful act is under an obligation to compensate for the damage caused thereby, in so far as such damage is not made good by restitution.
>
> 2. The compensation shall cover any financially assessable damage including loss of profits in so far as it is established.

153. The relationship between compensation and restitution is clarified by the final phrase of Article 36(1) of the Articles:

> The State must compensate for damages ‘in so far as such damage is not made good by restitution.’

154. Finally, this principle is further explained in the Commentaries on Article 36:

> Restitution, despite its primacy as a matter of legal principal, is frequently unavailable or inadequate. It may be partially or entirely ruled out either on the basis of the exceptions expressed in Article 35, or because the injured State prefers compensation or for other reasons. Even where restitution is made, it may be insufficient to ensure full reparation. The role of compensation is to fill any gaps so as to ensure full reparation for the damage suffered. As the umpire said in the ‘Lusitania case’:
>
>> The fundamental concept of ‘damages is … reparation for a loss suffered; a judicially ascertained compensation for wrong. The

> remedy should be commiserate with the loss, so that the injured party may be made whole.'[157]

X. THE LAW OF DAMAGES APPLIED TO THE FACTS OF THIS CLAIM

155. The basis for awarding damages is dictated by the nature of the breach. In this case, there are two potential bases for awarding damages: a determination that the enforcement practice which visited the MSA regime on the Claimants should never have been imposed; or a determination that while the MSA States were entitled to establish enforcement practices in respect of the Claimants' business, that the MSA-related regime, thus imposed, should have included an exemption equivalent to the most favoured treatment being received by a comparable domestic or foreign industry member.

156. Should this Tribunal determine that it was unfair and inequitable to have subjected the Investors to any aspect of the MSA-related regime operated individually and collectively by the forty six MSA States, and thus contrary to the minimum standard of treatment owed to the Investors under Article 1105(1) and customary international law, it would be obliged to remedy the breach by awarding damages for all of the harm caused to the Investors, including both past and future losses suffered because of the very existence of the measures.

157. In order to make the Investors whole again, it would be necessary to ensure that the Investors were compensated both for income that would have been realized in the past, and for forgone income on a going-forward basis. Such an analysis would include a valuation of the net present value of those future profits, in order to quantify them as of the date of the breach. As such, the damages and valuation analyses for a finding that Article 1105(1) has been breached would be identical to that used in expropriation cases under Article 1110 – except that the former would be valued on a state-by-state basis.

158. However, because the MSA States have consistently refused to meet a minimum level of transparency in respect of the Claimants' requests for disclosure of exactly what their total potential liability may be under any given Escrow Statute, it is not possible to fully and properly quantify the Investors' losses on this basis without having received such information through the discovery process.

159. In lieu of such information, it is possible to at least value some of the direct costs of being arbitrarily subjected to the States' MSA-related measures on a collective basis, contrary to Article 1105(1). One can quantify the present value of the estimated monies that the Investors will be forced to pay in the future to stay in business, net of any interest received on the monies. Such an analysis does not make the investor whole because it cannot account for income lost, but it does

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157 James Crawford, *The International Law Commission's Articles on State Responsibility – Introduction, Text and Commentaries,* Cambridge: University Press, 2002, at page 218 (Commentary 3 on Article 36).

encapsulate the dead loss that can be expected by the Investors on a going-forward basis. That amount would be approximately US$443 million see exhibit 24.

160. Alternatively, one could assign a value to the entitlement to an exemption under the MSA regime – the kind of exemption enjoyed by the Squaxin Tribe in Washington State and companies such as The Medallion Company, Inc. or Sante Fe Natural Tobacco, Inc. These two latter companies were recently the subject of public acquisitions in which the value of possessing an exemption under the MSA regime was quantified. Using the sale of these two companies as a proxy, and estimating the total sales for the Investors' business based upon past performance, it is possible to arrive at a per cigarette value for being exempted from the regime.

161. On the premise that no MSA-related measures should ever have been imposed upon the Investors, contrary to Article 1105(1), this Tribunal could award the Investors an amount equivalent to the value of a complete exemption from the collective regime. This is because the value of being able to purchase an exemption similarly approximates the value of an estimate of the likely penalties that could be paid going forward. Based upon an estimate of the Investors' future sales, the value of a complete exemption from the regime would be between US$210 million and US$452 million, depending upon the proxy transaction used and the discount rates applied.

162. Alternatively, should this Tribunal conclude that Article 1105(1) was not breached by the Respondent, but that the practice of States having granted more favourable treatment to comparable industry members did violates Article 1102 and/or 1103, damages could be awarded to compensate for the lost exemption.

163. The most favourable treatment offered by any of the States to a similarly-situated comparator was that which was received by the Squaxin Band of Washington State, which distributes its products exclusively through on-Reserve sales throughout the United States (and never "joined" the MSA as did the other exempt companies). If the Investors were to be awarded damages equivalent to the cost of purchasing an exemption for all of their on-Reserve sales, on a going-forward basis, they would be entitled to an award of between US$100 million and US$210 million, depending upon the proxy transaction used and the discount rates applied.

164. Alternatively if the Investors were to be awarded an amount equivalent to the estimated cost of the payments that they can expect to be forced to make in the future for all non-Reserve sales, they would be entitled to damages of US$212 million.

165. It is essential, however, that the Respondent provide the Claimants with access to the necessary data and documentation, which is held exclusively within the hands of the NAAG and its membership, in order to properly value the entire value of

the losses suffered by the Claimants, i.e. by taking into account past and future income forgone. This is true for the valuation of any NAFTA breach. Such information includes: The number of Units Sold of the Investors' products for which the MSA States claim that Investors must make escrow payments; the number of lawsuits filed or planned by the MSA states against Grand River, NTD or NWS, the negotiation documents relating to the adoption of the MSA and its implementing legislation, particularly insofar as they relate to the doling out of exemptions, and documents of the MSA States relating to the enforcement of these measures against the Investors and or NTD or NWS.

(III) Relief Sought and Damages Claimed

166. The Investors claim damages for the following:

i. Damages of not less than US$210 million to US$452 million, as partial compensation for the damages caused by, or arising out of, the United States' measures that are inconsistent with its obligations contained within NAFTA Article 1105(1); or

ii. Damages of not less than US$100 million to US$212 million, as partial compensation for the damages caused by, or arising out of, the United States' measures that are inconsistent with its obligations contained within NAFTA Articles 1102 or 1103; and

iii. Costs associated with these proceedings, including all professional fees and disbursements;

iv. Fees and expenses incurred to oppose the promulgation of the infringing measures;

v. Pre-award and post-award interest at a rate to be fixed by the Tribunal;

vi. Payment of a sum of compensation equal to any tax consequences of the award, in order to maintain the award's integrity; and

vii. Such further relief as counsel may advise and that this Tribunal may deem appropriate.

Dated: June 30, 2005

By: ________________________

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