NAFTA/UNCITRAL ARBITRATION RULES PROCEEDING

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In the Matter of Arbitration :
Between: :
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GRAND RIVER ENTERPRISES SIX NATIONS LTD., :
et al., :
:
Claimants/Investors, :
:
and :
:
UNITED STATES OF AMERICA, :
:
Respondent/Party. :
:
- x Volume No. 6

HEARING ON THE MERITS

Saturday, February 13, 2010

The Fairmont Hotel
24th and M Streets, N.W.
Roosevelt Room
Washington, D.C.

The hearing in the above-entitled matter came on, pursuant to notice, at 9:00 a.m. before:

MR. FALI S. NARIMAN, President

PROF. JAMES ANAYA, Arbitrator

MR. JOHN R. CROOK, Arbitrator

Also Present:

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C O N T E N T S

CONFIDENTIAL PORTIONS

P R O C E E D I N G S

PRESIDENT NARIMAN: Mr. Violi, your side is ready?

MR. VIOLI: Yes, we are.

PRESIDENT NARIMAN: We are ready, if you are.

MR. FELDMAN: Thank you, Mr. President. Good morning.

Just housekeeping, as an initial matter. We have two documents that we are circulating in response to the Tribunal's request. The first concerns a list of documents for which we are claiming confidentiality protection. And the second, yesterday the Tribunal had requested statistic numbers on the per carton payment amounts for the various categories of manufacturer, as well as the market share over a series of years for the various manufacturers. The Freedom Holdings decision in the Southern District of New York --

PRESIDENT NARIMAN: What was that?

MR. FELDMAN: The Freedom Holdings

decision in the Southern District of New York took statistics from the PWC notices which contains this information, and we have compiled a chart directly from the numbers set forth in Freedom Holdings setting forth the various market share numbers, as well as the per carton payment amounts for the various categories of manufacturers, and that list is also being circulated at this time.

PRESIDENT NARIMAN: Yeah, okay.

I don't understand this freedom holdings.

MR. FELDMAN: I'm sorry. The Freedom Holdings decision, it is in the record, it is in our core bundle. It's from the Southern District of New York.

PRESIDENT NARIMAN: What is this then?

MR. FELDMAN: Those are statistics that are contained within the freedom holdings decision that, in turn, are taken from the PWC notices, and we have produced several of these PWC notices in this case.

Claimants have relied on them and in

Dr. Eisenstadt's report, and this is simply a simple chart setting out the per carton payment amounts and the market shares for the various categories of manufacturer.

PRESIDENT NARIMAN: Okay.

MR. VIOLI: At present, we have no objection to the opinion coming in. This is Freedom Holdings, it's a case. In that case there was no economist produced by the defendant, so I guess this is a table that was prepared by the state's expert, I don't know, but the raw data, PWC documents are in the record. I don't know why the Respondent is relying on a case for factual statistics when the data and their economist had the actual data and could have used that.

So we'll just reserve the objection now. We don't object to the opinion coming in. Whether these statistics are accurate, however, is another matter.

PRESIDENT NARIMAN: Noted. Noted.

MR. FELDMAN: Mr. President, we would just note these statistics set forth in the

opinion, that is public information, the Tribunal -- this can be a public award. The PWC notices are confidential, so it's helpful to be able to rely on this information when it's given in a public setting decision such as the decision in Freedom Holdings.

PRESIDENT NARIMAN: Okay.

MR. FELDMAN: And we also from the response to the Tribunal's request from yesterday, we have the first amended complaint in the Philip Morris, the federal action in New York and we are circulating --

PRESIDENT NARIMAN: What date is that action, is it mentioned?

MR. FELDMAN: Yes. The date is February 28th of 2001.

PRESIDENT NARIMAN: Thank you. That's been distributed.

MR. FELDMAN: Yes.

09:03:12 PRESIDENT NARIMAN: What are we doing today?

MR. KOVAR: We're going to start,

Mr. President, if you would with Ms. Morris the character of the measure under Article 1110, the expropriation article.

MS. MORRIS: Good morning.

PRESIDENT NARIMAN: Yes, please, Ms. Morris.

MS. MORRIS: Mr. President, Members of the Tribunal. Yesterday several of my colleagues discussed Claimants' asserted expectations both on and off-Reservation, and I discussed the alleged economic impact of the challenged measures on Claimants' investment.

I will now turn to the third and final factor in the expropriation analysis character. As Mr. Kovar noted in his introduction, the character of the challenged measures, that is whether the measures are non discriminatory in nature and serve a public purpose is also considered in determining whether regulatory expropriation has occurred under Article 1110.

As I will discuss, there can be no doubt that the challenged measures, as well as the

MSA serve critical public health interests of the settling states and are entirely not discriminatory. Their character, therefore, in no way supports Claimants' expropriation claim under Article 1110.

Claimants' make three principle arguments as to why the MSA regime should be considered discriminatory.

The first is that the settling states weren't actually concerned with promoting the public health, which Claimants admit is a valid public purpose. Rather, they assert that the states colluded with the participating manufacturers to protect the PMs' market share in return for payments under the MSA, all at the expense of the NPMs.

The second is that the federal government of the United States has somehow implicitly endorsed Claimants' assertions about the motives of the states and the participating manufacturers by pointing out in various fora the inadequacies of the MSA.

And the third is that the allocable share release mechanism is no more a loophole than the grandfather shares offered to SPMs that signed the MSA within 90 days of its execution.

Claimants assert that all they want is an opportunity to join the MSA on terms equal to those granted to the grandfather SPMs. As I will explain, each of these allegations is unfounded and the MSA regime is, in fact, non discriminatory and serves the public health.

First and foremost, the public health interest motivating the MSA and the challenged measures is evident on the face of the settlement and statutes themselves. The MSA, for example, states among its recitals, whereas the undersigned settling state officials believed that entry into this agreement and uniform consent decrees with the tobacco industry is necessary in order to further the settling states policies designed to reduce youth smoking, to promote the public health and to secure monetary payments to the settling states.

Similarly, the Idaho escrow deposit statute, which is representative, lists among its findings and purposes that cigarette smoking presents serious public health concerns to the state of Idaho and to the citizens of the state. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year.

09:07:06

The legislature continued. It would be contrary to the policy of the state if tobacco product manufacturers who determine not to enter into such a settlement with the state could use a resulting cost advantage to derive large short-term profits in the years before liability may arise without ensuring that the state will have an eventual source of recovery from them, if they are proven to have acted culpably.

09:07:38

With respect to its complementary legislation, the Idaho legislature found that violations of Idaho's tobacco Master Settlement

Agreement Act establishing escrow deposit obligations threatened the integrity of Idaho's Master Settlement Agreement with leading tobacco manufacturers, the fiscal soundness of the state and the public health.

The legislature finds that enacting procedural enhancements will help prevent violations of Idaho's tobacco Master Settlement Agreement Act and thereby safeguard the Master Settlement Agreement, the fiscal soundness of the state and the public health.

09:08:13

The settling states could not have been clearer about the public health concerns motivating their adherence to the MSA and their enactment of the challenged measures. And we submit that under these facts, the Tribunal should not seek to go behind these explicit statements of purpose in search of some alleged true purpose hypothesized by Claimants.

09:08:40

Mr. Hering neatly summarized the motivations behind the MSA in his testimony last Tuesday, enumerating the four different ways the

MSA addresses the public health. The first way is the payments themselves which are a public health measure because higher payments mean lower consumption. The second are the public health restrictions contained in section three of the MSA which I will be addressing at greater length later in my presentation.

The third is the creation of the American Legacy Foundation, a non profit

09:09:19

organization that is, quote, dedicated to a world where youth reject tobacco and everybody can quit, end quote.

The fourth is the source of funds used by the states for anti tobacco and other similar measures. Professor Gruber also testified to the public health benefits of the MSA regime stating, quote, as the price of the cigarette goes up, it's a disincentive for youth to start smoking. It also helps encourage some people to quit that

09:09:48

might not otherwise quit, end quote.

Professor Gruber identified as another public health positive of the MSA regime, the

ability of states to begin to recoup some of the costs that they had incurred as a result of prior cigarette sales. Reinforcing the validity and veracity of the stated purposes of these measures is the fact that they have, indeed, been effective at promoting the public health.

U.S. courts asked to review the MSA have found that it painstakingly accommodates the public interest, and tellingly, despite their

09:10:27

various attacks on the public health objectives of the MSA, Claimants themselves openly acknowledge that the MSA has successfully reduced smoking rates.

As stated in Claimants' reply, independent studies attribute almost one-quarter of reductions over the past decade in youth tobacco use to a successful public information campaign executed by the American Legacy Foundation, which was created and funded under the

09:10:54

MSA.

In his testimony, Mr. Hering stated that in large part because of the MSA, consumption

has gone down, sales have gone down, nearly 25 percent in ten years, which is something the attorney generals are very pleased with.

Mr. Hering further testified the MSA has resulted in great declines in the consumption of cigarettes from over 480 billion in the year before the MSA began down to 260, less than 260, I believe, or thereabouts in the most recent year. Over hundred billion cigarettes.

09:11:35 And those are cigarettes because they are not being sold on which the states will never be paid. We will receive no MSA payments for cigarettes that are not sold. However, as one of our member AGs have said, it's the best money we never got because we save more in avoiding the public health costs resulting from the death and disease than we lose in payments.

ARBITRATOR ANAYA: Excuse me?

MS. MORRIS: Yes.

09:12:07 ARBITRATOR ANAYA: Is there any proof in the record beyond the statements of Mr. Hering that the reduction in consumption of cigarettes

is, in fact, due to the MSA?

MS. MORRIS: Yes. We have various charts that are based on CDC data that show a dramatic reduction immediately after the MSA, and there have also been several studies and journal articles that are in the record that have studied the matter and have determined that the MSA was, in fact, effective in reducing smoking rates.

PRESIDENT NARIMAN: As far as I

09:12:39 recollect, there are also some documents on the record which suggest the contrary that the -- that because of the MSA, consumption has not gone down. Am I right or am I wrong? There are some documents, which we should have both of them, if you don't mind. On the record, I've noticed I remember that.

MS. MORRIS: Certainly, Claimants have put in a variety of articles to suggest --

PRESIDENT NARIMAN: Not just articles,

09:13:05 some documentation. It may not be just the opinions of some people but some documentation.

MS. MORRIS: Are you referring to the

consumption charts that --

PRESIDENT NARIMAN: Not charts, some documents.

MR. VIOLI: It's the CDC report that Respondent put in, that said the premium cigarette distribution did not go down in percentages. CDC is the U.S. Government Center for Disease Control, so there is, I think it was 2001 or 2003. I believe Respondent put that in.

09:13:38 MS. MORRIS: We also have cigarette sales data from the CDC that shows a remarkable drop in consumption.

PRESIDENT NARIMAN: Thank you.

ARBITRATOR ANAYA: I understand that there's been a reduction, there doesn't seem to be a dispute, but the question is the causation.

MS. MORRIS: Yes. And there are several journal articles that we've put into the record in which social scientists and

09:14:00 statisticians have done studies with statistical certainty that shows the MSA and related public service announcements, for example, have, in fact,

had a statistical reduction in smoking.

ARBITRATOR CROOK: You will give us a list of where to find that.

MS. MORRIS: Certainly.

Similarly, Mr. Hering described -- I got ahead of myself. Attorney General Sorrell he seconded the statement in his memo to the state Attorneys General writing, reductions in settlement payments resulting from an overall

09:14:34 reduction in cigarette consumption benefit the state because the healthcare costs imposed by each cigarette exceed the settlement payments.

Similarly, Mr. Hering described the willingness of the settling states to forego MSA payments in return for compliance with the public health provisions of the agreement, explaining, we focus as much on public health as on payments in terms of enforcing the Section 3 restrictions against the banned uses of advertising and

09:15:07 marketing. And, of course, the end result of most of those actions is lower sales.

We have most recently, I think, one of

the cases we brought was a case against RJR for advertising with cartoons in Rolling Stone Magazine, and another one that was recent was a case brought against an SPM, Sherman's for selling brand name merchandise. That is merchandise meaning clothing, trinkets, ashtrays, things like that emblazoned with their logo on it, which is also banned under the MSA.

We do all of those things and we wouldn't do those if we were trying to maximize sales and thereby payments under the MSA. As I will discuss in more detail the states were also willing to give up a certain amount of payments from the grandfathered SPMs in the form of the grandfather share in order to encourage them to voluntarily settle and submit themselves to the public health restrictions of the MSA.

Again, this is not something the states would have done if the MSA were only about revenues.

Also, contrary to Claimants' assertions NPMs were not shut out of the legislative process

through which this important public health framework was established. As Mr. Hering testified, he spoke in favor of the Allocable Share Amendments in at least 13 states and his testimony was quite often opposed by a number of entities including CITMA, the Counsel of Independent Tobacco Manufacturers in America and on occasion NPMs, and on occasion other groups.

CITMA was an organization established by certain NPMs to represent their interests, including appearing before state legislature to oppose the Allocable Share Amendments. That organization, among others, was quite involved in the legislative processes of various states, considering the Allocable Share Amendments and the complementary legislation.

For example, CITMA participated in a public hearing on Oregon's proposed legislation and Allocable Share Amendment. Other participants of that hearing included representatives from the Attorney General's office, Single Stick Tobacco Company and USA Tobacco Distributing. A related

work session on the Oregon bill included comments from Philip Morris, R.J. Reynolds Tobacco and American Heart Association.

CITMA offered several arguments against the complementary legislation and Allocable Share Amendment similar to that offered by Claimants here before the Wisconsin, Arizona and Michigan legislature, as well.

In Michigan, CITMA's testimony was countered by testimony from various parties including the Michigan Department of Treasury, the Michigan Department of the Attorney General, the Michigan Grocer's Association, the Michigan Distributors and Vendor's Association, R.J. Reynolds, Commonwealth brands, Altria, the current owner of Philip Morris. Lorillard Tobacco. Liggett group, Top Tobacco and Japan Tobacco.

As Mr. Hering testified, CITMA and its allies were able to persuade the Missouri Legislature not to pass the proposed Allocable Share Amendment. As Mr. Hering stated, the interests there had managed to defeat it, although

I've been out to Missouri three times to testify. Mr. DeLange testified that the process in Idaho was similarly open, stating that the Allocable Share Amendment in Idaho was vigorously opposed by some NPMs who came to Idaho and disputed and argued their position.

Mr. DeLange stated that Grand River could have engaged in similar lobbying and testimonial activities had it wished to do so and that the public was made well aware of the proposed legislation, in part because Idaho publishes all of its proposed bills on the Internet.

Indeed, all the states have Web sites that provide information to tobacco manufacturers regarding the MSA and the state's related legislation, in order to provide as much information as possible to the manufacturers and anyone else interested in the state's tobacco regulations.

Along these same lines, Claimants pointed yesterday to e-mails between Phil Stanbeck

and the Oklahoma Attorney General's office and Alex Shachnus, counsel for the OPMs as purported evidence of collusion between the states and the participating manufacturers in the passage of the Allocable Share Amendments and the complementary legislation. Claimants mischaracterized these e-mails.

As has already been described the states needed --

09:20:03 PRESIDENT NARIMAN: What do you mean by mischaracterized?

MS. MORRIS: I'm about to explain.

As has already been described the states needed to have qualifying statutes in effect in order to claim the safe harbor from application of an NPM adjustment. Section 9(d)2(e) of the MSA says that the model statute in Exhibit T would be deemed a qualifying statute, quote, if enacted without modification or

09:20:35 addition, open paren, except for particularized state procedural or technical requirements, close paren, and not in conjunction with any other

legislative or regulatory proposal, end quote.

Since the Allocable Share Amendments were modifying the model statute, and the complementary legislation was in conjunction with the model statute, the states simply wished to assure themselves that the participating manufacturers would not later contend that the Allocable Share Amendments or the complementary legislation meant that the amended Escrow Statutes

09:21:16 were no longer qualifying statutes.

These communications do not suggest, however, that the participating manufacturers forced certain laws upon the state attorney's general. That the participating manufacturers somehow controlled the outcome of votes on these measures in the state legislature or that NPMs were unable to make their voices heard during the legislative process.

Michael Hering's e-mail, also referred

09:21:46 to by Claimants yesterday, was similarly mischaracterized. The asterisks in the copy of the e-mail produced by Claimant are not in the

original version of the e-mail, which we are happy to provide to the Tribunal, if you so wish.

MR. VIOLI: We would object vehemently to that because we've asked for that in New York litigation, we've asked for it in this case, and the response we received is that they could not find it. We object vehemently to the production and they've known about this since the jurisdictional hearing.

09:22:18 MR. KOVAR: Mr. President.

MR. VIOLI: Let me finish, please, Mr. Kovar.

We produced that in the exact form that you saw in the jurisdictional hearings three years ago and made a request when Mr. Klinefelter said, well, we'll see if we can find it. We don't know where it came from and we requested that three years ago.

For you now to produce it with those

09:22:37 asterisks replaced has violated everything I've ever seen in a court of law.

PRESIDENT NARIMAN: Okay. Okay. Go

on.

MR. KOVAR: Mr. President, we'll be happy to go back and look at the transcript of that, but we know this document was never requested in the document discovery requests but we'll go back and look back at the jurisdictional transcript and see what that was all about.

In any case, we have the original. If it turns out that it's something you want to see

09:23:08 and it's not a problem. Thank you.

PRESIDENT NARIMAN: Go on.

MS. MORRIS: The asterisks in the copy of the e-mail produced by Claimants are not in the original version of the e-mail which we are happy to produce to the Tribunal, if you so wish. Those asterisks are in place of the letters SC for South Carolina. The unredacted text thus stands for the unremarkable proposition that Michael Hering and his colleagues at NAAG believed that the Allocable

09:23:38 Share Amendments and the complementary legislation were important to protect South Carolina by preserving its escrow deposits, enacting and

enforcing a tobacco directory and the accompanying certification requirements, and so promoting the public health.

As such, it is apparent that the various state statutes at issue here were adopted through open, transparent, Democratic processes after testimony by various parties representing various interests, including those of the NPMs.

These statutes clearly stated their public health purposes and have, in fact, furthered those purposes since their enactment. Turning now to Claimants' second argument, they assert that the U.S. federal government has pointed to the failures of the MSA supposedly buttressing Claimants' allegation that the MSA regime was not intended to and did not serve the public health.

Mr. Violi stated in his opening argument that, quote, Respondent itself has many things to say about the MSA, none of which are good. All that the MSA is ineffective, doesn't really do its job, doesn't really accomplish its

goals or objectives, end quote.

However, a closer examination of the sources Claimants point to reveal that they do not support Claimants' assertions.

One of those sources is the racketeering and corruption case brought by the United States against Philip Morris and several other major tobacco companies. The United States sued because it believed that the tobacco manufacturers continued to engage in conduct that violated federal law after the signing of the Master Settlement Agreement with the states.

These violations of federal law were independent of and in addition to the claims the states had asserted against the companies for state law violations and had settled by entering into the MSA. The defendants in the federal case sought to use the MSA as a shield against perspective injunctive relief arguing that the MSA effectively barred them from engaging in any future misconduct of any kind.

The United States wanted to convey to

the Federal Court that the MSA did not bar every form of misbehavior that the tobacco companies had engaged in or may engage in in the future, and that the states may lack the resources to fully enforce the MSA's marketing restrictions.

As the U.S. District Court in Washington, D.C., pointed out in its decision, the MSA did not contain each and every provision in favor of the public health that one might wish for. For example, the MSA did not require the defendants to make corrective statements regarding health risks and nicotine addiction. Did not include economic incentives to avoid marketing to youth, otherwise known as a youth look back provision, and did not ban all brand name sponsorships.

The MSA did, however, raise the marginal cost of cigarettes, which as Professor Gruber explained is itself a public health benefit. The United States also recognized in its post trial brief that the truth campaign, a series of antismoking public service announcements aimed

at teens and funded through the MSA was responsible for approximately 22 percent of the overall decline in youth smoking rates between 2000 and 2002.

Indeed, the United States noted that youth smoking had decreased by 30 percent between 1997 and 2003. The United States also described several instances similar to those identified by Mr. Hering in his testimony in which the state attorneys general successfully enforced the advertising provisions of the MSA against various participating manufacturers.

Now, the MSA is not a perfect solution to the problem of smoking, and it is certainly true that the United States and, indeed, the individual states might prefer, for example, to see even more stringent restrictions on the advertising and sale of tobacco products. However, that does not mean that the MSA has not been effective or that it does not serve significant public health interests of the states.

And indeed, it is important to remember

that the Master Settlement Agreement was just that, a settlement between parties to litigation. As such, it necessarily involved compromises but as I will discuss those compromises were not one-sided.

The states received important concessions from the tobacco manufacturers that served to the public interest and the MSA successfully lowered smoking rates as the United 09:28:57 States recognized in its litigation submissions.

The result is similar when examining the June 2009 statute Claimants introduced in their opening argument. The Family Smoking Prevention and Tobacco Control Act.

I would note at the outset that Claimants are attempting to rely on a statute that was passed in 2009, and so post dates all of the briefing in this case which Claimants submitted to arbitration in 2004.

09:29:24 In any event, Claimants argued that this statute demonstrates that the United States did not believe that the MSA was effective, and as

a result the federal government needed to step in.

This is not the case. There are significant differences between the MSA and the June 2009 statute that undermine Claimants' self-serving argument. The findings of purpose in the federal statute state in part that federal and state governments have lacked the legal and regulatory authority and resources they need to address comprehensively the public health and 09:30:01 societal problems caused by the use of tobacco products.

The findings continue, children who tend to be more price sensitive than adults are influenced by advertising and promotion practices that result in drastically reduced cigarette prices.

PRESIDENT NARIMAN: Maybe you can stop there. This is one of the measures I was thinking of and put to you when Mr. Violi interrupted and 09:30:30 said look at the CDC report.

The June statute, federal statute says as one of its purposes that federal and state

governments have lacked legal and regulatory authority and resources they need to address comprehensively public health and societal problems caused by the use of tobacco products.

Now, my question to you is, is this not an admission that the federal government considered that the MSA did not have sufficient teeth, if I may so put it, to prevent what was sought to be prevented, namely excessive smoking?

09:31:21 MS. MORRIS: Well, as I'm about to explain, and I'm happy to get into this in more detail, the federal regulatory program established under the statute and the MSA did have some overlapping goals but they also had some --

PRESIDENT NARIMAN: I'm not asking about overlapping goals, sorry. My point is different. Of course, they overlap, definitely but it makes a finding of purposes, that is to say it reviews as it were the previous working of the 09:31:49 MSA, and said that this lacked legal and regulatory authority and resources to address comprehensively public health.

So, in effect, it was virtually not, could not do what it proposed to do, but presumably because it was a compromise between the majors and the states.

MS. MORRIS: If I can go through the next little bit, address that question specifically.

PRESIDENT NARIMAN: You can go through it but please bear that in mind. That's one of 09:32:24 the points, at least in my mind, is somewhat of an answer to Michael Hering's testimony which says that in large part because of the MSA, consumption has gone down, sales have gone down, et cetera, which is something that the attorney general's were very pleased with.

Attorney generals were very pleased with but the federal government was certainly not pleased with this. That's what this purpose says, and also about youth smoking, it also seems to 09:32:52 suggest that children are influenced by, still influenced, that is despite MSA provision for advertising and promotion practices that result in

drastically reduced cigarette prices.

So they feel that this is helplessness of the MSA to curb this excessive cigarette smoking.

MS. MORRIS: I attempt to rebut that very implication in my the next part of my presentation. So to the extent I have not been fully successful, I look forward to discussing that point more with you, if you wouldn't mind.

09:33:29 In light of these and other factors, Congress granted general regulatory authority to the federal Food and Drug Administration or FDA to oversee the tobacco manufacturing industry. The statute gives the FDA the power to set national standards controlling the manufacture of tobacco products and to regulate the level of tar, nicotine and other harmful components of tobacco products.

It also establishes an inspection

09:34:01 program and lays out requirements for tobacco warnings among many other provisions.

Finally, the statute sets out a

schedule of fees to be paid by the tobacco industry in order to cover the administrative costs of the FDA in carrying out its oversight obligations. Congress noted its concern that state governments alone have lacked the legal and regulatory authority and the resources they need to address comprehensively the public health and societal problems caused by the use of tobacco products.

09:34:36 Many of these regulatory powers are not available to the states as a result of constitutional restrictions on the regulation of speech and interstate commerce.

By creating a national regulatory regime the June 2009 statute can address certain aspects of the cigarette market in a more comprehensive way than the MSA regime, which at its core embodies a settlement agreement between certain states and tobacco manufacturers.

09:35:09 Nevertheless, the MSA is actually more stringent in certain respects than the June 2009 statute. Because the tobacco companies have

agreed to some key restrictions that could not be mandated through legislation or even won in litigation.

As Mr. Hering testified, the June 2009 statute and the MSA are not entirely identical and they can't be because the U.S. Supreme Court has held that certain practices that are now prohibited under the MSA are constitutionally protected under the first amendment to the United

09:35:53 States Constitution as business speech and, therefore, the FDA cannot, they cannot regulate business speech. They can not restrict it, although the companies can voluntarily submit themselves to such restriction.

Thus, while the June 2009 statute surely provides welcome additional regulation of the tobacco industry, it does not imply that the MSA is not effective or that it does not serve the public health. Rather, it simply indicates that

09:36:30 it is always possible to do more when it comes to the regulation of addictive, carcinogenic products like cigarettes.

ARBITRATOR CROOK: Ms. Morris? Can I ask you a question under the U.S. Constitutional scheme, could individual states regulate the tar and nicotine content of cigarettes that were transported in interstate commerce?

MS. MORRIS: I have to say my understanding of the dormant commerce clause is not comprehensive enough for me to answer that but I'm happy to discuss with our NAAG experts that

09:37:06 I'm sure have looked into that, and if I may get back to you, I would be happy to do so.

ARBITRATOR CROOK: I'm just struck that a large part of this legislation at least hit the papers most significantly was that it gave the FDA regulatory power over content of cigarettes. And I'm just curious whether that's something the states could have done on their own.

MS. MORRIS: I certainly suspect they could not because of the interference with

09:37:33 interstate commerce, but like I said, I would like to confirm with my colleagues and get back to you.

ARBITRATOR ANAYA: In fact, under the

Supreme Court option federal government by statute can authorize the states to regulate commerce, whereas it couldn't otherwise, when it couldn't otherwise because of the dormant commerce clause. So isn't it true that under this statute that congress could have authorized the states to do what the FDA wanted to do?

MS. MORRIS: I'll be happy to defer to you on that.

09:38:09 ARBITRATOR ANAYA: Let's assume that's the case and that congress could have authorized the states to regulate in this way, any insight on why it didn't go that route?

MS. MORRIS: I assume when you have the FDA, which is a national regulatory authority anyway, that it makes sense to regulate -- because cigarettes are usually sold nationally, it makes sense to regulate them at a national level rather than to do it by state. That would be my

09:38:38 assumption.

ARBITRATOR ANAYA: Thanks.

MS. MORRIS: Equally meritless is

Claimants' assertion that the proposed 1997 federal tobacco settlement, which did not take effect due to congress's failure to adopt implementing legislation contained, quote, more concessions from OPMs than the MSA.

First and foremost, even assuming that the proposed federal settlement agreement did include more concessions from OPMs that fact has no bearing on whether or not the MSA serves the

09:39:15 public interest.

Nevertheless, an examination of some of the central provisions of both documents readily belies Claimants' attacks. A critical component of the federal settlement agreement, for example, was a broad antitrust exemption, which would have prevented the participating manufacturers to jointly confer, coordinate or act in concert in order to achieve the goals of the agreement.

The Federal Trade Commission made clear

09:39:46 its concerns regarding the exemption, warning that Antitrust immunity that is unnecessary, imprecise or excessively broad can enable firms to engage in

collusive arrangements that can harm consumers.

There is no similar Antitrust exemption in the MSA. In addition, the proposed federal settlement would not only have settled all current and future claims by state Attorneys General, it would also have eliminated punitive damages for past actions by the tobacco industry, barred all private class actions against the tobacco industry and capped the total amount of damages for which

09:40:31 the tobacco industry would be liable in any given year as a result of losses and suits brought by individuals.

The MSA, on the other hand, settled only the lawsuits brought by the states themselves, providing a much narrower release of liability than that offered by the proposed federal settlement agreement.

As Professor Gruber testified, his judgment, based on his experience as a government

09:41:02 official responsible for evaluating the 1997 proposed federal settlement was that, in general, the 1997 proposal was not nearly as punitive on

the OPMs, not nearly as good for the public health as was the MSA.

He went on to note that the proposed federal settlement agreement required the participating manufacturers to pay more than the MSA did, but, quote, the extra amount it had them pay was not nearly enough to compensate for the huge legal risks they were getting out from under by having all these private lawsuits settled, end

09:41:44 quote.

In this respect, although Mr. Violi contrasts the $207 billion, the participating manufacturers agreed to pay under the MSA with the $356 billion face value of the proposed federal settlement, the Federal Trade Commission stated in its report on competition and the financial impact of the proposed tobacco industry settlement that, quote, after taking into account the anticipated decrease in the volume of cigarettes sold

09:42:17 resulting from the likely increase in cigarette prices and a general decline in smoking in the U.S. the public sector could realize revenues from

taxes and the settling payments of about $207 billion, thus it is unclear whether the proposed federal settlement actually would have resulted in higher payments than those required by the MSA.

Until light of the fact that the proposed federal settlement some offered significant advantages for manufacturers then, one can understand why the tobacco industry might have preferred the federal settlement to the subsequent MSA, and correspondingly, why that proposal was rejected by congress.

I should note in this respect that Claimants have pointed to no evidence indicating provisions regarding native American tribes or territories motivated congress's decision to reject the proposed federal settlement agreement.

Claimants also referred in their opening slides to testimony by Professor Gruber in the Philip Morris case and a report for the U.S. Department of Agriculture for the proposition that the MSA has not been successful in various ways.

However, Professor Gruber himself

rejected Claimants' characterization of his statements in his rebuttal report stating in paragraph 126 of their reply, the Claimant states that I quote, admitted that the MSA was ineffective at controlling youth tobacco consumption, end quote.

I am aware of no such statement that I have made in past proceedings or written work. What I have said is that the MSA's impact on youth smoking could be strengthened by additional provisions such as a youth look back penalty that penalized tobacco manufacturers for a failure to lower youth smoking. But saying that the MSA could have done more to lower youth smoking does not in any way imply that the MSA was ineffective in doing so.

Indeed, the very sharp decline in youth smoking right around the enactment of the MSA shows how effective it was in lowering youth smoking. With respect to the U.S. Department of Agriculture report, although the report suggests cigarette consumption might have declined less

than expected, Claimants admit that median tobacco use by state has declined by at least 16 percent between 1997 and 2006.

Furthermore, the report notes that in addition to payments to the states, the MSA included provisions for $1.5 billion over ten years to support antismoking measures and $250 million dollars to support research in reducing youth smoking.

Again, to suggest the MSA could have done more is not to say it is not effective or that it does not serve the public health. In sum, although Claimants have pointed to several documents to suggest that the federal government of the United States believes that the MSA was not motivating by public health concerns or has no value from a public health perspective, an actual examination of those documents makes clear that federal agencies and the congress recognize that the MSA indeed has value and serves the public health interests of the settling states.

With respect to Claimants' third point,

they assert if the allocable share release mechanism was a loophole, then so must be the grandfather share. As Mr. Violi argued in his opening statement, quote, if a $400 million exemption, a 13 billion stick exemption does not constitute a loophole, then it cannot be seriously argued that Claimants were operating under a loophole under the original measures at issue.

If it was truly a matter of youth smoking and health initiatives, there would be no exemptions, end quote. Mr. Weiler even went so far as to state, quote, we doubt the veracity of the statement that it was a loophole and we think their feigning surprise, end quote.

Claimants also argued it was discriminatory for the settling states to limit the offer of a grandfather share to those tobacco manufacturers that joined the MSA within 90 days of its signing. None of these allegations, however, would stand scrutiny.

As an initial matter, Claimants conveniently overlooked the fact that this

Tribunal had already determined that the original allocable share release mechanism was a loophole. In the decision on objections to jurisdiction this Tribunal stated, the states came to regard these provisions which authorized substantial rebates of escrowed funds with NPMs with sales concentrated in a few states as a loophole and the evidence indicated that 38 states had adopted amendments to plug the loophole by September 2004.

09:47:34 Mr. DeLange provided first-hand confirmation of that fact in his testimony. He noted that given Idaho's allocable share of 0.63 percent, it would be possible for an NPM that concentrated its sales in Idaho to receive a release of over 99 percent of its escrow deposits in any given year.

He explained, so you're talking change left in the escrow account after the allocable share release worked. That's not what we

09:48:09 intended. That's not what we imagined, and quite frankly, as much as anyone, I'm the one who took the blame. I'm the one who didn't realize the

effects when I was advising my Attorney General of the original legislation that that's what could happen.

He continued, so, after we saw the allocable share release in effect working, we said that isn't what we think the legislature intended. We need to go back and explain that to the legislature and explain, here's the net effect of what's happening and we don't think this is what

09:48:42 you intended. And we proposed the Allocable Share Amendment.

Mr. DeLange and his colleagues were correct that the legislature had not anticipated the use to which some NPMs would put the allocable share release mechanism. As indicated in the statement of purpose attached to Idaho's Allocable Share Amendment. This proposed legislation is designed to eliminate an unintended consequence of language found in Idaho's Tobacco Master

09:49:15 Settlement Agreement Act.

Some tobacco product manufacturers, not parties to the Master Settlement Agreement have

begun utilizing present language in Idaho's escrow deposit statute to obtain an early release of the great majority of their escrow deposits. This frustrates the purposes for which the act was passed.

And indeed, the unintended nature of the allocable share release mechanism is manifest in the facts, to borrow Mr. Weiler's phrase. As Mr. Hering testified, I do not think that the OPMs

09:49:49 had it in mind that they would force a defective statute upon the states and then later exploit it through price advantages, and then somehow convince or force the states to pass a fix to it. I find that hard to believe.

Furthermore, Claimants allege that the allocable share release mechanism was intended to encourage NPMs to remain regional brands, as though the states would have some policy reason to foster the development of regional tobacco brands

09:50:20 would drastically reduce escrow deposit obligations.

If Claimants are right, then certain

states with small allocable shares were inviting Claimants and other NPMs like them to concentrate their sales in those states. Knowing that the harm to public health from those cigarettes would be concentrated in their states, but that the accompanying escrow deposits would be greatly reduced.

There is simply no scenario under which this would have been a rational policy and

09:50:56 Claimants point to none. Clearly, the allocable share release mechanism was a loophole. As Mr. Hering explained, the great irony is that if you exploit the allocable share release to the maximum and sell your cigarettes in just one state, the harm that the cigarettes that cause the disease, the cancer, the death, all the harm is concentrated in that one state.

However, in that instance, the state has the least amount in escrow essentially as a

09:51:28 bond to protect it whereas if that harm is spread out, potentially there is no release.

Indeed, Claimants themselves admit they

were able to use the allocable share release mechanism to great effect lowering their escrow deposits from approximately five dollars per carton to 50 cents per carton or less.

I would note that even using the blended or average marginal cost of grandfathered SPMs as a point of comparison, which as we had discuss and I will discuss further, we do not believe is appropriate from an economic standpoint. An escrow deposit obligation of 50 cents per carton would result in an MSA related marginal cost for Grand River that is somewhere between a quarter and a third of the blended average MSA related marginal cost of the grandfathered SPMs.

Furthermore, Grand River's off-Reservation sales are not limited as is the grandfather share by historical market shares. And, indeed, the more cigarettes Grand River was able to sell off-Reservation in a few states, the larger its releases of escrow deposits and the lower its MSA related marginal costs.

Importantly, the fact Claimant sold their cigarettes off-Reservation in only a few states does not mean that they sold only a few cigarettes. Indeed, in 2005, Grand River alone sold over one billion cigarettes just in the state of South Carolina.

There is no reason to believe that South Carolina encouraged those sales especially in light of the large escrow releases that followed simply because Grand River's so-called regional status meant that it was not selling equivalent numbers of cigarettes in the other 49 states.

The grandfather share offered to manufacturers that signed the MSA within 90 days of its execution however, differs in fundamental ways from the allocable share release mechanism. Had a significant and rational purpose and was not a loophole.

The MSA states had a strong interest in including as many tobacco manufacturers as possible within the MSA. In order to maximize

application of the MSA limitations on tobacco manufacturer conduct. However, as I have mentioned, the MSA is an agreement and contains some voluntary restrictions on speech and conduct that could not have been imposed directly by legislation or even won in litigation.

Thus, the grandfather shares were offered to small market players which represented approximately two percent of the cigarette market at the time as an incentive for them to join the MSA immediately. As hoped, the grandfathered share successfully persuaded 15 tobacco manufacturers to sign the MSA within 90 days of its execution.

As a result, these additional 15 companies which combined with the original participating manufacturers represented over 99 percent of the tobacco manufacturing market at the time voluntarily waived advertising and lobbying rights that they otherwise would have retained as NPMs.

Claimants agree that the offer of a

grandfather share served its purpose by successfully persuading many SPMs to sign the MSA within 90 days of its execution. As stated in their particularized statement of claim, quote, inducing manufacturers and competitors that had never been accused of nor sued for any wrongdoing to enter into a settlement agreement required an incentive. That incentive came in the form of a payment exemption or grandfather share. As such the grandfather share functioned exactly as intended hardly the definition of a loophole.

And although as Professor Gruber testified, if you can say, take the MSA as it was exactly, changing nothing and get rid of the exemption, then I think that would have been a good thing to do. Importantly, he continued.

My understanding is the reason they got this exemption was to buy the cigarette manufacturer's agreement with the deal. And the issue is, without the exemption, would the deal have even come together. So, in some sense when you talk about do we wish the exemption weren't

there, well, if the exemption not being there would have meant would we have had the MSA at all, then the exemption in my mind was a small price to pay to get the MSA to come together.

Furthermore, unlike the allocable share release mechanism, the grandfather share in operation did not create unintended consequences that undermined the purposes of the MSA regime. As Mr. Feldman has explained, MSA exploitation of the allocable share loophole occurred on a massive scale. Indeed, Mr. Hering has testified that MSA states were forced to release nearly 60 percent of the escrow deposits they received for NPM sales in 2003.

Such exploitation of the allocable share loophole by NPMs had several damaging consequences. First, MSA states were denied access to escrow deposits that would ensure payment of any future judgments against or settlements with NPMs to compensate states for the health cost arising from the use of NPMs tobacco products in their states. Second, NPMs were able

to maintain lower prices which did not reflect the full cost of states of their products and which gave them a significant competitive advantage vis-a-vis participating manufacturers.

The ensuing loss of participating manufacturer market share resulted in a reduction in payments by participating manufacturers to the MSA states while the loophole meant that there was no adequate corresponding increase in NPM deposits. And third, lower prices for NPMs cigarettes, increased demand among price sensitive consumers to the detriment of public health.

PRESIDENT NARIMAN: What do you say to this, that there were a large number of majors who had, it is said, deliberately inflated their prices much higher and thereby their market share went down, which the Claimants and various others in the same category stepped in and took advantage of. What do you say to that?

MS. MORRIS: I would say although that might be one reason --

PRESIDENT NARIMAN: Is that one reason?

MS. MORRIS: That's one reason, but another reason is the ultra competitive advantage they had as a result of their artificially decreased marginal costs.

PRESIDENT NARIMAN: Is it possible to assess that whether it was only because, I mean can you compute these, the percentage in which these reasons operated? It's very difficult perhaps, that for what reason did they come forward and grab, as it were, the share which, the reduced share of OPMs which got reduced only because the prices were increased many fold.

MS. MORRIS: I believe that Professor Gruber addressed the point --

PRESIDENT NARIMAN: No, forget that. I want you to address it, please.

MS. MORRIS: I would have to defer to Professor Gruber and say that--

PRESIDENT NARIMAN: Forget Professor Gruber. I want to know is there anything in the record that you can point to that will help us to determine that the sole reason was as you allege

and -- or there were two reasons and you cannot say which of them operated, is that your case?

MS. MORRIS: Well, we certainly believe that there was more than one reason. But --

PRESIDENT NARIMAN: And this was perhaps the reason?

MS. MORRIS: This was, indeed, a reason and as far as evidence in the record, I would point to Professor Gruber's testimony that approximately two percent of the market growth was due to NPMs and the Allocable Share Amendments, and so the Allocable Share Amendments were intended to address that extra increase.

PRESIDENT NARIMAN: Okay.

MS. MORRIS: The grandfather share, on the other hand, encouraged participation in the MSA and thereby resulted in expanded coverage of its healthcare provisions. Claimants argue, however, that an additional undesirable consequence of the grandfather share was a pricing advantage for the grandfathered SPMs over NPMs, to the detriment of both NPMs and the public health.

As Professor Gruber has explained and as the U.S. District Court for the Southern District of New York agreed after hearing the arguments and examining the evidence on both sides, the grandfather share does not lower marginal cost, which is the basis for pricing and, therefore, does not provide the grandfathered SPMs with a competitive advantage. So while it is true certain grandfathered SPMs may choose to price
10:00:55 below market cost in some circumstances, such a strategy would not be profit maximizing and could not be maintained.

Furthermore, such a short-term pricing strategy is available not only to grandfathered SPMs but also to Grand River or, indeed, any company. The allocable share release mechanism on the other hand did lower the NPMs marginal cost, and accordingly also lowered the price of their cigarettes.

10:01:21 As Professor Gruber testified, the public health issue is not about the wealth of the tobacco companies. The public health issue is

about the price of cigarettes.

Additionally, although Claimants hold up the fact that the grandfather share gave those manufacturers a permanent exemption from MSA payments on sales up to their grandfather market share, they ignore the benefit to the states under this agreement, namely, that SPMs would be subject to ask extensive restrictions on conduct that do not apply to NPMs like Grand River.

10:01:58 PRESIDENT NARIMAN: Excuse me. Was it possible, I just want to know, for the states to have devised a methodology instead of amending the Allocable Share Amendment, allocable share provision, to in some manner devise a scheme for controlling prices that you shall not charge below such and such or above such and such. Was it not possible for the states to do it? Was it legally possible? Feldman, you can answer it, I have no objection, you can answer that also. If you can.
10:02:34 Because I want an answer to it. I don't mind whether she answers it or you answer it.

MS. MORRIS: My understanding is that

antitrust challenges have been brought even against the MSA alleging that it results in price controls. So my understanding is that it would be very questionable, if not illegal, under U.S. law for the state to set prices of cigarettes.

MR. VIOLI: Mr. Chairman, it's a question. May I answer that question. I've been practicing Antitrust since I got out of law school. States can do that, but they have to
10:03:05 monitor the pricing. If the state wants to put a price control on products, agricultural products, whatever, in its state, it can do so pursuant to public health initiatives, public welfare benefit.

The law provides, however, the state must monitor the prices to make sure they are tailored to the interest of the state and meet the -- it's called a clear articulation and a close supervision test.

PRESIDENT NARIMAN: Thank you. Sorry.

10:03:32 MR. FELDMAN: Mr. President, I would just emphasize that in terms of the obligations under NAFTA Chapter 11, these obligations, the

purpose of them is not to analyze whether or not a state has adopted the optimal policy in a given situation. The question is whether the policy that has been adopted, in fact, violates international law.

PRESIDENT NARIMAN: No, but if there is an another alternative, possible alternative and that's one factor to be taken into consideration.

MR. FELDMAN: Thank you. We would just
10:04:08 emphasize--

PRESIDENT NARIMAN: Just remember that.

MR. FELDMAN: Yes, thank you.

PRESIDENT NARIMAN: Sorry. I interrupted you.

MS. MORRIS: For example, restrictions on all participating manufacturers under the MSA, including grandfathered SPMs, include the obligation to refrain from targeting youth in the advertising and marketing of tobacco products, to
10:04:32 refrain from using cartoon characters to promote cigarette sales, to limit tobacco brand name sponsorship of athletic, musical and other events.

To refrain from distributing, offering or selling any apparel or other merchandise bearing a brand name. To refrain from using billboards or other advertising. To refrain from lobbying congress to diminish the states's rights under the MSA or to use MSA payments for programs other than those related to tobacco or health. To refrain from suppressing research related to smoking and health, and to refrain from representing the dangers of using tobacco products.

Arthur Montour has made clear in his written and oral testimony that freedom to publicize the Seneca brand throughout the United States has been a key to Claimants' success in the market. Mr. Montour confirms NWS has distributed hundreds of thousands of articles of merchandise from clothing to smoking equipment to bandannas to decals. NWS has erected billboards and placed newspaper advertisements. It has run contests to win free merchandise such as chopper motorcycles and cars. These are all activities that grandfathered SPMs are prohibited from engaging in

under the MSA.

With respect to the ban on brand named merchandise, Mr. Violi has asserted that, quote, the MSA only stops these promotions in non adult only facilities, end quote. But that Claimants' merchandise is not aimed at children.

Mr. Violi is mistaken. The terms of the MSA are quite clear that such brand name merchandise is only permitted to be worn or used while inside an adult only facility and may not be distributed to any member of the general public. Thus, even if Claimants argue that their T-shirts, for example, are not sized for children that does not change the fact that they are selling brand name merchandise to the general public, which would be prohibited under the MSA.

Furthermore, yesterday Mr. Violi misrepresented various conduct restrictions in the MSA implying that the exceptions had somehow swallowed the rule and undermined the purpose behind those provisions.

Mr. Violi highlighted the fact the MSA

only limits but does not prohibit brand name sponsorships. That is true but what he failed to mention is that participating manufacturers no longer engage in these sponsorships making these provisions to a certain extent, moot. More importantly roadside billboards and T-shirts, for example, like the one worn by Mr. Montour during his testimony, are most certainly prohibited under the MSA.

Although Mr. Violi stated that the banned on merchandise and apparel doesn't apply to items the sole function of which is to advertise tobacco products or written or electronic publications, Section 3-F of the MSA actually forbids any apparel or merchandise other than tobacco products, items, the sole function of which is to advertise tobacco products or written or electronic publications which bears a brand name. This is an essential distinction. Merchandise and apparel bearing tobacco brand names may not be sold or otherwise distributed under the MSA.

Tobacco products such as the cigarettes themselves may bear tobacco brand names but that is a very different matter. Matchbooks like those distributed by NWS are banned by the MSA because they do not serve the sole function of advertising Claimants' brand.

So although it is true that any gift may be given in consideration for a purchase of cigarette provided proof of age is required, that gift could not consist of any of these forbidden forms of advertising or merchandising making it hard to discern the value such a program might hold for the tobacco manufacturers.

As Mr. Hering testified, then after the 90-day window closed, 99.6 percent of the U.S. market was a participating manufacturer in the MSA. That means they were subject to the multiple public health restrictions that you've heard about. That is no more T-shirts with Marlboro on them, no more belt buckles, leather jackets, billboards, hats, no more Joe Camel, no more other cartoon advertising, no more marketing to youth in

youth magazines. All those public health restrictions came into play and they apply to 99.6 percent of the U.S. market.

In contrast to the allocable share release mechanism which only benefitted the NPMs, the grandfather share was part of a deal that benefitted both the participating manufacturers and the settling states and cannot be considered a loophole. Nor should the offer of grandfather shares only to those manufacturers that adhere to the MSA within 90 days be considered discriminatory.

10:09:48

10:10:14

As confirmed by both Professor Gruber and Mr. Hering, there was a reasonable public health rationale for the time limited nature for the offer of grandfather share. In his rebuttal expert report, Professor Gruber explained subsequent manufacturers had the right to join the MSA upon the inception of the company and pay no premium.

However, as Claimants note manufacturers who chose instead to operate outside

of the MSA then faced a back payment obligation if they later wanted to join the MSA. This is a sensible public policy which ensures that manufacturers face the right pricing incentives--

PRESIDENT NARIMAN: The back payment obligation have a time limit according to you or is it a matter of discretion of each state as to when to enforce it and within what installments?

MS. MORRIS: My understanding is that

10:10:50

the back payment obligation does apply to any participating manufacturer that joins -- that signs the MSA after it has begun selling cigarettes.

PRESIDENT NARIMAN: No NPM.

MS. MORRIS: Yes. So an NPM that chooses to sign the MSA will have to make back payments.

PRESIDENT NARIMAN: I'm asking you about the time schedule.

10:11:09

MS. MORRIS: Yes. Under Section 2JJ of the MSA there is to be a reasonable time period under the circumstances. So that would be a

matter of negotiation between the states and the NPM.

PRESIDENT NARIMAN: So that's a matter of negotiation.

MS. MORRIS: Yes, sir.

PRESIDENT NARIMAN: Between the relevant state and the NPM and the concerned applicant NPM.

MS. MORRIS: It would be the settling

10:11:31

states, so all of the MSA states and the NPM who wishes to become a participating manufacturer, yes.

PRESIDENT NARIMAN: So they could give them five years to pay back or two years to pay back.

MS. MORRIS: Yes, and I believe with General Tobacco it was 12 years even, depending on the circumstances the parties could come to an agreement.

10:11:50

PRESIDENT NARIMAN: But see the point is, did you offer, did any of the states, is it on record that they offered them -- all right, you

want to join, okay, but your back payment should be spread over ten years and if they have said then no, they would have been unreasonable in my view, but that was not forthcoming in that May letter of NAAG. Assuming that NAAG had the authority of the states to write that letter.

MS. MORRIS: I am going to be discussing Claimants' MSA application in further detail. My understanding is that the states would

10:12:27

have been happy to engage in those negotiations with the Claimants, but that the process didn't reach that point because of other more fundamental problems with Claimants' MSA application.

PRESIDENT NARIMAN: What were the other problems? I mean they could have -- I just want to know, because please remember, that we are talking in the background of an existing NAFTA proceeding that's already started.

MS. MORRIS: I understand.

10:12:53

PRESIDENT NARIMAN: In that sense, the parties were -- I agree, but an offer was made by them in a particular letter which is on record,

the letter, to which the response was made no, no, that we can't even send it to the states, the states even cannot consider it but let's assume that after due consideration the states had through the NAAG written that letter of May 16th or May whatever it was, back to Violi. Now could they not have said that, are you prepared to pay, make all back payments, we accept you as a participating manufacturer. You must make these back payments within a reasonable time and we think that the reasonable time is say five years to which they may have responded and say give us ten years, they may have said no. And then, of course, the states could have said, no, we think five years in your circumstances are enough and that might have been a reasonable way to look at it.

We don't find that sort of negotiation between the applicant, non participating manufacturer. We only have two letters. One a letter of April before the 15th of April and another response of May. And that's about all and

there the matter ends.

MS. MORRIS: If I can beg your indulgence --

PRESIDENT NARIMAN: You see my point is that you must realize that that goes to the question of treatment which they are alleging whether that falls under 1102 or 1105 or is a matter which we will determine later, but I'm just asking you.

MR. KOVAR: Mr. President, if I may just foreshadow where Ms. Morris is going.

PRESIDENT NARIMAN: Please.

MR. KOVAR: The problem here is the negotiations never even got close to that stage because the Claimants weren't really interested --

PRESIDENT NARIMAN: No, no, no, but you refused to negotiate -- not you, NAAG refused to negotiate.

MR. KOVAR: That's not true.

PRESIDENT NARIMAN: That's the letter, the letter says, no, we closed it.

MR. KOVAR: They had already been

discussing it for several months and that, in effect --

PRESIDENT NARIMAN: Is it your case, is it your case that they had refused to make payments even at reasonable times, back payments within reasonable times, is it your case? I don't find that in the letter that back payments should be made within such and such number of years.

MR. KOVAR: I will let Ms. Morris address what's on the record, but I would like to recall for you that the U.S. District Court Judge Keenan said it smacked of pretext, that it was not a serious offer on their part, that that letter was a litigation tactic. It was not a serious offer by the Claimants. And Ms. Morris can go into more detail.

PRESIDENT NARIMAN: That's not how it was treated by NAAG. It was treated as on merits and they answered it on merits, in the May response, the April letter to which the May response.

MR. KOVAR: In any case, let Ms. Morris

go into more detail.

PRESIDENT NARIMAN: I'm indicating my point, so that you can deal with them. I have this problem.

ARBITRATOR CROOK: All right, could -- at some point, maybe Ms. Morris is going to do this. You'll address paragraph 59 of Mr. Jerry Montour's declaration where he sets out the terms under which he instructed his counsel to seek to join the MSA.

MS. MORRIS: Yes.

ARBITRATOR CROOK: Will you be addressing that?

MS. MORRIS: I certainly will.

ARBITRATOR CROOK: Thank you very much.

MS. MORRIS: My pleasure.

So this is a sensible public policy which ensures that manufacturers face the right pricing incentives inside and outside the MSA. Indeed, this is similar to other public policies which prevent those who do not enroll at the appropriate time from thereby reaping unwarranted

benefits.

Mr. Hering expanded on his policy rationale last week, testifying that this is an argument that has been made from time to time by a number of NPMs who have not been pleased with the grandfather share. The deal that the NPMs are looking for from our perspective is the ability to build up your market share through sales in the previously settled states where no escrow is due, staying out of the MSA and through, as I have said earlier, exploitation of the allocable share loophole.

Then at the time they determine that it's an advantage to become a participating manufacturer to demand that they receive an exemption for the year prior to when they join, rather than 1997 or 1998. And in most instances, like with Grand River, these are companies that had no market share in 1997 or 1998.

10:17:45 In sum, then, the allocable share release mechanism was a loophole that undermined the public health purposes at the core of the MSA

regime where the grandfather share furthered those purposes in a non discriminatory manner.

Furthermore, making a grandfather share available for a limited period of time in order to encourage as many tobacco manufacturers as possible to settle with the state by signing the MSA and thus, be subject to the MSA limitations or conduct plainly served the public health goals of the MSA and was a reasonable policy decision

10:18:22 deserving of deference by this Tribunal on the part of the states.

Turning finally to Grand River's attempt to join the MSA. Claimants assert that the best treatment here would be the opportunity to join the MSA with grandfathering. As is clear by an examination of the facts, however, this claim is no more credible than when Grand River filed a short lived application to join the MSA in 2006.

10:18:49 Indeed, given the back payments that Grand River would need to make, both for the many years it has sold Seneca cigarettes without full

payment of escrow and for the cigarettes intended for sale in the United States that are manufactured for third parties, it would be even more costly for Grand River to sign the MSA now than it would have been in 2002, which Claimants' counsel has already acknowledged would have been uneconomical.

As I will discuss Grand River's application to the MSA and its statements in this

10:19:20 proceeding make clear that what Claimants are, in fact, seeking is treatment unlike and much more favorable than the treatment offered to any other tobacco manufacturer under the MSA regime.

Grand River's application to sign the MSA, which it filed --

PRESIDENT NARIMAN: Excuse me for interrupting, Mr. Kovar, where is Judge Keenan's decision where he says this was a pretext.

MS. MORRIS: I have the citation for

10:19:47 you.

PRESIDENT NARIMAN: Would you give me the citation later, so I can note it.

MS. MORRIS: Certainly. It is Grand River versus Pryor.

PRESIDENT NARIMAN: That's the Prior case.

MS. MORRIS: Yes, but there are various decisions in that case and this one has the citation 2006 WL 1517603 and the relevant section is around page star seven.

PRESIDENT NARIMAN: What?

10:20:19 MS. MORRIS: Star seven.

PRESIDENT NARIMAN: What is star seven?

MS. MORRIS: Westlaw, page seven.

MR. VIOLI: Do you have the citation where that was reversed and affirmed in part by the Second Circuit? Do you have that for the Tribunal?

MR. KOVAR: That specific ruling was not reversed.

MR. VIOLI: It went up on appeal.

10:20:44 MR. KOVAR: The case has gone through many stages and we can give you the full --

PRESIDENT NARIMAN: I wanted to know

that it's relevant, that's why I'm saying where does Judge Keenan say it was a pretext. Now is this reported in the authorized series --

MS. MORRIS: No, it's only available on Westlaw. It's a very short decision.

PRESIDENT NARIMAN: It's not available in our papers?

MS. MORRIS: Yes. I don't have the precise tab number now but I can get back to you.

10:21:11 MR. FELDMAN: It's in our brief, as well.

MR. KOVAR: You'll also find, Mr. Chairman, that the decision was not reversed. It was, in fact, affirmed.

MR. VIOLI: It was reversed on the finding that good will was an asset for their protection.

MR. KOVAR: It was affirmed on other grounds, but you'll see that for yourself.

10:21:30 PRESIDENT NARIMAN: Okay.

MS. MORRIS: It's in the record in our counter Memorial, volume eight, tab 118.

PRESIDENT NARIMAN: Volume eight.

MS. MORRIS: Tab 118.

PRESIDENT NARIMAN: Thank up very much.

MS. MORRIS: My pleasure measure.

Grand River's application to sign the MSA which it filed on April 3rd, 2006, readily reveals its lack of interest in actually signing the agreement. Indeed, Judge Keenan of the Southern District of New York, stated in the

10:22:02 course of the Grand River V Prior case, that Grand River's stance with respect to its MSA application, quote, smacked of pretext, end quote.

This is not only because Grand River gave the settling states a mere ten days to consider its application before requesting a judicial order requiring the states to permit Grand River to sign the MSA, a process that Mr. DeLange explained could take months.

It is also because Grand River sought

10:22:30 in its application and seeked here concessions that would fundamentally alter the compromise represented by the MSA in a way solely in Grand

River's own favor.

For example, Grand River requested that it not have to make MSA back payments on sales of certain brands for which it would otherwise be responsible.

MR. VIOLI: May I just clarify for the record. You're not now speaking about what Judge Keenan said, right?

MS. MORRIS: No, I'm not.

10:23:00 MR. VIOLI: Just to make that clear.

MS. MORRIS: Sorry if I was unclear on that.

PRESIDENT NARIMAN: No, that's clear.

MS. MORRIS: And Grand River indicated that it intended to remain in default on its prior escrow obligations in numerous states. Claimants also suggest that Grand River would seek a grandfather share based on its market share in the two years prior to joining the MSA, rather than

10:23:23 1997 and 1998, in which it had no market share.

Despite the very nature of the MSA as a settlement, Grand River also makes the stunning

request that its application to join the MSA be without prejudice to its continuing to pursue litigation in various fora challenging the legality of the MSA regime.

Claimant seemed to present the request as entirely ordinary but in doing so, they apparently overlooked the oddity of seeking to enter into a settlement of claims while nevertheless pursuing legal claims related to that

10:24:04 settlement.

PRESIDENT NARIMAN: Yeah, that's a good point.

MS. MORRIS: Thank you. Grand River's position is antithetical to the very nature of the MSA and is prohibited by one of the MSA's provisions. Furthermore, in his second witness statement, Jerry Montour explains that he insisted that, quote, our right to serve on-reserve markets without application of the MSA regime be fully

10:24:28 respected by every MSA state, end quote.

The implication of that statement is that Grand River would have refused to make MSA

payments on cigarettes that were ultimately sold on reservation. Such a position, however, contradicts the manner in which all MSA payments are calculated. Obviously, a fundamental aspect of the agreement.

Indeed, all participating manufacturers make MSA payments with respect to their cigarettes that are sold on-Reservations. It also happens in this case that the result would be the exclusion
10:25:08 of a substantial majority of Claimants' sales from any payment obligation. Mr. Montour also insisted that, quote, eventually the grandfathered SPMs lose their exclusive exemptions, end quote.

It is unclear whether Mr. Montour maintains this condition in light of Claimants' demand here for Grand River's own grandfather share, but it was in any case a condition that Mr. Montour was in no position to impose. Given that he sought voluntarily to sign a settlement
10:25:42 agreement with certain basic fixed terms such as the grandfather share.

Equally fundamentally, Claimants have

asserted at this hearing that Grand River would not concede to the advertising and marketing restrictions that form the core of the public health provisions of the MSA. Claimants' counsel seems to suggest that these advertising provisions would not actually affect any of Claimants' promotional activities, stating, quote, the types of health considerations that -- the things that one would have to give up here were really the
10:26:17 kind of things that a company like Grand River wasn't doing.

It would not be hard to give up. End quote.

Contrary to Claimants' assertions, however, and as i have already described, it is not just advertising on NASCAR or advertising on television that is prohibited under the MSA. Rather, as Mr. Hering testified, virtually all forms of merchandising are prohibited as is the
10:26:43 use of billboards and many forms of print advertising. As such, much of the advertising that NWS currently engages in as described by

Mr. Arthur Montour in his testimony would be prohibited under the MSA.

For example, Claimants could no longer sell hundreds of thousands of shirts with the Seneca logo on them. Claimants could no longer sell or give away decals with the Seneca logo on them. Motorcycles emblazoned with the Seneca brand name would also be prohibited. So will would Claimants' billboards and hundreds of
10:27:19 thousands of matchbooks they have distributed.

In short, almost all of NWS would be prohibited under the MSA. So requesting an exemption from those requirements contrary to Claimants' counsel representation would be no small matter. Taking Claimants' negotiating position with respect to the MSA as a whole, it becomes apparent that Grand River made no bona fide attempt to join the MSA. What they are really seeking is what they claim under their
10:27:49 alternative damages theory, namely, a so-called partial payment exemption from their obligations under the Allocable Share Amendments.

As Mr. Hering testified, what they wished to do is to remain an NPM and to argue that the allocable share release is akin to the grandfathered share.

That is, they don't want to make payments, they don't want to submit to the public health provisions of the MSA and yet they want to be able to get a release of nearly all of their escrow under the allocable share provision arguing
10:28:21 that it is essentially the same deal that the SPMs got.

As I hope my presentation has made clear, however, these deals are not essentially the same. In fact, they are not even close. Claimants are seeking to perpetuate the benefits of the original allocable share release mechanism which this Tribunal and many state legislatures have already determined to be a loophole. While remaining outside the public health restrictions
10:28:49 of the MSA. Such a position is in no way comparable to that of any other tobacco manufacturer and would put Claimants in a far

better position. It is hardly discriminatory of the states not to agree to such terms.

For the reasons I have discussed, both the Allocable Share Amendments and the complementary legislation which are challenged measures in this arbitration and the MSA, which is not, serve important public health interests and do so in a non discriminatory manner.

The character of the MSA regime thus 10:29:21 utterly undermines claimant's expropriation claim under Article 1110. And to summarize our larger presentation on Article 1110, international Tribunals consider three factors in determining whether an expropriation has occurred.

The economic impact of the measure, the investor's reasonable investment backed expectations and the character of the measure at issue. Claimants' expropriation claim fails on all three counts. The economic impact on 10:29:49 Claimants' overall investment is insufficient to support a conclusion that their investment has been taken from them.

Claimants had no legitimate expectation that their on-Reservation sales would be exempt from state regulation or the allocable share release mechanism would not be amended and the challenged measure is a non discriminatory regulation intended to promote the general welfare.

For all these reasons then, Claimants' expropriation claim under Article 1110 should be 10:30:17 rejected. Thank you.

MR. VIOLI: Mr. President, I need to make a statement and perhaps a request. It's very important. We heard a number of things --

PRESIDENT NARIMAN: What's your point? Please let them finish.

MR. KOVAR: Yes, this is still our case.

MR. VIOLI: It's not argument, but we've been severely prejudiced.

10:30:39 PRESIDENT NARIMAN: State it in two words.

MR. VIOLI: Ms. Morris has gone way

beyond the record in this case in a number of statements about shirts, youth magazines. She's also commented about signing the MSA but reserving the right to contest it. We've asked since the beginning and at the first day of the hearings for a complete copy of the MSA because General Tobacco as you've noted --

MR. KOVAR: I object to this. This has been gone over and over again. We have given full 10:31:07 copy of the MSA.

MR. VIOLI: General Tobacco has an agreement where it says, we think this agreement that we signed is anti competitive.

MR. FELDMAN: They're out of time, Mr. President.

PRESIDENT NARIMAN: Yes, I agree. Yes, I agree. You're out of time. You do it in your turn, please. You'll have the last say.

MR. VIOLI: As long as I have freedom 10:31:32 to refer--

MR. KOVAR: The Claimants have an opportunity in their closing to say whatever they

want.

PRESIDENT NARIMAN: They will be summing up.

MR. KOVAR: I believe the Respondents have the last word in the closing, Mr. President.

PRESIDENT NARIMAN: Yes, but whenever they speak in response to Ms. Morris's statements.

MR. KOVAR: And I think, Mr. President, you'll find Ms. Morris's slides are carefully 10:31:57 footnoted to the record and everything she's said has a reference to the record. Thank you very much.

Mr. President, we are ready now to turn to 1105, the minimum standard of treatment.

PRESIDENT NARIMAN: We'll break now.

MR. KOVAR: Short break.

PRESIDENT NARIMAN: And come back 15 minutes. 10:45 sharp.

(Whereupon, at 10:30 a.m., the hearing 10:44:34 was adjourned until 10:45 a.m., the same day.)

PRESIDENT NARIMAN: Just before we begin, again, I'd just like to know something that

you handed up today, this United States versus Philip Morris, the defendants -- it says "et al," which means -- are they all the majors and the exempt SPMs?

MR. FELDMAN: There were several if not all of the majors. I would need to check to see precisely which of the majors were listed.

PRESIDENT NARIMAN: No, because there it's mentioned in one of the paragraphs, they are given. So, if you can just give us the entire list of the defendants, because that's not there.

MR. FELDMAN: Ms. Morris informs me the defendants were all the four majors and Lorillard.

PRESIDENT NARIMAN: And?

MR. FELDMAN: And Lorillard Tobacco.

MR. VIOLI: And Liggett.

PRESIDENT NARIMAN: But not the exempt SPMs; right?

MS. MORRIS: That's my understanding. We're happy to get you a list of all the defendants.

PRESIDENT NARIMAN: Because some of the

paragraphs mentioned certain names and there are certainly more than four. I want a list of them.

MS. MORRIS: Certainly. We'll get you the entire list.

PRESIDENT NARIMAN: And secondly, I want you to know, sorry, Mr. Feldman -- secondly, I just want to know, did this proceed to any preliminary judgment or judgment or anything? What is the state of the stage at which this is?

MS. MORRIS: My understanding, I think, from what Mr. Violi has said is that it's ongoing. The request for monetary relief has been dismissed and I believe --are the court --

PRESIDENT NARIMAN: I want to see the judgment about dismissal of monetary relief.

MS. MORRIS: And I believe that the requests for injunctive relief are still being considered.

PRESIDENT NARIMAN: Yes, but I want to see the dismissal of the --

ARBITRATOR CROOK: While that's being clarified, we can just note for the record that

the defendants are all identified in Paragraphs 10 through 22 of the complaint.

PRESIDENT NARIMAN: Are they all the defendants? I don't know.

ARBITRATOR CROOK: They are named and described in the complaint.

PRESIDENT NARIMAN: They are named, but are they part of the group? Yes, Yes.

I just want to know who they are, the exempt SPMs and OPMs like that, that's all I want to know.

MS. MORRIS: And then, if I can make just two minor clarifications.

The first one, I've been informed in that case the injunctive relief was granted by the district court and it was affirmed by the second circuit and is now being appealed -- the DC circuit, sorry, and it's now being appealed.

PRESIDENT NARIMAN: To the Supreme Court?

MS. MORRIS: Yes.

PRESIDENT NARIMAN: I want both those

judgments.

MS. MORRIS: And then my second point of clar --

PRESIDENT NARIMAN: Yes, please provide. I'm telling you today because we don't have, now, any time, so that this record becomes complete one way or another.

MS. MORRIS: And then my second point of clarification you were asking why the MSA states hadn't begun to negotiate with Claimants regarding their back payments, and I just wanted to note that in the letter to Mr. Violi from Mr. Greenwald, which is in the record, he states in the second paragraph, "As you have been informed on numerous occasions, the settling states require that a manufacturer be in compliance with all applicable state laws and regulations, in particular the state Escrow Statutes before any manufacturer can join the MSA. The states have consistently applied this policy to all MSA applicants. Grand River has repeatedly violated the laws of numerous states and has

refused demands by the states to bring itself into compliance."

PRESIDENT NARIMAN: Thank you.

MS. MORRIS: And then, just at the very end he says "You are welcome to submit a new application at such time Grand River is compliant with Allstate laws can demonstrate its willingness to support and comply with all the provisions of the MSA and can provide all the information and documentation missing from the current application."

PRESIDENT NARIMAN: And that was never submitted?

MS. MORRIS: To my knowledge, no.

PRESIDENT NARIMAN: Thank you.

MR. KOVAR: Mr. President, I would ask you to call Ms. Thornton to begin with 1105.

PRESIDENT NARIMAN: Yes.

Please, I didn't get the name.

MS. THORNTON: I'm Ms. Thornton.

PRESIDENT NARIMAN: What is Ms. Thornton going to be speaking about?

MS. THORNTON: I'm going to be talking about the minimum standard of treatment obligation in Article 1105.1. I would like to preface my presentation with a few thoughts.

Professor Anaya, at one point, I think, before the snow storm, you indicated that your charge was to define the scope and the content of Article 1105.1, and we submit that you are exactly right in that. I'm going to be focussing primarily on the contact of the minimum standard of intent and Article 1105.1. My colleague, Mr. Kovar, is going to go specifically address Claimants' obligation that the minimum standard treatment obligation in Article 1105.1 includes this obligation of nondiscriminatory treatment to indigenous investors.

Now, Professor Crook, you've asked us, and very patiently a number of times in this proceeding, what our position is on whether or not a claim for frustration legitimate expectations can arise under Article 1105.1. I'm going to focus chiefly on responding to that question in my

presentation now.

And finally, President Nariman, you asked us yesterday whether the MSA states could have achieved the stated purpose of the MSA in a way that would have caused less loss to all concerned. I'm going to address that point as well and try to focus your attention on the degree of deference that we believe you should extend to the MSA states when reviewing the challenge measures at issue in this arbitration.

So, let me start first by trying to --

PRESIDENT NARIMAN: And you have no written presentation.

MS. THORNTON: I do have a written presentation.

PRESIDENT NARIMAN: But they have not been distributed.

MS. THORNTON: I'm sorry. Have the slides not been distributed?

Catherine, could you please distribute my slides?

Thank you.

ARBITRATOR CROOK: Ms. Thornton, I only get the honorific on the days I teach.

MS. THORNTON: Okay. All right, Mr. Cook, I'll proceed accordingly.

(Pause in the Proceedings.)

MS. THORNTON: Does everyone have my slides?

PRESIDENT NARIMAN: Go ahead.

MS. THORNTON: Okay. Mr. President, Members of the Tribunal, Article 1105 of the NAFTA contains Chapter 11's minimum standard of treatment obligation, which reflects the NAFTA parties' commitment to provide certain basic international law protections to the investments of investors.

More specifically, Article 1105.1 -- in Article 1105.1, the NAFTA parties agreed, and I've projected the text of the Article on the slide for your benefit, that 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.

Now, I would like the Tribunal to focus on two aspects in particular of this provision. The first is that the minimum standard of treatment obligation in Article 1105.1 requires a standard of treatment for the investments of investors.

You can see we've highlighted that language on the screen.

10:53:32 The second is that the minimum standard of treatment obligation Article 1105.1 requires treatment in accordance with international law. The United States will demonstrate --

PRESIDENT NARIMAN: Sorry to interrupt at such an early stage because you'll probably deal with it, but my reading of 1105 is that this is a positive obligation on the party and on whom is the burden of proof to show that treatment is in accordance with international law, including

10:54:09 fair and equitable treatment and full protection? Is it not burden of proof on the Claimants or is it burden of proof on the Respondents?

MS. THORNTON: The NAFTA parties have been very clear about what this obligation means, and the NAFTA parties in 2001 issued a binding interpretation which said, this obligation means that we are obligated to provide the investment of investors with the customary international law minimum standard of treatment. Now, because it's a customary international law doctrine, the burden is on the Claimant, the proponent of a customary

10:54:46 norm to prove the norm's existence.

You'll see the ICJ held accordingly in the Asylum Case when Columbia was trying to assert a particular customary international law norm had emerged with respect to the right of political asylum. And the ICJ said, it's your burden. If you're going to tell us that a custom has evolved in this way, it's your burden to prove that to be the case. And as we will address -- my colleague, Mr. Kovar, will address this more specifically

10:55:22 there were requirements for proving a norm of customary law has emerged.

PRESIDENT NARIMAN: Okay. All right.

Thank you.

MS. THORNTON: So, the United States will demonstrates in its examination of this obligation that Claimants have not established as a matter of fact or of law that their investment, to the extent they can establish they've made one, has not received the minimum standard of treatment under international law. Claimants argue that the United States has violated Article 1105.1 in three

10:55:56 ways.

First, by frustrating their expectation that the United States would not regulate their on-Reservation sales and that the Escrow Statutes would not be amended to eliminate the refund of portions of their escrow deposits. That's allegation number one.

Allegation number two is that we violated the minimum standard of treatment obligation in Article 1105.1 by discriminating

10:56:24 against them as Canadian First Nations investors when failing to consult with them before enacting the Allocable Share Amendments in violation of

their human rights and peremptory norms of international law.

And third, they allege that the United States has denied them justice when requiring that Grand River make escrow payments to satisfy potential future determinations of liability or settlements in the absence of a present judicial determination of liability against the company. These are their Article 1105.1 claims.

10:57:02 In the process of explaining why Claimants have not established a breach of Article 1105.1 based on such claims, I will recall for you our earlier presentations addressing why Claimants could not have had the legitimate expectations they assert.

I am then, as I said before, going to ask Mr. Kovar to speak specifically to you about the discrimination allegations and the international human rights arguments.

10:57:32 Finally, I'm going to come back and I'm going to address Claimants' allegations that the challenged measures amount to a denial of justice,

which we do recognize as a norm subsumed with the minimum standard of treatment.

Now, the United States and Claimants concur on one thing with respect to the minimum standard of treatment obligation in Article 1105.1 that it requires treatment in accordance with customary international law.

Now, as I'll project on the slide, on July 31, 2001, the NAFTA parties acting through 10:58:12 the NAFTA Free Trade Commission issued a formal note interpreting the minimum standard of treatment in Article 1105.1. This Free Trade Commission, known as the FTC or The Commission is comprised of cabinet-level trade ministers of the three parties and is authorized to in interpret Article 2001 to resolve -- authorize in Article 2001, excuse me, of the NAFTA to resolve disputes regarding the agreement's interpretation.

Now, in Article 1131.2 of Chapter 11, 10:58:53 the investment chapter of the NAFTA, the NAFTA parties specifically provided -- and this is projected on the slide -- that an interpretation

by The Commission of a provision of this agreement shall be binding on a Tribunal established under this section.

As the title of Article 1131 indicates, a binding FTC interpretation constitutes the governing law of the case. So, this is the provision in Chapter 11 which tells you what to do with the binding note of interpretation that my colleagues have just distributed to you.

10:59:35 Now, in its July 31 interpretation the Free Trade Commission stated that it had "reviewed the operation of proceedings under Chapter 11 and adopted certain interpretations in order to clarify and reaffirm the meaning of certain of its provisions."

The The Free Trade Commission specifically characterized the obligation in 1105.1 as the "minimum standard of treatment in accordance with international law," and clarified 11:00:15 that, one, 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. The Free Trade Commission clarified further that the concepts of fair and equitable treatment and full protection and security do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens. This is significant and I will return to this.

PRESIDENT NARIMAN: But aliens doesn't 11:01:05 come in 1105, does it? That's the interpretation only. The word "aliens" is not there in 1105. It says "each party."

MS. THORNTON: No, the text -- the chapeau, the title of Article 1105 is the minimum standard of treatment.

PRESIDENT NARIMAN: I'm talking of aliens, to whom?

MS. THORNTON: What the text of Article 1105.1 refers to is investments of investors.

11:01:27 PRESIDENT NARIMAN: I'm not talking -- if you could deal with it later if you don't have --

MS. THORNTON: Yes, I understand. I can deal with it right now.

The minimum standard of treatment for aliens is a customary international law doctrine.

PRESIDENT NARIMAN: No, that's not my query. I'm sorry, that's not my query. My query is, am I right in assuming that the text of 1105.1 doesn't speak of aliens at all; it only speaks of each party and another party.

11:01:54 MS. THORNTON: It speaks of investments of investors and we will submit to you that that informs how you should analyze the minimum standard of treatment under customs.

PRESIDENT NARIMAN: Yes, we have to read into 1105 having regard to the interpretation --

MR. KOVAR: Mr. President.

PRESIDENT NARIMAN: One minute.

That is, each party shall accord to 11:02:13 investments of investors of another party who are aliens, treatment in accordance with -- do we have to read it like that? I want to know your

position.
MS. THORNTON: Our position is the July 31, 2001, interpretation controls your interpretation of 1105.1.
PRESIDENT NARIMAN: That it does. My query --
MS. THORNTON: Yes. The answer to your question is yes.
PRESIDENT NARIMAN: Article 1105.1 along with The Commission's interpretation must therefore permit us to read or require us to read that each party shall accord to investments of investors of another party who are aliens in treatment with accordance with international law.
MS. THORNTON: Right.
MR. KOVAR: Mr. Chairman, just to point out, what is implicit there is that, of course, in the United States it has to be an investor from Canada or Mexico who are by definition an alien.
PRESIDENT NARIMAN: I just want to know, yes. I just want to know whether I'm right.
MS. THORNTON: Yeah you're right.

You're right. And other NAFTA Tribunals have taken a look at this question and have been very clear that that Chapter 11 applies to foreign investors and their investments. So, that's what the parties are getting at with that obligation.
Yes.
ARBITRATOR ANAYA: Ms. Thornton. There's no question Grand River falls under the category of alien; is that right?
MS. THORNTON: Yes.
ARBITRATOR ANAYA: How about the other Claimants?
MS. THORNTON: Yes, I believe they are -- well, the citizenship of Arthur Montour, I think he submits he's a member of a First Nations tribe and not a Canadian citizen, but we assume he's an alien for purposes of this analysis.
ARBITRATOR ANAYA: For purposes of this case.
MS. THORNTON: Yes.
ARBITRATOR ANAYA: So, we don't really have to concern ourselves too much with the word

"alien" here, because it's not really -- there's not really a question here about whether any of the Claimants are aliens; right?
MS. THORNTON: There's no question about that but the issue is --
ARBITRATOR ANAYA: Yes, I understand the issue is -- I misspoke. When we look at the standard we have to look at --
MS. THORNTON: Well, looking at the standard but we submit you have to look at the standard in the context of the ordinary meaning of the treaty. The ordinary meaning of the words of the treaty understood in context in light of its object and purpose. And in our view, Article -- Catherine, can you que the 1105.1 slide, please.
Article 1105.1 is an obligation that goes to investments of investors, right? Some of the obligations Chapter 11 go to both the investor, the alien, and its investment, its property interest. This obligation goes only to its property interest. This is a point Mr. Kovar is going to develop at some length in his

presentation, but just to give you a full answer I wanted to address it.
So, if we could go back to the July 31 slide, the binding interpretation. The final conclusion of the FTC was that a determination there has been a breach of the determination of the NAFTA or a separate international agreement does not establish that there is a breach of Article 1105.1.
ARBITRATOR ANAYA: Could it, though, be relevant to a breach of 1105?
MS. THORNTON: The violation of another international agreement? No.
ARBITRATOR ANAYA: Another international agreement or -- it couldn't be relevant?
MS. THORNTON: Our position is the only the legal obligations that are relevant in Article 1105.1 are the customary international law obligations subsumed within the minimum standard of treatment.
ARBITRATOR ANAYA: But what if those

customary international law obligations are embodied in a treaty or the same norm is related to a treaty norm?

MS. THORNTON: Well, it's true that treatise can, for lack of a better word, codify custom, but your task is to identify any customary international law norm that Claimants have proffered, determined whether it's subsumed within the minimum standard of treatment of aliens as applied to their economic interest, their property interest, their investments, and establish whether or not that's been breached.

So, I mean, the point of this provision --

ARBITRATOR ANAYA: I'm not sure about your answer, though, that it's not relevant. I'm having a difficult time seeing how --

MS. THORNTON: It could be relevant --

ARBITRATOR ANAYA: I understand your argument that it's not -- a breach of another treaty doesn't breach this provision, in and of itself, but I can't see how it wouldn't be

relevant in some cases.

MS. THORNTON: Well it could be relevant to the extent the treaty codifies custom; it could be relevant. But the mere allegation of a breach -- and Claimants have not come to you with that argument. They haven't come to you saying, there's a breach of a treaty therefore there's a violation of 1105.1. They're trying to place this within the customary international law framework. We say that they failed for various reasons, but the Claimants are very familiar with these interpretations. Professor Weiler projected it on the screen, as well. They know the ground rules.

PRESIDENT NARIMAN: Sorry to interrupt like this, but I read along with the interpretation, the binding interpretation, as you put it. It doesn't say on whom is the burden. It just says, under 1102 you cited cases showing on whom is the burden -- that it's always on the Claimant. This doesn't say anything about the burden, does it? The burden -- who has to show

that we have accorded to investment of investors of aliens treatment in accordance with international law which is fair and equitable and giving full protection and security?

MS. THORNTON: Well, if --

PRESIDENT NARIMAN: That's the question I asked you initially. Is this a positive obligation on the states?

MS. THORNTON: Yes.

The United States and its treaty partners believe this is an obligation that provides real protection for foreign investments. This is not an offset.

PRESIDENT NARIMAN: Therefore it's an obligation of the state.

MS. THORNTON: It's an obligation of the state, but what we say is that we acknowledge established, well settled, customary international norms that are in play here and that we obligated to commit ourselves when signing up to Article 1105.

If Claimants are going to come to you

and say that there's an additional customary international law norm in play it's their burden to prove that, A, it is a custom -- in fact, a customary international law norm; and B, it's a customary international law subsumed within the minimal standard of treatment as it affects the foreign investors property interests.

PRESIDENT NARIMAN: I understand your argument that they are not investments; that's already been argued.

MS. THORNTON: Okay.

PRESIDENT NARIMAN: But assuming they are investments and they have established that they are investments, then on whom is the burden of proof just as the burden of proof is always on the Claimant under 1102? On whom is the burden of proof under 1105? That's a little problem with me.

MS. THORNTON: Well, we would submit the burden of proof is always on the Claimants to prove their case under Chapter 11. It's not our burden.

If there's an established customary international law norm that Claimants have alleged has been violated that we recognize it's our burden to prove to you we haven't violated the norm, but we submit there are no established customary international law norms that have been violated here.

MR. KOVAR: Mr. President, if I can clarify a little bit.

11:10:28 In any system of law, municipal law or national law or, in this case, under a treaty, there are obligations on entities and sometimes it's obligations on a government. In this case, the three NAFTA governments have undertaken these obligations, but for a party to bring a claim that those obligations have been violated, the party has the burden to prove the law and the facts that support their claim.

And in that respect, there's no

11:10:57 difference between Article 1105 and Article 1102. And so, I think that's the question you've been asking, and I just wanted to make sure you got a

very clear answer on that point.

Thank you.

ARBITRATOR CROOK: It does occur to me, Mr. Chairman, that we are agreed the arbitration here is to be conducted in accordance with the UNCITRAL rules, which I don't have the rules readily at hand, but it does have a rule to the effect that the burden of proof of a proposition falls on the party asserting it. And it seems to

11:11:30 me that if one asserts that something is a rule of customary international law and that it's been violated, the UNCITRAL rule indicates who has the burden of showing that.

MS. THORNTON: We would agree with Mr. Crook's assertion there.

ARBITRATOR ANAYA: Not to belabor this --

MS. THORNTON: That's fine. We're here to answer your questions.

11:11:50 ARBITRATOR ANAYA: Can we do sua sponte find a fact or a legal conclusion?

MS. THORNTON: What kind of fact or

legal conclusion?

ARBITRATOR ANAYA: That there's customary international norm, even though the Claimants haven't adequately put forth -- even if they haven't.

MS. THORNTON: I would say the parties have not authorized this Tribunal to resolve disputes ex aequo et bono. You are charged to resolve --so that confines the jurisdiction of the

11:12:26 Tribunal.

ARBITRATOR ANAYA: Ex aequo et bono is different, though.

MS. THORNTON: Right. No, I hear what you're saying. And we would submit that the interpretation is clear that Claimants have to prove that there is a customary international law norm that has been violated.

ARBITRATOR ANAYA: Let me put it differently.

11:12:48 Can we look beyond -- in examining that question, can we look beyond what they put to us?

MR. FELDMAN: Professor Anaya, I would

just flag that, as the Respondent we should have the opportunity to respond to all legal arguments that are made in the case. And so, if there were to be a legal argument that we did not have an opportunity to respond to that would prejudice us as the Respondent in this proceeding.

MR. VIOLI: I think Claimants' position would be the relevant --

MR. KOVAR: Mr. President, I think this

11:13:23 is our case, and they made their case, and they'll have time in their case --

MR. VIOLI: All right. I just thought you wanted to hear from the Claimant; that's fine.

PRESIDENT NARIMAN: Hold your horses. Hold your horses.

MS. THORNTON: Okay. So, the July 31, 2001, interpretation addressed two issues fundamental to your resolution of this case.

The first is it reaffirmed the standard

11:13:49 of treatment owed to investments of investors and other parties in Article 1105.1 is contained within the customary international law and minimum

standard of treatment of aliens.

Second, it clarified the reference to fair and equitable treatment and full protection security in Article 1105.1 are not to be interpreted as requiring treatment in addition to or beyond that which is required by the customary international law standard.

I would submit, therefore, Mr. President and Members of the Tribunal, that the legal obligation that the NAFTA parties undertook in Article 1105.1 is clear. It requires them to provide the investments of investors with the customary international law and minimum standard of treatment. While Claimants agree in principle that this customary international law doctrine is the governing law of this provision, they do not confine their arguments to allegations that establish customary international law protections for covered investments have been breached.

Instead, they ask this Tribunal to consider customary international law protections

afforded to individuals rather than to investments. Furthermore, Claimants essentially invite this Tribunal to interpret the fair and equitable treatment obligation in Article 1105.1 as containing additional obligations not found in customary international law, including an obligation to refrain from amending laws in a manner that frustrates an investor's expectations.

PRESIDENT NARIMAN: Sorry to interrupt again.

MS. THORNTON: That's fine.

PRESIDENT NARIMAN: I just want to be very clear. Is it permissible for a NAFTA Tribunal to say that having regard to the record, we find that the treatment afforded to one party, the Claimant, is not fair and equitable, but there is no breach of customary international law? Is it possible for us to say that?

MS. THORNTON: Well, I mean, to this I would say look to the Loewen Tribunal.

PRESIDENT NARIMAN: Answer yes or no. You must say no or yes for me to understand.

MS. THORNTON: Right.

PRESIDENT NARIMAN: My premise is wrong that's all I want --

MS. THORNTON: The fair and equitable treatment obligation has to be analyzed in the context of custom.

PRESIDENT NARIMAN: I'm asking a specific question. I'm asking a specific question.

MS. THORNTON: Right. Well --

PRESIDENT NARIMAN: Is it open to a NAFTA Tribunal to say that, having regard to everything that we have heard and the record that we have seen, the treatment accorded is not fair or equitable and that it does not matter whether it is or is not in accordance with customary international law.

MS. THORNTON: No. The binding FTC interpretation, July 31, 2001, prohibits you from doing that.

PRESIDENT NARIMAN: Which part?

MS. THORNTON: I would say look to Part

Two of the binding interpretation. The concepts of fair and equitable treatment and full security is it not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens. Your analysis has to be within the framework of custom.

PRESIDENT NARIMAN: I see.

MS. THORNTON: And this way, the fair and equitable treatment obligation in Chapter 111 is different than the fair and equitable treatment obligation in other treaties.

Now, Claimants' sort of most recent arguments -- argument most recently in the context of these proceedings, Claimants' attempt to recast their good faith argument as one for an abuse of right under international law.

Now, this doctrine is a difficult doctrine to understand but, we would say just as with the principle of good faith, the abuse of right doctrine is an equitable principle that cannot create binding legal obligations where none

would otherwise exist. Claimants' own authority on this proposition, Ben Chang, characterizes it as such. At best, it's a general principle of international law; it's not a customary international law norm.

Therefore, Claimants' interpretation of the customary international law obligation in Article 1105.1 should be rejected because they have not established the existence of any customary international law norms that have been breached.

11:18:50

Now, as I mentioned -- I'm sorry.

ARBITRATOR ANAYA: I don't want to get too abstract here, but is it general principle international law -- necessarily not a norm of customary international law? Are those two --

MS. THORNTON: Not necessarily, but I would submit in Article 38 of the ICJ statute they are treated as different sources of international law and the NAFTA parties have been clear that the applicable source of international law for your determination and interpretation of Article 1105.1

11:19:24

is custom.

Now, a general principle might inform that analysis, but it can't form a separate legal obligation to which we can be bound.

ARBITRATOR ANAYA: But what if we find that customary international law includes general principles of international law like some authors have argued? And indeed, it appears that in many cases the ICJ conflated the two categories.

11:20:01

MS. THORNTON: Well, in that respect I'd say we differ with the ICJ. We believe there are definite requirements for proving a rule of customary international law. A proponent has to prove state practice in opinio juris.

ARBITRATOR ANAYA: Okay.

MS. THORNTON: And the general principle analysis is different; it's a comparative law analysis.

ARBITRATOR ANAYA: According to one theory. Anyway, I understand your point.

11:20:21

ARBITRATOR CROOK: It is the case, is it not, that Ben Chang is the leading writer on

general principles, subscribes to the notion you just suggested, which is that it is derived from a comparative analysis.

MS. THORNTON: Yes, that is the case. And in our view it's a very different analysis than the analysis that has to deal with the issues of customary international law norm.

ARBITRATOR ANAYA: I am now arguing with my good friend, John Crook, but it is also the case the ICJ has looked at the general principals in the form of customary international law; right?

11:20:53

ARBITRATOR CROOK: I think we can probably continue in private with the text of Article 38 in front of us.

ARBITRATOR ANAYA: I'm sorry. I must say, this is entirely abstract. I'm struggling with the context of this particular case and the particular rules here we're having to deal with. So, I am trying to get a clear picture here.

11:21:18

MS. THORNTON: Well, we would submit that the NAFTA parties have tried to be as

explicit as they can on this point, that the obligation of Article 1105.1 is an obligation derived from customary international law and they were very intentional on this point. So, I take your word for it, that the ICJ may have conflated these principles, but the NAFTA parties have not.

Now, as I mentioned before, we believe that the customary international law minimum standard of treatment is well settled and that sufficiently broad practice and opinio juris have converged to require that states provide the property interests of aliens with certain basic guarantees, such as, the protection against criminal conduct, which is referred to as the obligation of full protection and security.

11:21:58

Freedom from judicial treatment that is "notoriously unjust" or "offends a sense of judicial propriety."

Three, freedom from direct and indirect expropriation without payment of prompt adequate and effective compensation.

11:22:36

Now, the prohibition against

expropriation without compensation is the most widely recognized customary international law norm subsumed within the minimum standard of treatment rubric that applies to legislative and rulemaking acts. Given its significance, the NAFTA parties negotiated a particular provision governing this obligation in Article 1110.

Now, what is the purpose of this obligation in context? States include the minimum standard of treatment obligation in their investment agreements to protect the investments of their investors instances where national treatment is not sufficient. The reason why this is necessary is that, in the event the host state treats the investments of its own nationals with manifest injustice and accords the investments of foreign investors the same level of treatment, the NAFTA parties wanted there to be a floor beneath which the treatment couldn't fall.

So, the minimum standard of treatment ensures that regardless of how a host state chooses to treat the investment of its own

nationals, its treatment of foreign investment can't go below that absolute minimum floor of treatment.

Now, significantly, for your purposes, the customary international law minimum standard of treatment does not impose a duty on states to compensate any investor who complains that a particular law or regulation is unfair or detrimental to its interests. The exercise of government, governmental regulatory or legislative powers, may sometimes result in outcomes that appear unfair or erroneous to some, but in the absence of a specific customary international law rule governing state conduct, the minimum standard of treatment does not direct or limit how a state must conduct its domestic regulatory affairs.

Now, Claimants argue the Allocable Share Amendments in the complementary legislation violated their expectations about the regulatory environment in which they were investing and that the minimum standard of treatment obligates states to refrain from frustrating those expectations.

Now, I think as my colleagues, Mr. Kovar and Ms. Cate, have already explained to you, Claimants could not have had a legitimate expectation that their on-Reservation sales would be completely unregulated based on either the Jay Treaty or U.S. Federal Indian Law.

And my colleague Mr. Feldman explained to you yesterday that, with respect to their off-Reservation sales, Claimants could not have reasonably expected a -- large releases of their escrow deposits in perpetuity. Claimants had no reason to expect that the states would refrain from taking additional legislative efforts revising or adopting legislation specifically designed to regulate NPM conduct. It may be that the Claimants assumed these things or wished that the regulatory framework would not change, but they could not have legitimately and reasonably expected that the states would refrain from regulating the tobacco market as they have done.

Nevertheless, even if we were to suppose Claimants could show their expectations

were legitimate and reasonable, which we submit they can't, Claimants have failed to demonstrate the existence of a customary international law norm requiring states to refrain from frustrating investor expectations regarding the treatment of their investments. As we've discussed in our colloquy, as with all customary international norms, the burden of proof is on the proponent of the norm, and I would direct you to the asylum case for this, to establish its existence.

Claimants make no effort to identify any practice of states, much less widespread and virtually uniform practice or opinio juris that would support the existence of the norm, nor do Claimants point to any domestic law which makes the frustration of an investors expectations by the government per se unlawful.

What Claimants do do is they point you to numerous investment treaty Arbitral awards such as the Tecmed v. Mexico award and the CME v. Czech Republic award to support the notion that the customary international and minimum standard

of treatment expectations includes the prohibition against the frustration of an investor's expectations.

But my point for you today is that these Tribunals interpreting autonomous fair and equitable treatment obligations, they weren't obligated to understand the fair and equitable treatment obligation in the context of customary international law, so they didn't have to square this analysis of legitimate expectations with what customary international law provides. We would submit that if you do square the analysis, you will see it makes no sense to suggest that customary international law includes a prohibition against the frustration of an investor's legitimate expectation about the regulatory environment in which it's investing.

Now, in a halfhearted attempt to salvage their 1105.1 expectations claim, Claimants recasted as one for detrimental reliance on a "preexisting government policy or law."

Now, international law has long

maintained that a state's business and regulatory regime does not create vested or actionable rights that would prevent it from altering that regime to meet new needs or to address new economic problems. We submit that the Oscar Chinn Case is instructive here.

As this Tribunal has already expressly stated, investment -- international investment agreements are not substitutes for prudence and diligent inquiry by international investors in the conduct of their affairs, nor are these agreements -- nor do they agreements prevent states from altering their legal and regulatory regimes in a manner that might impact foreign investments absent specific assurances to the contrary.

Now, as I mentioned before the United States submits that it just doesn't make sense to argue that customary international law has evolved to include a prohibition against the frustration of expectations. And the reason why it doesn't make sense is because a state does not ordinarily incur liability under international law for

ordinary breaches of contract.

Well, international law prohibits states from engaging in certain kind of contract repudiation which is different from the breach -- repudiation -- and refusing to provide aliens remedies for such claims. It leaves ordinary breach of contract claims to the domain of domestic law.

As the Panel in Azinian v. United Mexican States made very clearly, NAFTA does not allow investors to seek international arbitration for mere contractual breaches. Indeed, NAFTA cannot possibly be read to create such a regime which would have elevated a multitude of ordinary transactions with public authorities and to potential international disputes. Plainly, if a state cannot be found liable under customary international law for violating an investor's expectations, when they're based on an actual contract with the state, it can't be found liable for frustrating expectations such as the Claimants, which were based simply on their

understanding of a regulatory regime.

The emphasis that Claimants have placed on the legitimate expectation analysis in their Article 1105 claim, we submit, is without foundation in customary international law.

In contrast, when the Tribunal takes the minimum standard of treatment obligation, Article 1105.1 it should keep in mind the deference that customary international law typically extends to domestic administrative and legislative decision-making.

This is particularly true given that the Tribunal is charged with examining a complex multistate regime designed by the states to ensure that they can fulfill critical public health and welfare responsibilities.

I would like to direct your attention to the S.D. Myers Tribunals conclusions on this subject which I will project on the screen. The S.D. Myers Tribunal held that when interpreting and applying the minimal standard a Chapter 11 Tribunal does not have open ended mandate to

second guess government decision making. Governments have to make many potential controversial choices. In so doing, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others, and adopted solutions that are ultimately effective or counterproductive. The ordinary remedy for this, if there were one, for errors in modern governments is through internal political and legal processes, including elections.

Now, the S.D. Myers Tribunal goes on to conclude that a breach of Article 1105.1 occurs only when it is shown that an investor has been treated in such an unjust and arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their

borders.

Thus, we submit that the Tribunal must extend the United States a measure of deference when examining the legislative measures at issue in this proceeding.

So, in conclusion, in order to establish a violation of the minimum standard of treatment obligation in Article 1105.1, Claimants must demonstrate that the United States has violated a customary international law norm subsumed within the minimum standard of treatment which is applicable to their investments.

Claimants have failed to demonstrate that the customary international law minimum standard of treatment includes a prohibition against frustrating the expectations of an investor about the legal and regulatory regime that will be applied to its investment, nor have Claimants demonstrate that they reasonably could have held legitimate expectations that the original Escrow Statutes would apply in perpetuity to their investments.

Now, I'm happy to address any additional questions the Tribunal might have.

ARBITRATOR ANAYA: Just a clarification.

I think I know the answer to this, but I just want to get your statement from you. This first bullet point where you say customary international law norm subsumed within the minimum standard of treatment. Is it possible for there to be a violation of another customary international law, customary international law norm, but one that is not subsumed within the minimum standard of treatment?

MS. THORNTON: It's possible, but that would not be actionable in this context.

ARBITRATOR ANAYA: That's what I mean. That's what I mean.

MS. THORNTON: Yes. We submit that as President Nariman and his colleagues in the Wintershall Case pointed out, international Tribunals are Tribunals of limited competence. Your competence -- you have been charged to

determine whether or not the obligations in Section A of Chapter 11 have been breached, and that's the limitation on your competence.

ARBITRATOR ANAYA: So theoretically -- so theoretically there could be customary international law norms that play but aren't relevant for the purposes of this claim.

MS. THORNTON: Absolutely. Absolutely.

ARBITRATOR CROOK: Ms. Thornton can you help me, I'm a little dusty here. You cited Oscar Chin. Is this case Oscar Chin?

MS. THORNTON: I think it's similar to Oscar Chin in that Oscar Chin complained about the fact that the regulatory landscape that he had entered when starting up his riverboat navigation system changed because of the economic crisis in 1929. And Belgium decided to adopt a measure that was only applicable to a state-owned enterprise, and Oscar Chin said you've changed the regulatory environment and the British government backed him up in this and said, you violated your treaty obligations to our nationals by changing the terms

on which he made his investment in your territory. And the Tribunal in that case determined or the PCIJ, excuse me, that laws and regulations don't create vested rights, that international law is about protecting vested property rights. And we submit that you can't derive vested rights simply from your assumptions about how a legal or regulatory regime will operate.

PRESIDENT NARIMAN: There is nothing

11:38:05 apropos what you have said. I just want to know whether you have got offhand date of Amendment 21 in the MSA. It was mentioned the other day.

MS. THORNTON: I'm sorry I don't have it offhand but I believe one of my colleague does.

PRESIDENT NARIMAN: Can anyone give me the date of the of the amendment of the MSA, Amendment 21 that was given?

MR. KOVAR: We're still working on it.

PRESIDENT NARIMAN: Okay. Thank you.

11:38:33 Thanks very much. Very good. Thank you.

(Pause in the Proceedings.)

PRESIDENT NARIMAN: Mr. Kovar.

MR. KOVAR: Mr. President and Members of the Tribunal, Claimants' second claim under Article 1105.1 is that the U.S. has violated the minimum standard of treatment by discriminating against them as indigenous investors. They allege that this discrimination consists of the failure of the MSA states to consult with them, private Canadian First Nations investors before adopting the measures they challenge in this arbitration.

11:39:25 Claimants assert that certain international human rights or indigenous rights principles have been established as customary international law or as peremptory norms of international law thereby giving rise to binding obligations on the part of the U.S. that prohibited the states of the United States from enacting measures having an impact on Claimants' business when the states have not previously sought out and consulted them. We submit that

11:39:56 these claims have no basis in law or in fact. Claimants point to no treatment that they've received that differs from that which has been

received by any other NPM or tobacco wholesaler, including foreign, domestic, indigenous and non-indigenous businesses, nor do Claimants establish that the particular rights they claim under international human rights law or the UN Declaration of the Rights of Indigenous People are incorporated into the customary international law minimum standard of treatment, which under Article 1105.1, as Ms. Thornton has explained, applies to

11:40:36 investments and not to individuals.

Finally, Claimants' arguments about the UN charter and peremptory norms of international law and the role that they might play in this case we believe are misguided, having no basis in international law. So, one way or another, these cases are not cognizable under Article 1105, Subparagraph 1.

First and fundamentally, Claimants do not prove the existence of any discrimination on

11:41:09 the grounds of race or indigenous status here. The statutes with which Claimants take issue are neutral on their face; they do not distinguish in

any way on the basis of race or indigenous status.

There is no evidence on the record of any animus on the part of state officials against Claimants or investments because of Claimants' race or indigenous status, and there is no evidence that the contested measures involved any race-based distinction that resulted in different treatment for the investments of any group of tobacco manufacturers of a certain racial or

11:41:52 indigenous status.

Claimants suggest that the mere fact of their indigenous status combined with the alleged adverse effects of the challenged measures is sufficient to demonstrate discrimination prohibited under international law.

To the contrary, such a showing cannot be sufficient here; otherwise, any generally applicable regulation would be ipso facto discrimination, if even a single member of

11:42:23 minority group happened to be adversely effected.

For example, if Article 1 of the UN convention on the elimination of all forms of

racial discrimination, which is enforced for 173 states parties, including the United States -- if that were to provide the applicable case for discrimination in this context, hypothetically, let's say, Claimants' argument would be insufficient. Claimants make no serious effort to demonstration how they're alleged mistreatment involved -- and I'll quote from the treaty, "a distinction, collusion, restriction or preference based on race, color, dissent, or national or ethnic origin which has the purpose or effect of nullifying or impairing the recognition, enjoyment, or exercise on an equal footing of equal rights and fundamental freedoms. "

Even the authority cited by Claimants in support of their racial discrimination allegations, the advisory opinion of the Inter-American Court of Human Rights in the juridical condition and rights of the undocumented migrants case, agrees that the claims of discrimination must allege discrimination "against a specific group of persons because of their race,

gender, color, or other reasons."

ARBITRATOR ANAYA: Mr. Kovar, are you going to get into the way this language which you've quoted from the Convention on the Elimination of Racial Discrimination has interpreted by the UN treaty monitoring body that's happened in this regard, in the specific context of indigenous peoples?

MR. KOVAR: I wasn't planning to, but if you had some questions we can see if we answer them.

ARBITRATOR ANAYA: You seem to be arguing the CERD simply proscribes what might be affirmative, purposeful discrimination where I asserted the CERD Committee itself in its General Recommendation 23 which the Claimants cite says that there are affirmative obligations placed on states to refrain from action which may be neutral on its face but that have adverse impacts on indigenous peoples, somewhat akin to the U.S. trust responsibility within the U.S. domestic law. So, I'm just wondering how that interpretive body

of opinion informs this analysis.

MR. KOVAR: I don't have that in front of me and I can try to take a look at it before closing.

ARBITRATOR ANAYA: Yes, we're closings by the Claimants.

MR. KOVAR: Okay. I don't have it in front of me. I apologize for that. I'll have to see if I can get you an answer by tomorrow.

But I will point out that the CERD is not at issue in this case. We're using it as an example. So, I'm not devaluing the point that the committee itself may have made an interpretation --

ARBITRATOR ANAYA: What is the standard of discrimination, then? I assume you're trying to inform us on the standard of discrimination and you put up CERD and I'm asking you about the standard as interpreted by the relevant UN body, and you say we shouldn't look to CERD.

MR. KOVAR: My point is I'll have to look to see what the committee --

ARBITRATOR ANAYA: What is the relevant standard just so I know what we should be looking at.

MR. KOVAR: Well, we're going to get to that, but the point in which we've been making is that there is not a case under the minimum standard of treatment of aliens of investments --

ARBITRATOR ANAYA: No, I understand that, but --

MR. KOVAR: But what my point here was even if we were to look at the CERD, the claim that they've made, which, as a private investor under the MSA regime, under the Escrow Statutes and complimentary acts -- because they claim that, like every other NPM, they have lost some market share or it has cost them some sales. That in itself does not violate the CERD. And I have to admit, I haven't looked at the decision of the committee, but I would be surprised if the decision of the committee would have found under those facts that there would be a violation of the CERD in this case. That's my point, but I

apologize because I don't have that in front of me. So, I pledge that I'll take a look at it.

PRESIDENT NARIMAN: So, you've cited the definition of discrimination in CERD for some purpose I have take it.

MR. KOVAR: Yes.

PRESIDENT NARIMAN: What's the purpose, then?

MR. KOVAR: The purpose is you have to demonstrate that there is -- that a measure has adversely affected you on account of your race. It can't simply be that this measure causes -- that certain market players do more poorly under this measure than under some other measure, but the fact that I am a -- of a particular race or particular indigenous group, that alone doesn't make a race discrimination violation. It has to be that the measure itself has discriminated against you on account of your status. And it doesn't have to be intentional but it still has to be linked to your indigenous status.

So, that's what we're trying to argue

that the Claimants have to show that there's been some form of treatment that drew a distinction or other restriction based on their race or indigenous status and that has the purpose or effect of nullifying or impairing their equal rights, but they haven't alleged, much less shown, that their treatment satisfied the various elements of the standard.

Now, the fact that Grand River's owners are members of the Canadian First Nations does not, without more, transform the treatment accorded to Claimants under the Allocable Share Amendments and complimentary statutes into racial discrimination simply because it may have had some impact on their business.

If Claimants cannot present evidence demonstrating that the economic impact they've experiences was because of their race, their discrimination claim appears to be a demand for some sort of special treatment under the minimum standard.

PRESIDENT NARIMAN: As I see it, the

case of the Claimant on this duty to consult that you are talking about in your note, is that -- it's in the context of an existing playing field which was suitable to everybody concerned.

Now, everyone else -- that's their case. Everyone else was consulted but you never consulted the Claimants, that is, their group, that this, that this was the best way out of the loophole that was discovered. That seems to be their case.

MR. KOVAR: Well, they certainly are arguing that there was some sort of affirmative obligation on the states to consult them as businesses and businessmen before enacting the Allocable Share Amendments and the complimentary act.

PRESIDENT NARIMAN: No, sorry. Having regard to the existing state of affairs because someone was altering an existing state of affairs in respect of which, it's not as if you didn't consult the major manufacturers, exempt SPMs. You consulted everybody except them who were the most

affected. That's the charge.

MR. KOVAR: Well, we'll get into whether they are able to fit that not customary international law minimum standard of treatment, but I would just refer back to Ms. Morris's presentation today, which is that, because the Allocable Share Amendments and the complimentary act has to be consistent with the MSA, the MSA states and the parties to the MSA, the PMs, had to reach agreement on that in order to avoid a challenge that it somehow violated the MSA.

But then, once they agreed on what the outlines of the changes would be, each state had to itself go through its normal legislative processes in order to pass that and in that context everyone, including the NPMs, including the Claimants had an opportunity to express their views to the states, pro or con, and it was fully vetted. And in fact, I think as it's been pointed out, at least in one state the NPMs prevailed in Missouri and Missouri did not pass the legislation.

PRESIDENT NARIMAN: But this is pre-legislation that we are talking about, that you need to consult. He's not saying it's in the legislation. The pre-legislation when a decision was arrived at, a concerted decision that we must amend because of this loophole, et cetera, that's the stage at which they're concerned. Everybody else is consulted and they are not, although they are the most affected. They could have said
11:51:39 suggested another way out, if at all.

MR. KOVAR: Again, just -- as going back to the record because they were not a party to the MSA and those consultations were among the parties to the MSA, because the MSA is an agreement. So.

, in order to change any element of it, the parties had to agree; otherwise, one of the parties could have challenged whether the change was consistent with the MSA. But be that as it
11:52:06 may, I think I'll get to whether -- whether there is any duty to consult under the minimum standard of treatment in Article 1105.1. I don't know if

that answers your question adequately.

PRESIDENT NARIMAN: Yes.

MR. KOVAR: Claimants argue that since they're members of indigenous North American Nations who run their businesses or native lands they can not be subject to the state's escrow laws and complementary legislation. In our view, this is not a discrimination claim, nor does 1105.1 operate to enforce rights that they may believe
11:52:45 are owed to North American Indians under the Jay Treaty or the Treaty of Canadaigua, even if the treatise were violated, and yesterday I tried to show they were not. The NAFTA Free Trade Commission stated clearly in its 2001 interpretation, and Ms. Thornton has already gone through this, that a determination that there has been a breach of a separate international agreement does not establish that there's been a breach of Article 1105.1 and this interpretation
11:53:14 is binding on all NAFTA Tribunals. Second, Claimants have --

ARBITRATOR ANAYA: Let me just press on

you the same question I was pressing on Ms. Thornton.

Could it be relevant though if another treaty is violated particularly if it relates to trade like the Jay Treaty allegedly does?

MR. KOVAR: Well, I guess we'd have to ask what it's relevant for.

ARBITRATOR ANAYA: Well, the Jay Treaty says -- if we interpret the Jay Treaty to say free
11:53:51 passage and that includes free trade and that's violated, does that somehow -- is that relevant to analysis of violation of minimum standard of treatment?

MR. KOVAR: I don't think so because the FTC has said that that does not constitute a --

ARBITRATOR ANAYA: No, no, no, no. But --

MR. KOVAR: I know, I know, I know. You're asking if it is relevant --

ARBITRATOR ANAYA: Well, then, you keep asking --

MR. KOVAR: Well, no, no, but then the second -- that's the first part. The second stage of the answer is, what would it be relevant to?

It wouldn't be relevant to trying to figure out what the content of the customary international law obligation is. As I think Ms. Thornton pointed out, you can sometimes look to treaties to help determine whether something is customary international law or to help define its
11:54:35 content, but there could be many treatise out there that some aspect of a Claimant in a Chapter 11 dispute -- some aspect of what they're doing could be arguably a violation of, but NAFTA Chapter 11 Article 1105.1 doesn't provide jurisdiction for resolving those.

And so, the relevance in the abstract is hard to define. I guess that's our problem.

ARBITRATOR ANAYA: Well, in the specific case of the Jay Treaty we would have to
11:55:13 find, first of all there were a norm that were applicable in this case, in some sense, and then that norm embodied in the treaty were part of the

customary law of the minimum treatment of aliens.

MR. KOVAR: I guess one way would -- but I'm not sure a violation of the Jay Treaty would get you to the customary international law point.

Perhaps the most obvious answer to your question is when we go back to what we were talking about yesterday. What the Claimants are arguing in the Jay Treaty is part of an expectations argument. They're saying, look, this treaty has been out here for two hundred years, and we've always known that it means we can -- as long as we're in the tobacco business, we can -- we're unfettered. And we had that expectation and it was reasonable; so that is relevant. Let's say hypothetically they were right -- we don't think they are, but hypothetically they're right, that's relevant only to their expectations argument. And what we've argued is the expectations argument is under 111110, which is an expropriation claim, and it is relevant there. It's always been part of the expropriation analysis, but under 1105.1 our

argument is -- and I think Ms. Thornton tried to lay that out in some detail -- it's not relevant. There is no minimum standard of treatment obligation of the frustration of -- the violation of frustrated expectations that the Claimants would say.

I hope that answers your question. I'm glad you asked it again.

Second, Claimants put forward an argument that a prior duty to consult with in indigenous groups and individuals must be read into 1105.1. Claimants argue that a duty to consult is guaranteed by international law and must therefore be incorporated in the "fair and equitable treatment provision" of Article 1105.1. However, as Ms. Thornton has just discussed, the NAFTA parties adopted Article 1105.1 as a limited obligation and it does not incorporate all the rights that an individual might arguably possess as a result of a state's obligations under all of international law.

PRESIDENT NARIMAN: What would you say

to having consulted one group of people who were affected? You choose not to consult another group who is even more affected.

I mean, there is where that so-called duty to consult arises, not in the abstract. There's no duty to consult, I will go along with you, but what if you have consulted prior to arriving at a decision between the contracting states, between the OPMs, so on, everybody, and you exclude NPMs who are already there, who are not people who are totally outside the system? They are selling cigarettes, they are at that po 0.40 percent, what then?

In that context, is there or is there not some obligation? It may not be a duty, some requirement to consult, and not having consulted would that not breach either 1102 or 1105?

MR. KOVAR: Mr. President, I think you're now outside the area of race discrimination.

PRESIDENT NARIMAN: I'm not talking about race discrimination.

MR. KOVAR: Right. I understand. I think what you have -- if I may, I think the question that you have posited is similar to the Claimants' argument that they have been denied administrative and procedural due process or, in a sense, a denial of justice.

PRESIDENT NARIMAN: No, no I'm not on that, nothing to do with due process.

Having consulted a group of people deliberately before arriving at a decision whether to do the thing that was intended to be done and was later passed by the legislature, having intended to do -- having consulted one group, you do not consciously consult and you say, no, no we don't want to consult these people, don't bother about them. So, is that something which would fall under either 1102 or 1105?

MR. KOVAR: And the answer is no. That's not the purpose of NAFTA Chapter 11.

PRESIDENT NARIMAN: Why not? In a particular instance, why not?

It all depends on the facts of a case.

I agree that a duty to consult may not be there as part of the international law, customary international law, but where you have chosen to have detailed consultations and taken a certain decision and left out a group of people who may have suggested an alternative by which to proceed.

MR. KOVAR: Mr. Chairman, the reason when I start today answer your question I went to the denial of justice is because I was trying to take your facts and apply them to the provisions of the treaty, because in life and in business there can be many things that are unfair or unlegal, that are not right, but they're not necessarily violations of the NAFTA. To violate the NAFTA you have to bring your facts within -- the Claimant has to bring his facts within the articles, and the facts that you've put forward in order to constitute a violation of Articles 1102 or 110 three would have to go back to the requirements of Articles 1102 and 1103, including the distinction drawn between NPMs and non-NPMs there has to do with their nationality and other

things.

And under 110 -- but otherwise, there's no violation of 1102. In other words, our bottom line here, Mr. Chairman, is that there is nothing in NAFTA Chapter 11 that says the Tribunal should decide whether something has been fair or whether it was right or even that it was wrong under domestic law. That's not what Chapter 11 is all about. Chapter 11 has very specific provisions in this: National treatment, most favored nation treatment -- they have very specific requirements -- expropriation, very specific requirements.

PRESIDENT NARIMAN: These are all facets of treatment. All facets.

We have to see the facts of each case in each specific case. In this particular case, we have this situation which I don't find an answer to -- I mean, an effective answer to, so far.

You did ask everybody else but you never asked them this, because it's going to affect you the most. Now, what do you want to

say? Would you like to take -- would you like to suggest some other way in which everyone else could be accommodated including NPMs, OPMs, et cetera, and you keep them out?

Now, is that -- it may not be a violation of NAFTA but is that fair? Is that a fair way of looking at it?

MR. KOVAR: Mr. Chairman, I think we would take issue with that that was the facts, and we tried to point out that that's would not be the way the facts are proffered. That's, of course, their case, but even if you took that case to be true, it doesn't violate the NAFTA. The Claimants have the burden to show that this unfair process that they argue existed.

PRESIDENT NARIMAN: But you agree as the United States Government that this was an unfair thing. You are not the states. As he says, he has no complaint against you. You are the United States Government whose duty it is to see that everybody is treated fairly, also.

It may not be, as you rightly say --

some case may say it's not a violation of NAFTA, but is that something which you as the United States Government consider to be fair? That's all I want to know.

MR. KOVAR: Well, Mr. President, I don't think we agree with their statement of the facts, so I would say no, but if you were to hypothesize --

PRESIDENT NARIMAN: I don't hypothesize I'm talking about statement of facts. You say they were consulted prior to any decision taken?

MR. KOVAR: Let me see if I can restate your question and then maybe I'll be able to answer it.

What you're asking is that, if we take as true that the MSA states and the PMs got together and discussed amendments to the MSA in terms of closing the loophole, the Allocable Share Amendments, and complementary legislation, so, to increase enforcement, if the question is the fact the NPMs, assuming this is true, were not consulted before they did that --

PRESIDENT NARIMAN: That is true. That is true. You're saying "assuming."

If you say it's not true, that's an end to the argument that they were consulted. They were not. That's what the records show.

MR. KOVAR: We will come back to the record. I don't want to address the record, I'm just saying if you take that as true -- if you take it as true, Mr. Chairman, I've lost my train of thought, but --

12:04:20

PRESIDENT NARIMAN: Sorry I've cut you off.

MR. KOVAR: The point is, if you take that as true that you have a case where the parties to the MSA, it's their agreement, got together and drafted a draft statute on how to close the loophole and how to increase enforcement of the MSA regime through complementary legislation and after they had reached agreement among themselves that this was consistent with the MSA, that the fact that they didn't consult with -- assuming it's true -- that they didn't consult

12:04:47

with the NPMs --

PRESIDENT NARIMAN: Why do you keep saying it isn't true.

MR. KOVAR: Because we -- I don't know that we agree that it's not true. I'm just saying, I don't want to have to agree on the record. What I want to do is say with you -- let me assume.

PRESIDENT NARIMAN: I'm saying whether you agree. It if you say you don't agree --

12:05:09

MR. KOVAR: We'll have to get back to you on that question. I'm not in a position to tell you where in the facts -- one thing or the other, but even if it were true it doesn't violate the NAFTA. And even if one -- do I think it's unfair? No, I don't think it's unfair, because this had to be passed in 46 state legislature it had to be justified; it was open process; that's how legislation it is made.

12:05:38

PRESIDENT NARIMAN: I'm not speaking of legislation, Mr. Kovar. I'm speaking to the decision to adopt legislation, please. They are

two distinct things.

MR. KOVAR: But that didn't adopt legislation. It still had to be passed by the legislatures of the states.

And even today on Capitol Hill in the United States or in Ottawa in Canada, legislatures are talking with interests about legislation, and there's no requirement before they present a draft bill that they have consulted with every

12:06:08

conceivable interested group, and they don't. But when they present the bill, the bill has to be done in an open and transparent way and it has to be passed through with proper procedures, and there's absolutely nothing on the record that suggests that was not the case here. Every one of these statutes was passed completely openly and properly through the normal legislative procedures. I hope that answers your question but we can also get back to you on --

12:06:38

PRESIDENT NARIMAN: That can't be helpful. I'm only putting my doubts and difficulties as I did with them my doubts and

difficulties I put to each side it makes no difference.

MR. KOVAR: Thank you. I appreciate that.

Did you want to ask something, Mr. Crook?

ARBITRATOR CROOK: I don't think I can contribute here.

PRESIDENT NARIMAN: Sorry we put you off.

12:07:00

MR. KOVAR: That's okay. That's okay.

We were talking about -- Ms. Thornton just talked about the NAFTA Article 1105 is a limited obligation and it doesn't incorporate all the rights that an individual might arguably possess as a result of the state's obligations under international law. Obviously, states have multitude of such obligations.

In fact, the NAFTA parties guaranteed

12:07:24

investments under 1105.1 only those rights established in the customary international law minimum standard of treatment.

Claimants agree consistent state practice and opinio juris are required to demonstrate the existence of the norm of customary international law, yet, as we argued, Claimants have failed to make either showing with respect to the establishment of their professed norm in the customary international norm and minimum standard of treatment here.

Indeed, Claimants point to not a single instance of a state engaging in consultation with indigenous investors located outside its territory prior to enacting legislation that may affect those investor's economic interests, much less that a state engaged in such consultation out of a sense of legal obligation.

Because the obligation in Article 1105.1 runs only to the investments of the investors and not to the persons of the investors, a Chapter 11 Claimant cannot invoke the minimum standard of treatment obligation in Chapter 11 to address all of the rights that a natural person might be able to assert under customary

international law.

ARBITRATOR ANAYA: So, Mr. Kovar, are you now not arguing, then, that there is -- let me try to put this differently.

What is your position, then, now, as to whether there is any customary international law regarding consultation of indigenous people?

MR. KOVAR: I will address that, Professor Anaya. I'm sure -- we have addressed it in our briefs, but I will address it here.

ARBITRATOR ANAYA: It just seems like you're saying something slightly different now. In your briefs, I understood you to be saying there is no customary international law at all regarding consultation concerning indigenous peoples. Now, I understand you to be saying a narrower point consistent with what Ms. Thornton argued there's no customary international law within the framework of the NAFTA standard.

MR. KOVAR: Well, in the -- as we often do, we'll make alternative arguments and so eventually I'll get to the argument about whether

in fact there is customary international law norm that relates to our duty to consult. I think our position on that is pretty familiar so I won't spend a lot of time on it.

ARBITRATOR ANAYA: Are you getting to it now?

MR. KOVAR: I will soon. It's not that long.

In this connection, it's instructive to compare the language of Article of 1105.1 with the language of Articles of 1102 and 1102.1 and 1102.2, the national treatment obligation.

As you can see, 1102.1 addresses certain rights of investors, and 1102.2 addresses those same rights with respect to their investments. By contrast, in Article 1105.1, the NAFTA parties guaranteed minimum standard of treatment only to the investment of an investor.

Now, last week Mr. Crook asked if the relevant question is not whether human rights are included in the customary international and minimum standard of treatment, but which rights

are included. I don't know if that's a fair re statement of your question, and I would begin by saying that question still begs the essential question: Yes, the customary international law minimum standard of treatment of aliens has evolved to address both investment rights and individual rights, but these have emerged as different areas of the law.

For example, there may be a denial of justice related to individual rights, violation of the rights reflected, for example, in Articles 8 and 10 of the Universal Declaration of Human Rights or there may be a denial of justice related to investment rights, which would be violation of the rights, for example, reflected in Article 1105.1.

Under the treaty provision at issue in this case, Article 1105.1 of the NAFTA, the focus must be on the customary international law minimum protections for investments.

Now, contrary to Claimants' suggestion, then, this Tribunal has not invested with

jurisdiction to resolve any and all claims that the Claimants might assert under international law, even if those claims are framed as important issues related to human rights. Claimants have to demonstrate they're part of the customary international and minimum standard of treatment applicable to investments. Now, in their Memorial, Claimants argued the existence of a duty of government officials to consult with indigenous investors before implementing any law that might adversely affect those investors's economic interests, asserting it is also a peremptory norm of international law.

In their reply brief, Claimants claim this right was erga omnes and incorporated in the UN charter and thereby necessarily into Article 1105.1.

Now, regardless of which arguments Claimants ultimately seek to rely on, their legal assertions are unsupported in the law. Claimants suggest that a duty to consult constitutes a norm of customary international law and they point to

support to the UN 888Declaration of the Rights of Indigenous People and to the International Labor Organization's Convention number 169, but these sources are not themselves adequate for this purpose.

The 2007 UN Declaration is aspirational; it is not binding like a treaty. Moreover, the ILO convention 169 is enforced.

ARBITRATOR ANAYA: Mr. Kovar.

MR. KOVAR: Yes.

ARBITRATOR ANAYA: Is it your position that a UN Declaration can never, because of its character -- is non-binding cannot reflect customary international law or embody certain principles?

MR. KOVAR: No, that's not my position. It can reflect customary international law and it can provide evidence that customary international law is evolving in some circumstances, but in --I tried to be precise, in itself --

ARBITRATOR ANAYA: I just wanted to be clear.

MR. KOVAR: More over -- the ILO -- I'm sorry.

ARBITRATOR ANAYA: Is that it with regard to the Declaration.

MR. KOVAR: I'll be back. We'll get to it. I'm sorry, it's excruciating.

Moreover ILO Convention 169 is enforced for only 20 out of 183 members of the ILO, not including the United States, despite being open for signature since 1979.

ARBITRATOR ANAYA: I'll ask the same question, not withstanding the lack of ratification by many countries, are you saying that it cannot reflect customary international law.

MR. KOVAR: Well, clearly not in itself, but I can imagine circumstances where it was one of many indications.

But my point is the Claimants point to these things but they don't point to anything else. And that's why we say they haven't seen established the customary international law status

of the norm that they're arguing for, putting aside whether it then is in the minimum standard of treatment.

ARBITRATOR ANAYA: You seem to make very broad statement -- or you do make very broad statements in your brief and I don't know if you're going to repeat them now, that the declaration and the ILO 169 do not at all reflect customary international law because they're not binding.

MR. KOVAR: I don't think my position is that broad. I think there could be aspects that may reflect customary international law. Whether or not they reflect customary international law for the United States would depend on which provision it is or which principle it is.

ARBITRATOR ANAYA: How about the consultation provisions of either 169 or the Declaration. I'm not talking about the whole Declaration or the whole Convention.

MR. KOVAR: I'll get to this, but in

our view that hasn't arisen to the level of customary international law binding on the United States, and even if it has for some states, arguably, and I'm not saying that it does, but if arguably it did, the U.S. has been a persistent objector, and under international law, that would --

ARBITRATOR ANAYA: Specific objector to a rule of consultation?

12:15:31 MR. KOVAR: Certainly to -- that's one of the things that we objected to in the Declaration when we voted against the --

ARBITRATOR ANAYA: What the U.S. objected to, as you pointed out in the brief, is provision that provides right of veto, not consultation.

MR. KOVAR: Again, I think you could define that duty to consult in different ways and I'm not here to say --

12:15:55 ARBITRATOR ANAYA: I'm asking you to define it in certain waste could there be a duty to consult under customary international law.

MR. KOVAR: I don't have a position here to tell you whether there is some aspect of the duty to consult that the United States accepts as customary international law principle. I want to be clear on that.

ARBITRATOR ANAYA: Because your brief seems to read that as long as it's in the Declaration there doesn't -- your brief seems to read that, as long as the Declaration -- there

12:16:22 doesn't 00 that the norms can't be customary international law.

MR. KOVAR: Well, we obviously have stated our disappointment with the way the Declaration has come out for a number of reasons that it creates confusions and overlapping --

ARBITRATOR ANAYA: Yes.

MR. KOVAR: So, probably a good part of our frustration is that it's hard to drill down to what might be the hard principles that we can all

12:16:47 agree on and we express that as a true frustration.

ARBITRATOR ANAYA: I understand. I

think that's sincere and I appreciate that, but I'm just reacting and asking about the statements in your brief which seem to go beyond expressing frustration about certain aspects of the declaration to expressing some kind of disapproval with it in its entirety.

MR. KOVAR: Well, I mean, I'm not here to -- I don't have a position that where I can tell you that there was one particular aspect that

12:17:18 we think is customary international law.

ARBITRATOR ANAYA: But the consultation thing, especially since the U.S. made repeated statements in many contexts about its consult -- its favoring consultation --

MR. KOVAR: And in fact, we do, and we've made that as something we believe ALL states should do and we have tried to lead by example with executive orders --

ARBITRATOR ANAYA: Exactly.

12:17:40 ARBITRATOR CROOK: I wonder if I can interrupt this dialogue and ask a couple questions.

Are you -- Jim, are you about done?

ARBITRATOR ANAYA: I'm not finished.

ARBITRATOR CROOK: You're not done. No. Okay.

ARBITRATOR ANAYA: No.

MR. KOVAR: So, we have led by example, but of course, this executive order -- I guess it is 13175 from the Clinton Administration, it's an executive order directing the FEDERAL agencies to

12:18:05 consult with Indian tribal authorities on important regulatory matters at the federal level it could have an impact on trials.

ARBITRATOR ANAYA: Let's say that we were to think to that extent, the extent of the United States own declarations, both domestically and internationally, those are a norm of consultation. How would that then impact on our analysis, assuming arguendo that we were to?

12:18:35 MR. KOVAR: Let me make sure I understand your question first.

You're not asking me whether what's in Executive Order 13175 is customary international

law, because of course that Executive Order only applies to federal agencies, it doesn't apply to states, and on its face it says it doesn't give rise to any rights that are enforced but --

ARBITRATOR ANAYA: Let me be more general.

MR. KOVAR: Okay.

ARBITRATOR ANAYA: Assuming we were to assume, not necessarily find, but assume that there were some norm of customary international law regarding consultation along the lines of what the U.S. has said both internationally and domestically, which is a duty to, in good faith consult on the indigenous peoples on matters affecting them, to try to -- I think that you are familiar with these statements. How would that, assuming there was such a norm, that we were to find or otherwise consider that there were a norm, how would that then effect our analysis here?

12:19:34 MR. KOVAR: If such a norm existed, it would almost certainly be limited to tribal authorities so the consultations would have to be

between the GOVERNMENTAL authorities of the state, whether it's a national or subnational part of the state, and the tribal authorities, not with private businesses and business parties. And furthermore, it would almost certainly be limited tribal authorities within the state's jurisdiction.

What we have here are private Canadian businessmen and their businesses who are asserting

12:20:07 that there's a customary international law duty to consult with them and, in our view, that is way beyond the realm of what one could fairly say is -- there's a great deal of support for the existence of customary international law duty.

ARBITRATOR ANAYA: Right. And beyond that, how would it relate specifically to 1105?

MR. KOVAR: Well, the -- let's say hypothetically we --

ARBITRATOR ANAYA: If a norm exists,

12:20:38 would it be a norm subsumed within the minimum standard of treatment of investment treaties?

MR. KOVAR: Well, and this is where we

go back to the point that 1105.1 is a limited jurisdictional grant and that, in order for a duty to consult that may violate -- let's say there's been a violation of customary international law duty to consult, assuming we have the right duties and everything, it would have to be brought within the customary international law minimum standard of treatment of investments because I think, as I've already tried to say, there could b a

12:21:13 violation of individual rights which doesn't necessarily violate the investment.

And that right may need a remedy, but the remedy won't be in NAFTA Chapter 11. I hope that's clear. Yes?

MR. FELDMAN: Professor Anaya, I would note in our briefs we indicated, and as Ms. Thornton addressed, the minimum standard of treatment sets a floor of treatment for all aliens. And so, particularly with respect to an

12:21:44 obligation such as the duty to consult, it simply would not fit into that framework because the consultation obligation would not run to all

aliens; it would only run to a subset of aliens.

MR. KOVAR: I think I made the point about the ILO convention.

ARBITRATOR CROOK: Could I maybe squeeze in my questions now?

MR. KOVAR: Yes.

ARBITRATOR CROOK: I think Professor Anaya, in your colloquy, just addressed one of them, which is that, if there's an obligation to

12:22:16 consult, it runs to governmental entities and not to individual businessmen. But I'm just wondering, does the Tribunal need to go to these waters?

Do we need to make any sort of ruling whether there is or is not a customary duty of consultation and, if so, what its content is isn't the principle inquiry that even assuming arguendo there is such a principle, the issue is whether it is subsumed within 1105, which gets you to the

12:22:52 point that Mr. Feldman just made.

MR. KOVAR: I would agree with that, yes.

I don't see any scenario under which the Tribunal should have to get to this question, either under the facts as they've been presented or even assuming the facts and the law that would demonstrate a violation.

Claimants have not demonstrated that that right is part of the customary international law minimum standard of treatment as it applies to investments. So, and as I said, even if there's a violation of the individual, it doesn't necessarily mean that it comes under 1105.1.

ARBITRATOR CROOK: And if it were to be part of the minimum standard, you'd somehow have to deal with the anomaly that a certain group of aliens gets treatment that's better than other aliens, which I guess raises question how you define a minimum standard.

MR. KOVAR: Well, that's the point that Mr. Feldman made, I think, yes.

So, I pointed out that the ILO Convention 169 is only enforced for 20 states, but even if these two instruments, the UN Declaration

and the ILO Convention reflect customary international law norm of prior consultation, they only address consultations with indigenous tribal authorities that are located within the territory of the state. This is the point we made in our colloquy with Professor Anaya. They do not address consultations between a state and indigenous tribes located outside the territory in another country, nor do these instruments suggest a duty on states to consult with individual indigenous persons, whether they're natural or legal persons, particularly indigenous persons from outside that state whether these instruments, the ILO Declaration and the UN Declaration refer to consultation between state authorities and tribal or indigenous authorities. Claimant simply cannot claim an individual right to consult with the government under this principle. Indeed, in our view, Claimants' argument would make the duty to consult unmanageable. There are 564, about, federally recognized tribes residing within the United States. Any duty to consult that extended

beyond those recognized tribes to include tribes from potentially any other country where there may be indigenous people that might be affected by U.S. legislation would be wholly unfeasible. This is even truer if consultations were required of individual members of all potentially affected tribes, regardless of their location.

So, for the United States and any other state with a significant indigenous population, to consult business with tribe -- to conduct business with tribes, we must be able to work with tribal government representatives and limit that relationship to tribes within our jurisdiction. And that, as we've discussed, is the way the Federal Executive Order works.

Claimants' 11th hour efforts here to assert that they uniquely do speak for their tribes and nations, in our view, are really just self-serving. Even if Claimants' businesses provide significant employment on their territories, which we certainly don't take issue with, and tribal leaders supported their efforts

to market cigarettes free of state regulation, that in itself does not elevate Claimants to the level of tribal authorities. Indeed, Claimants themselves in this proceeding -- yes? Mr. Crook?

ARBITRATOR CROOK: No.

MR. KOVAR: Oh, I'm sorry.

Indeed, Claimants themselves in this proceeding have decried consultations between states and large tobacco manufacturers. They called it an infiltration of the core of American democracy; I can quote them. So, clearly there's a difference between consulting individual businesses and consulting tribal authorities.

I will not repeat in detail other defenses set out in the U.S. Counter Memorial they're at pages 125 to 139 but -- and Professor Anaya asked about this: The U.S. position that customary international law does not include the duty to consult alleged by Claimants has been repeated publicly and is well known.

Moreover, the Government of Canada submitted an interpretation of Article 1105.1 --

in this case, under Article 1128, affirming their similar view that neither the UN Declaration nor ILO 169 means the legal threshold required for them to be considered customary international law. As I've already mentioned the UN Declaration and ILO 169 do not in and of themselves demonstrate state practice and opinio juris sufficient to prove existence of a customary international law norm of the duty to consult .

12:27:46 PRESIDENT NARIMAN: Sorry to interrupt, but this Canadian thing you cite -- you put it in here -- what is the reference to Grand River Enterprises versus United States, January 19. What has that got to do with it? You see at the bottom of --

MS. THORNTON: Definition of this case.

PRESIDENT NARIMAN: That's only what they filed -- it is not a separate case that they filed.

MS. THORNTON: No, it's this case.

PRESIDENT NARIMAN: That's okay. Thank you.

MR. KOVAR: They're just indicating that they filed an --

PRESIDENT NARIMAN: I thought it was legal authority.

MR. FELDMAN: No.

MR. KOVAR: Yes, no.

As Canada points out in their 1128 submission, this is particularly the case where states such as Canada and the United States, whose

12:28:21 interests are specially affected, given their large indigenous populations, have not followed the practice out of a sense of legal obligation.

Finally, even if it were agreed that customary international law norm has emerged, the United States would not be bound by such a duty in light of the persistent objector rule under international law, and we tried to clarify that we're taking the claim that the Claimants have made here. That doctrine provides, in any state

12:28:51 that persistently objects to a practice while the law is still in the process of development is not bound by that rule even after it matures. The

U.S. made many statements of objection and they've been listed in the record at page 134 and of the following U.S. Counter Memorial.

In our view, there can be no question the U.S. satisfies the requirements of the persistent objector rule with respect to the alleged duty to consult, and Claimants decline to address this argument in their reply.

Claimants also assert that the duty to

12:29:23 consult is guaranteed by the UN chart. They haven't made the argument in this oral proceedings but they made it in the briefs. Even if, for sake of argument, this was true, such a claim could not be cognizable under NAFTA Article 1105.1 since, as we noted, the NAFTA The Free Trade Commission explicitly ruled out that a breach of a separate international agreement could establish a breach of 1105.1.

Now, Mr. Weiler's suggestion last week

12:29:49 that a breach of a separate treaty obligation, while not sufficient in itself to establish a breach of 1105.1, is another factor adding up to a

breach of the duty of good faith -- is what he called it -- we think that's completely unsupported.

Claimants do not show how the duty of good faith, which is rule of treaty application rather than a source of independent rights, could have this effect under the customary international law minimum standard of treatment.

As the International Court of Justice

12:30:21 in the Border and Transporter Armed Actions case between Nicaragua and Honduras, and I'll quote, "The principle of good faith is one of the basic principles governing the creation and performance of legal obligations, but it is not in itself a source of obligation where none would otherwise exist."

Moreover, every link in Claimants' argument leading to the charter is, in our view, flawed.

12:30:48 First, Claimants' pointed to Article 7 of the Universal Declaration of Human Rights; however, that Article reads simply, all are equal

under the law and are entitled without discrimination to equal protection of the law. All are entitled to equal protection against any discrimination in violation of this Declaration, and against any incitement to such discrimination.

Now, despite that plain language, Claimants argue that Article 7 implicitly contains a duty to consult with indigenous persons, and we submit that this language simply isn't found in the provision and can't reasonably be read into it. But if you did read it in, as Claimants do, they next would then seek to incorporate this amended or implicitly amended Article 7 into Article 103 of the UN Charter, 103. Article 103, like Article 7, in our view is clear and unambiguous, and it states, in the event of a conflict between the obligations of members of the United Nations under the present charter and their obligations under any other international agreement, their obligations under the present charter shall prevail.

However, Claimants assert without any

authority that Article 103 must be read much more broadly to say that, in the event of any conflict between any so-called ergo omnis norm and the obligations of members of the United Nations under any other international agreement, the obligations under that ergo omnis norm must prevail.

Claimants assert that what they identify as the duty to consult and bargain in good faith is such an ergo omnis norm and that it "preempts any limitation" that might exist in the scope of 1105.1's obligation. Such a reading has no obligation to the reading of the text of Article 103 of the charter which nowhere refers to ergo omnis norms much less the relationship between ergo omnis norms and other international agreements.

Moreover, Claimants do not establish that there is an ergo omnis duty to consult. Claimants seem to argue that the prohibition against racial discrimination is an erga omnis norm and that it includes the duty to consult. By extension, therefore, according to the Claimants'

logic, the duty to consult must also be erga omnis, but even if one accepted Claimants' assertions that the duty to consult is established as a binding principle of customary international law, they cite no authority to suggest it would also be erga omnis. Erga omnis norms such as the prohibition against genocide are those a state owes to the entire world and that convey rights that are enforceable by all states. In any case, pointing to the duty to consult as erga omnis cannot require its conclusion in Article 103 of the UN Charter or Article 1105.1 of the NAFTA. Finally, and we believe fatally to their argument, even if one assumed for the sake of argument Claimants' reading to this text was persuasive, Claimants also failed to demonstrate how the minimum standard of treatment offered to investments of alien investors under Article 1101 of the NAFTA conflicts with the UN Charter, simply by failing to provide a basis to arbitrate every right reflected in that charter. Claimants' arguments with respect to their alleged duty to

consult are, in our view, baseless.

Similarly, to the extent Claimants based their legal arguments under 1105.1 on the duty to consult as a peremptory norm of international law, they have utterly failed to demonstrate how that duty has emerged as a peremptory norm, much less how such a peremptory norm would override the jurisdictional limitations of NAFTA Chapter 11.

But even assuming that Claimants have carried their burden of proof with respect to establishing the existence of the duty to consult as a peremptory norm there's no basis for their assertion that Article 53 of the Vienna Convention on the Law of Treaties would require the incorporation of such a norm into NAFTA Article 1105.1. Article 53 renders void any treaty provision that conflicts with the peremptory norm. And according to the International Law Commission, examples of conflicts include former treaties regulating the slave trade which later came in conflict with the total prohibition on all forms

of slavery that developed as a peremptory norm of international law or a treaty to commit an act of genocide, for example, if such existed, or subject certain individuals to torture.

Claimants do not assert, nor could they, that the NAFTA contemplates or encourages conduct in violation of a peremptory norm, even assuming that a peremptory norm existed encompassing the duty to consult them, Claimants have not demonstrated that Article 53 is in any way relevant here. The mere absence in the NAFTA of a right to seek damages against the NAFTA governments on grounds that the duty to consult was violated is not a conflict with that norm.

Claimants' assertion that Article 1105.1 conflicts with any peremptory rule of law is, in our view, groundless.

So, I'll sum up. Claimants' discrimination arguments are completely unsupported by fact or law. Claimants present no evidence they have suffered any economic impact due to their race or indigenous status. And

despite their attempts to conjure up a legal basis to insert duty to consult in Article 1105.1, their efforts have failed. Even if there was duty to consult and it was incorporated in the customary international law minimum standard of treatment, as applied to investments, it does not extend consultations with individuals or companies, much less those outside the United States. The customary international and minimum standard of treatment in Article 1105.1 applies to investments not to individuals, and the human rights and indigenous rights asserted by Claimants are not included in it.

Thank you.

And I would then ask you to invite Ms. Thornton to address --

PRESIDENT NARIMAN: Just one minute. I have a question.

You have cited a couple of ICJ decisions in support of your argument. Do I take it that what is stated to be customary international law in decisions of the

international court of justice would be customary international law for purposes of 1105?

MR. KOVAR: Well, the International Court of Justice takes cases under different grounds of jurisdiction and their decisions are not on their face binding on all the states in every case.

PRESIDENT NARIMAN: No, I'm asking a simple question.

I'm saying that, is it your case, as the United States of America's case, that what is stated to be customary international law in decisions of the International Court of Justice is to be regarded as customary international law for purposes of 1105?

MR. KOVAR: Well, again, if the question is the customary international law related to human rights, then that decision may be binding between the parties and may be a very important precedent for establishing that customary international rule they address, but that doesn't mean that customary International

rule has inserted itself in 1105.1. You still have to look to the moon standard of treatment with respect to investments.

PRESIDENT NARIMAN: Then, where are we to have customary international law?

MR. KOVAR: Claimants have to prove it.

PRESIDENT NARIMAN: No, no. Where are we to find it, apart from them proving it? Where do we find the contents of customary international law, theoretically, not on whether they have to prove --

MR. KOVAR: The International Court of Justice addressed that and says you have to look at the practice of states and their expression of their intent to be bound opinio juris. And it's not -- you can't just pull out a treaty and say, this is the rule. You have to establish the custom, the practice -- it has to be universal and you have to show that the states have taken that action and that practice on an understanding and acknowledgement that they're bound to do it under the law. That's how customary international law

is formed. And that -- I mean, that is international law. It's not always the clearest form of international law but that's the way it is formed in this case the burden is on the Claimants to demonstrate that it exists. I hope that helps.

ARBITRATOR ANAYA: And we're competent to make that determination, you're saying.

MR. KOVAR: Well, you are the Tribunal to decide in this case.

12:39:37 ARBITRATOR ANAYA: So, we don't have to find someone else saying that this customary international law already exists. We can do that analysis of looking at state practice or opinio juris and so forth.

MR. KOVAR: Well, if Claimants have put that before you and made their case, that's what you're --

ARBITRATOR ANAYA: So, you're saying we have to limit ourselves to what the Claimants have

12:39:55 brought before us. I understand that's what Mr. Feldman said before.

MR. KOVAR: Yes.

ARBITRATOR ANAYA: Just to satisfy my own curiosity, though, perhaps -- but perhaps not just that, since they haven't raised this, but I want to now another putative norm that has to do with the United States admitted trust responsibility towards indigenous people's in this country, one that's well grounded in U.S. law for a century-and-a-half or more throughout the U.S. statutes relevant to Indian people and the U.S. in

12:40:38 international settings have affirmed its adherence to -- without getting into a debate about whether such a trust responsibility or special duty of care towards indigenous people, such affirms -- makes for affirmative obligations towards them, would such a duty, if we assumed it to exist, would it be relevant to 1105 or any other -- or 1102 or 1103?

MR. KOVAR: Well, I'd always take you back to the same framework for looking at it

12:41:13 because as I mentioned there's a lot of potential international law rules out there but they don't all find themselves in 1105.1.

So, that particular rule, if one were to establish that it existed and that it was violated, it would depend. If it --

ARBITRATOR ANAYA: Let's say we're applying it to the context to the interest of the tribes who were excluded from the MSA and who, like various terms of the MSA, are not parties or participant but whose jurisdiction appears to be affected by all accounts, if an argument can be

12:42:04 made that the U.S. has -- Federal Government or the U.S. for our purposes has the affirmative obligation to seek out and defend the interest of the tribes in this context and also that that hasn't been done, and how -- in that specific context, would the trust responsibility relate?

MR. KOVAR: Speaking in the hypothetical, because I don't want to give the impression that I necessarily --

ARBITRATOR ANAYA: No, no, no, and I'm

12:42:33 speaking in a hypothetical, too.

MR. KOVAR: Yes. Again, I think Chapter 11 isn't designed to enforce such a right.

So, if Claimants wanted to come to a NAFTA Chapter 11 Tribunal which is a specialized Tribunal, they would have to show that, first of all, that that duty existed under international law, that it was violated, and that it had relevance to one of the articles of Chapter 11, 1102, 1103, 1110 or 1105.1, and it's not obvious to me how they would do that.

ARBITRATOR ANAYA: John, if I could.

12:43:19 I understand, okay, what you're saying with regard to 1105 and having to fit it within the customary international law minimal standard. How about as to denial of justice? Could that somehow be relevant to denial of justice claim?

MR. KOVAR: Well, Ms. Thornton is going to address denial of justice, so, I don't want to preempt her discussion.

ARBITRATOR ANAYA: Okay.

MR. KOVAR: So, I think now that you've

12:43:46 asked the question she can be ready to address that. I hope that's good enough.

Mr. Crook?

ARBITRATOR CROOK: Referring to Professor Anaya's last question, I'm just trying to wrap my mind around it in the context of a treaty that addresses international economic and investment relations. It seems to me if there is a customary obligation of the kind he describes, it would seem to me to be one that runs from a state to indigenous persons who may lie within its territory, and it's a little hard for me to grasp how that kind of an inward looking obligation might then be taken out to extend to indigenous persons who are not subject to your territorial jurisdiction. I wonder if you could ponder that one with me.

MR. KOVAR: Well, I think that's the same issue with respect to the duty to consult.

So, if we were to look to it, duty to consult with indigenous persons, in our view there really is no authority for such a duty to extend beyond your borders to tribal authorities outside. And I think this would be -- if there's a duty -- a trust duty under international law for a state

to protect indigenous people who are under its sovereignty, then it refers to them, not to those who are outside in another state.

ARBITRATOR CROOK: Then further to Professor Anaya's intervention or his suggestion that perhaps we had measures here that were adverse to the interest of tribes, I take it, inside the United States, I wonder what the situation is. Do we have the competence as an international Tribunal to look to questions involving the rights of parties who are not before us?

MR. KOVAR: Well, this Tribunal has to decide the case that's in front of it, based on the law and the facts.

And I think when we opened our argument on the first day, the legal advisor, Mr. Koh, I think he addressed this point as clearly as he could, which is that the Claimants, in our view, really don't have a NAFTA case, so they're trying to find traction somewhere else and they're trying to create all this other stuff to encourage you to

find something that you'll be interested in, in ruling on.

And in our view what we've tried to do is, sometimes perhaps to too great a length, but to patiently say, you have to come back to the terms of your jurisdiction. You have to come back to the specific provisions of the NAFTA. They have to prove their case. And I think that would apply here too.

Thank you.

MS. THORNTON: I realize we're approaching the lunch hour and I can assure you my presentation is short.

PRESIDENT NARIMAN: Good. First, tell us what are you --

MS. THORNTON: I'm going to be talking about the denial of justice obligation. We do recognize that this is a customary international law norm subsumed within the minimum standard of treatment.

Just, right out of the gate I want to answer Professor Anaya's question, if I could.

The United States recognizes that it has trust obligations with respect to indigenous tribes within our territory. And as you know better than I, there are lots of doctrines of interpretation which now apply which say we have to construe the treaties we enter into with indigenous people's sort of to their benefit given the historical treatment that they received by our government.

But if Claimants are alleging that we've somehow violated those obligations, they've got to exhaust their challenges to that in our domestic courts if they're going to make a denial of justice claim before you today.

As I will try and demonstration in my presentation, the doors of our courthouses are wide open to Claimants and they are availing themselves to these domestic remedies, but the denial of justice doctrine is a distinct international law obligation and it has subsumed within it an exhaustion requirement. And our position is they can't bring this claim before you today because they haven't satisfied that

requirement. So, that's what my presentation is chiefly about.

ARBITRATOR ANAYA: I'm sure you're going to get to this, but just so I'm clear, you're affirming the denial of justice standard has subsumed within it an exhaustion requirement.

MS. THORNTON: That's our position.

ARBITRATOR ANAYA: An exhaustion of judicial remedies.

12:48:59 MS. THORNTON: Yes, because, in our view, the denial of justice doctrine implies a systemic failure of our judicial system. And therefore, if you're going to go to an international Tribunal and say that one of the NAFTA parties judicial systems has failed as a system, you've got to give us an opportunity to try to correct your complaint in our courts. And the Loewen Tribunal is very clear: You have to take it to the court of highest resort before you

12:49:25 can bring it to a NAFTA Chapter 11 Tribunal.

PRESIDENT NARIMAN: Is it reflected in the Loewen Tribunal?

MS. THORNTON: It is. It is.

Now, under customary international law, denial of justice claims can be based on evidence that a state has delayed or obstructed access to its courts, has administered judicial process in grossly deficient way, or has failed to provide procedural guarantees generally considered indispensable to the proper administration of justice.

12:50:08 Importantly, the erroneous application of municipal law by domestic courts, even that cannot give rise to a denial of justice claim.

Mr. Crook?

ARBITRATOR CROOK: Ms. Thornton, as I understood their denial of justice claim, at least as it was presented in their most recent pleading, it was sort of to the effect that requiring them to pay escrow without having been convicted of bad conduct or shown to have caused cancer or any such

12:50:40 things; that was the denial of justice. Is that a denial of justice as the concept exists under international law?

MS. THORNTON: Not in our view. What the United States acknowledges is that you can challenge a legislative measure as a denial of justice if it interferes with the process of obtaining judicial relief and you go to the domestic courts and they don't correct that problem, but there's got to be an involvement -- the failure of the judicial system in play.

And so, Professor Weiler pointed you to

12:51:13 provisions in Mr. Paulson's book which discusses when a legislative measure can give rise to a denial of justice claim, and in our view, it's only a legislative measure that interferes with the process of judicial relief that hasn't been corrected by the domestic courts. Our domestic courts have looked at Claimants' procedural due process challenge to these measures and they've said this is akin to posting of a bond and international law permits states to require this

12:51:45 of Claimants in their courts. There's not a violation of international law if you have a sort of bonding obligation.

So, yes, Mr. Crook, you're absolutely right, that's the challenge that their making. They're saying the legislation on its face creates a denial of justice, and our position is that, implicit within the denial of justice obligation, has to be some examination of how our judicial area has dealt with it.

Now, in order to assert denial of

12:52:20 justice claim before international law, a Claimant must demonstrate that it has exhausted adequate and effective domestic remedies for relief.

MR. VIOLI: Ms. Thornton, can I just ask you where in the record you said there was a case involving our Claimants that said it's the equivalent of posting a bond.

MS. THORNTON: I believe that was the determination of the Second Circuit in the prior case.

MR. VIOLI: Equivalent of posting a

12:52:41 bond?

MS. THORNTON: The Second Circuit analyzed your challenge -- your procedural due

process challenge under the United States Constitution and they said it was a piece of legislation of general applicable, did not require notice of hearing; it wasn't akin to the seizure of a car in a civil forfeiture proceeding for which you were entitled to notice and a hearing. I believe that was the Second Circuit's determination, and you did not appeal that.

MR. VIOLI: That's the first case, right?

MS. THORNTON: The prior case.

MR. VIOLI: There's two cases that went up on appeal in that case.

MS. THORNTON: Right, but that particular determination of the Second Circuit --

MR. VIOLI: There was a first one that dismissed the -- so you're referring to the first case.

MS. THORNTON: I am referring to the first case.

MR. VIOLI: As the bond.

MS. THORNTON: And it wasn't appealed,

that determination.

PRESIDENT NARIMAN: Okay. Please proceed.

MS. THORNTON: The exhaustion requirement is fundamental to denial of justice claims because a finding that a state has denied an investment justice, as I mentioned to you before, implies a systemic failure of a state's judicial system. This means that, unlike other claims an investor can make under NAFTA Chapter 11, a Tribunal cannot resolve a claim that a NAFTA party has denied to justice to an investor's investment until all available challenge to that denial have been made in the parties's domestic courts.

I'm going to project this Loewen finding on the slide.

As the Chapter 11 Tribunal in Loewen explained, the purpose of the exhaustion requirement for denial of justice claims is "to ensure that the state where the violation occurred should have the opportunity to address it by its

own means within the framework of its own judicial system."

Claimants failed to demonstrate that they've exhausted their local remedies, a fact which is simply fatal to their denial of justice claims. Instead, Claimants' attempt to avoid this fundamental prerequisite for the denial of justice claims by fashioning their claim, as Mr. Crook pointed out, as one for "denial of administrative or regulatory due process" rather than a challenge to the actions of our judiciary.

But my fundamental point is this: Nothing in the measures that Claimants challenge in this proceeding prevents them from seeking relief from their application before a U.S. court.

Indeed, the NAFTA Chapter 11 Tribunal in Feldman rejected a very similar denial of regulatory due process claim on the ground that "Mexican courts and administrative procedures at all relevant times were open to the Claimant." That case is a case that is not entirely dissimilar from this case, and the Feldman

Tribunal correctly concluded that, because these local remedies remained available to the Claimant, there was "no denial of due process or denial of justice there as would rise to the level of a violation of international law."

So, therefore, even if Claimants' complete is not with our judicial system but rather with the legislative process whereby Grand River has been required to make escrow requirements to secure potential tobacco-related judicial settlements or awards, they must still exhaust their challenge that those measures in domestic courts of last resort.

If the United States demonstrated in its Counter Memorial, Claimants challenge the Allocable Share Amendments adopted by 31 out of 47 of the MSA states and the complementary legislation adopted by 14 of those states.

I've projected the states whose measure Claimants have challenged and are continuing to challenge in Federal District Court in New York.

PRESIDENT NARIMAN: Does that not

satisfy the exhaustion rule or it doesn't?

MS. THORNTON: Well, what they're complaining about here is that the legislation on is face denies them justice under international law.

PRESIDENT NARIMAN: No, that's not the point.

You were making out a case, quite rightly, that a denial of justice cannot be just be projected before any international Tribunal without exhausting domestic remedies. This is a domestic remedy which they did choose and failed.

MS. THORNTON: Right, and they also haven't exhausted this remedy. They're in the middle will of these proceedings.

PRESIDENT NARIMAN: This is an ongoing remedy?

MS. THORNTON: This is an ongoing case; am I correct Mr. Violi?

MR. VIOLI: The due process claim was dismissed. That dismissal was affirmed in the Second Circuit and you don't get an automatic

right to the Supreme Court of the United States.

PRESIDENT NARIMAN: That's exhausted. That's over.

MS. THORNTON: No, it's not exhausted.

PRESIDENT NARIMAN: No?

MS. THORNTON: Because there was petition filed for Cert, excuse me, in that case by the defendant state AGs and Claimants could have cross-petitioned to appeal the second circuit's determination with respect to their procedural due process claim; they did not. They did not exhaust their domestic remedies to this claim.

PRESIDENT NARIMAN: That somehow waters down your case, which is an excellently presented case, if I may say so; you've done it extremely well, that they, for the denial of justice claim they have attempted a domestic remedy. That remedy has either succeeded or failed and right to go to the Supreme Court is not a right, it's subject to the discretionary powers of the Supreme Court to admit certiorari or not admit.

MS. THORNTON: The Loewen Tribunal addressed the issue quite squarely and said that you -- in order to prove that you've exhausted domestic remedies you have to petition for cert. They didn't petition for cert on this issue; therefore, they can never satisfy the exhaustion requirement with respect to the measures at issue in the prior litigation.

MR. VIOLI: But the other issue --

PRESIDENT NARIMAN: No, let her go on.

MS. THORNTON: As I just mentioned, and prior Claimants argued, that those measures, the measures adopted by the states at issue on the slide -- denied them due process of law under the U.S. Constitution, because they amounted to prejudgment depravations of property, which required prior notice and a hearing. This claim was rejected and, in 2005, the U.S. Court of Appeals for the Second Circuit affirmed the District Court's decision.

PRESIDENT NARIMAN: When was that?

MS. THORNTON: This was in 2005.

And this decision, just for your reference, is, it's attached to our Counter Memorial, Legal Authorities, Volume Eight, Tab 118.

Now, in 2005, the Court of Appeals for the Second Circuit affirmed the District Court's dismissal of Claimants' charge, finding that the escrow deposits are "designed to ensure that funds were available should litigation subsequently begin and result in judgment against manufacturers." Thus, the accounts are substantially different in kind from an individual prejudgment depravation of property.

PRESIDENT NARIMAN: This is your submission?

MS. THORNTON: This is the findings of the United States Court of Appeals for the Second Circuit.

PRESIDENT NARIMAN: State that again.

MS. THORNTON: The second circuit Court of Appeals found that escrow deposits are --- and I projected this on the slide -- designed to

ensure that funds are available should litigation subsequently begin and result in judgment against manufacturers. Thus, the accounts are substantially different in kind from an individual prejudgment depravation of property.

The reason why this is relevant is because an individual prejudgment depravation of property would require notice and a hearing, but the Second Circuit said, that's not what these escrow deposits are; therefore, the notice and hearing requirements are not in play.

ARBITRATOR ANAYA: Excuse me, that statement goes to the merits of the issue as opposed to the exhaustion, right?

MS. THORNTON: That's right. The exhaustion point is simply that they didn't appeal that determination.

ARBITRATOR ANAYA: Okay. So, what I want to get clear is how we treat a matter where a domestic certiorari remedies have been exhausted or we determined they've been exhausted. Let's say in this case we don't buy your point that they

have to go to the Supreme Court because we all know the chances of getting cert review are very, very low and we say that, okay, domestic remedies have been exhausted, then what? What's our --

MS. THORNTON: Then your standard is this, and I submit to you that it's extremely deferential. You have to find that no impartial decision-maker could have arrived at the result reached by the courts to find that there's been a denial of justice, referred to as a substantial -- substantive denial of justice. If you're going to make a determination that our courts got to wrong, you have to find that no impartial trier of fact could have arrived at the decision.

And I would submit to you -- you've had in the colloquy -- you've been liking for the standard of deference from us. That's an extremely differential standard in our view.

ARBITRATOR CROOK: Ms. Thornton, just to be clear, you're not asserting that exhaustion requires that cert be granted, but rather, as in Loewen, that cert be petitioned for, and if it is

denied, at that point, you've had exhaustion.

MS. THORNTON: Absolutely. Absolutely. We recognize Professor Anaya's point, but you have to petition. You have to attempt to exhaust your local remedies, and Claimants didn't, with respect to these measures.

ARBITRATOR CROOK: And that's Loewen.

MS. THORNTON: And that's Loewen, yes.

ARBITRATOR ANAYA: That's not a binding interpretation is it?

MS. THORNTON: No, no, but we -- the exhaustion requirement -- it's persuasive, but the exhaustion requirement is implicit in the doctrine of denial of justice.

ARBITRATOR ANAYA: Right. I understand that. I'm trying to think through the different possibilities --

MS. THORNTON: How you're going to arrive at your decision. I recognize that, yes.

ARBITRATOR ANAYA: And if we thought there was exhaustion, what -- but you've answered my question.

MS. THORNTON: I would simply point you to the Loewen award when -- there's lot of discussion about petitions for cert and probability of obtaining one, but it was found that you had to actually petition for cert to prove exhaustion.

PRESIDENT NARIMAN: Shall we break yet or you take some time.

MS. THORNTON: I'm at page 4 of 10, so you tell me.

(Discussion off microphone.)

MR. KOVAR: I think we should keep the lunch short so we have time.

PRESIDENT NARIMAN: 1:45.

MR. KOVAR: Mr. Chairman, if you could give her ten minutes to finish, I think that would put us in better position after lunch.

PRESIDENT NARIMAN: By all means.

MR. KOVAR: Thanks.

MS. THORNTON: I'll be short.

PRESIDENT NARIMAN: No, no, no. Please, you're presenting your case extremely

well, in my view.

MS. THORNTON: Thank you.

So, this is our legal case about their denial of justice claim. Now, we also submit that Claimants' denial of justice claim is premised not only on a faulty legal theory, but on several mischaracterization of facts.

Now I'm projecting on the slide, Claimants' central contention is that the Allocable Share Amendments have denied them justice because they "are forced to make payments into escrow that are equal to the payments being made by OPMs under the MSA," when the allegations of fraud, deceit, and conspiracy made against the OPMs have not been leveled against Grand River.

The problem with this assertion is that it obscures the fact that the escrow deposits can be used to satisfy judgments or settlements on any released claim brought against an NPM by the state, not just claims involving allegations of fraud and conspiracy in the marketing of cigarettes.

Now, I'd submit to you that this fact is readily apparent from the definition of release claims that you'll find in the MSA. It's in the definition section of the MSA and I've projected it on the slide, and it says claims, directly or indirectly based on arising out of or in any way related in whole or in part to the use, sale distribution, manufacture, development, advertising, marketing, or health effects of the exposure to or research statements or warnings regarding tobacco products fall within the definition of release claims.

So, Moreover, in addition to claims for fraud, deceptive practices, and conspiracy, many states brought other claims against the major tobacco companies when they initiated suits against them prior to negotiating the MSA.

As you can see from the slides, in addition to claims based on allegations of fraudulent conduct, the State of New York brought strict liability and negligence claims against the major tobacco manufacturers in 1997.

PRESIDENT NARIMAN: Philip Morris.

MS. THORNTON: That's right. This is pre-MSA. New York alleged that the major tobacco companies should be strictly liable for the manufacture and sale of their tobacco products because they "were likely to cause injury to persons who use them as intended."

Furthermore, New York's negligence claim was based on the assertion that "it was foreseeable by the defendants that certain New York residents who use their tobacco products would become ill and suffer injury, disease, and sickness as a direct result of using the tobacco products as the tobacco companies intended." New York also claimed that the major tobacco companies were negligent in failing to foresee that the state could have to pay millions of dollars each year to provide medical treatment for residents injured by tobacco products.

The point of all this is simply to counter Claimants' suggestion in their reply that the claims brought against the major tobacco

manufacturers all involved fraud, deceit, and conspiracy, claims that have not been leveled against them. Our submission to you is that they are product liability claims that a state might one day be able to bring against Grand River or another NPM that don't involve the same allegations, and that's what the escrow deposits are about.

Therefore, the deposits that an NPM places into escrow can be used to satisfy future judgments or settlements based on claims not arising from allegations of deceptive or fraudulent conduct.

Moreover, Claimants' assertion that payments NPMs make into escrow are equal to the payments made by OPMs under the MSA is incorrect. The deposits NPMs are required to make under the Allocable Share Amendments do approximate the payments they would make as SPMs, but from 1999 to 2003, OPMs were subject to initial payment obligations that exceeded $10 billion. There are no escrow deposit obligations that correspond to

these huge initial payment obligations that the original participating manufacturers had to make. Furthermore, the escrow deposit obligations of the Allocable Share Amendments imposed on NPMs are different in kind from the annual payment obligations of OPMs under the MSA because escrow deposits are the current property of an NPM unless and until they are released to satisfy tobacco-related judgment or settlement.

13:09:21 As Professor Gruber explained, and I've put this on the slide, the NPMs enjoy an advantage because they do not actually make payments to the government but rather put money in escrow, money that earns interest over time that is available on a current basis to the NPMs.

In addition to retaining ownership over its funds while they're in escrow and receiving interest on those funds, an NPMs can establish its escrow account with any financial institution of

13:09:49 its choosing, provided the institution federally state chartered and has assets of at least US$1 billion.

The key point is that these Escrow Statutes, either in their original form or as amended, established escrow deposits that cannot be released to the states in the absence of a tobacco-related judgment or settlement and that the escrow deposits reverse back to the NPMs after 25 years if such a judgment or settlement is not entered. Claimants will have the opportunity to vigorously contest any judicial determination of

13:10:31 liability on which the release of these deposits is predicated. Just as they are now, the doors of our courthouses will be wide open to Claimants to challenge these determinations.

In contrast, OPMs make annual payments and strategic contribution payments in perpetuity under the MSA based on their relative market shares of certain base amounts. There's no prospect that those payments will ever be returned to them.

13:11:02 Moreover, as my colleague, Mr. Feldman, and my colleague, Ms. Morris, have ably explained, OPMs and SPMs are subject to wide ranging conduct

limitations under the MSA which the states have not imposed on NPMs under the Escrow Statutes or complementary legislation.

For example, the MSA subjects OPMs and SPMs to extensive restrictions on tobacco-related advertising and marketing to which NPMs are not subject, as well as in their ability to promote products in the media and through merchandise. I'm not going to belabor the point. We have tried

13:11:37 to identify it over the course of this hearing, but the conduct restrictions imposed on participating manufacturers are not imposed on Claimants. Grand River's U.S.-based importer, NWS, has engaged in extensive promotional activities to support the expansion of the Seneca brand. A participating manufacturer simply cannot engage in these promotional activities under the clear terms of the MSA.

So, for these reasons we believe the

13:12:07 Tribunal should reject the central factual predicate of Claimants' denial of justice case, namely that PMs and NPMs are subject to identical

obligations.

So, in summary, we believe that, because Claimants have not exhausted their challenge to the Allocable Share Amendments and complementary legislation in U.S. court, and nothing in the challenged measure in these proceedings, either the Escrow Statutes in its original form or as amended prevents Claimants from challenging those statutes in U.S. courts,

13:12:40 Claimants denial of justice claim is just inadmissible before you.

The fact that Claimants' denial of justice claim is also predicated on a false premise, namely that participating manufacturers and NPMs are subject to identical obligations and restrictions while not being alleged to have engaged in the same conduct just confirms our view that the United States has not denied Claimants' alleged investment justice and has not violated

13:13:03 the obligation Article 1105.1.

PRESIDENT NARIMAN: Thank you very much. I just have one question.

Is a petition for certiorari after failing in the normal course of the country to the Supreme Court a matter of right or --

MS. THORNTON: It's a matter of the court's -- whether it grant the petition is a matter --

PRESIDENT NARIMAN: Is it a matter of right?

ARBITRATOR CROOK: The petition is.

13:13:29 MS. THORNTON: The petition is a matter of right, but the determination whether or not we will accept the petition is in some senses up to the court's discretion, but I think there are some matters it has to accept. It has to accept --

PRESIDENT NARIMAN: Is this one of those matters which it has to accept?

MS. THORNTON: Am I incorrect?

This is not one of those measures, but the point is they didn't file a petition.

13:13:48 PRESIDENT NARIMAN: Yes, okay.

MS. THORNTON: Right? The states petitioned for cert -- they could have

cross-petitioned to have the Supreme Court review the determination. They didn't do it so they didn't exhaust.

PRESIDENT NARIMAN: All right. Resume at what time?

MR. FELDMAN: 2:00.

PRESIDENT NARIMAN: 2:00? Okay.

(Whereupon, at 1:13 p.m., the hearing was adjourned until 2:00 p.m., the same day.)

AFTERNOON SESSION

PRESIDENT NARIMAN: Now we're on.

MR. KOVAR: If I may, thank you very much.

Mr. Anaya, first I wanted to just get back to you on your question about the General Recommendation 23 of the Committee of the Race Discrimination Convention the CERD. And I did take a look at that. It wasn't clear to me that

13:59:36 the CERD was actually offering an interpretation of Article 9 that would go as far as you suggested.

PRESIDENT NARIMAN: Would you read into the record General Recommendation 23.

MR. KOVAR: Well, it's a little too long.

PRESIDENT NARIMAN: Too long.

MR. KOVAR: Yes, and it's --

PRESIDENT NARIMAN: The relevant part?

13:59:55 MR. KOVAR: Well, essentially, the first paragraph talks about the practice of the committee to examine reports of states' parties

under Article 9 and of the cert of the convention, and in that respect the committee is consistently affirmed that the discrimination against indigenous peoples falls within the scope of the convention and all appropriate means must be taken into combat and eliminate such discrimination, and then they go on to talk about the international decade of the world's indigenous peoples and so on.

14:00:31 But maybe you could reformulate the question that you wanted to ask about it.

ARBITRATOR ANAYA: I'm not sure we're looking at the same document.

MR. KOVAR: Oh.

ARBITRATOR ANAYA: Do you have it some place?

MR. KOVAR: This is General Recommendation 23 --

ARBITRATOR ANAYA: Right.

14:00:54 MR. KOVAR: -- dated 1997.

ARBITRATOR CROOK: In light of the shortness of time, I wonder if Professor Anaya and

Mr. Kovar would be willing to meet at the break and sort out which document we need to look at and then we'll return to it after the break. Would that make sense?

MR. KOVAR: Sure.

ARBITRATOR ANAYA: Yeah. I mean, I don't know if we need to spend a lot of time on this.

ARBITRATOR CROOK: OKAY.

14:01:13 ARBITRATOR ANAYA: I mean, I -- I'm simply going to the point that the standard -- what that committee is doing is interpreting the standard of discrimination, the context of indigenous peoples and going beyond the language that you've displayed. I mean, that's what it's doing. It doesn't have any power to do anything other than that.

Now, whether or not its interpretation applies here, that was another question and that's

14:01:39 what we were talking about. I was asking you about, you know, whether or not you were aware of that, and what -- how you saw that applying to

what -- how you were describing the standard of discrimination --

MR. KOVAR: Yes.

ARBITRATOR ANAYA: -- of the treaty.

MR. KOVAR: There -- maybe there's another general determination or in some other document of the CERD Committee that they elaborate more on a particular interpretation of Article 9. At least in my review of General Recommendation

14:02:10 23, it doesn't appear it goes that far, but then, again, maybe I'm looking at the wrong document.

But in any case, even if we found an interpretation by the CERD Committee that elaborated on Article 9 in a way that's not necessarily clear on the face of the text and along the lines of what you suggested, in our view the cert itself doesn't have the power to issue binding interpretations of Article 9. They certainly play a very important role under the

14:02:49 convention, the U.S. has to submit reports to the CERD and respond to them and it takes its recommendation seriously, but we don't view them

as issuing binding interpretations of the CERD.

ARBITRATOR ANAYA: Right. But just to be clear, every time you cite a NAFTA decision or a decision by another by NAFTA Tribunal, you don't point out to us that it's not binding. I mean, I don't know why every time --

MR. KOVAR: Well --

ARBITRATOR ANAYA: -- one of these things is cited, it's pointed out to us that it's

14:03:22 not binding. I mean, that goes without saying, I think, that it's not binding, but it is an authoritative interpretation --

MR. KOVAR: Okay.

ARBITRATOR ANAYA: -- in much the same way as a decision of a NAFTA Tribunal.

MR. KOVAR: I think that's a good question. I think one distinction is that -- at least a decision of a NAFTA Tribunal is binding as between the parties.

14:03:36 ARBITRATOR ANAYA: Yes, but it's not binding on us.

MR. KOVAR: But it's not binding on us.

There's no star e cisus(ph) in that arbitration. That's correct.

I mean, your hands, whether you wanted to focus on another document further or whether this explanation is accurate.

ARBITRATOR ANAYA: No, no, no, it's fine.

MR. KOVAR: Okay.

ARBITRATOR ANAYA: I would -- I'm

14:04:02 looking at that it now, and it calls upon states to do a series of things.

MR. KOVAR: Yes.

ARBITRATOR ANAYA: Affirmatively calls upon states, in paragraph four, to recognize and respect different culture, it's very much in line with the sort of affirmative obligation I was talking about.

MR. KOVAR: Yes.

ARBITRATOR ANAYA: And it may be that

14:04:17 it doesn't apply here.

My point isn't that it applies or doesn't. It's simply to point out that it's not

just the standard in the document, at least as this committee sees it now.

MR. KOVAR: YES.

ARBITRATOR ANAYA: It's not binding on us either, that interpretation. I accept that. But it is an interpretation of the committee itself.

MR. KOVAR: Okay.

ARBITRATOR ANAYA: But I'm satisfied -- I'm not sure my colleagues are -- with your answer.

MR. KOVAR: Yes.

PRESIDENT NARIMAN: Okay.

MR. KOVAR: Two other pieces of housekeeping, Mr. President. You asked about the letters that make up the -- Amendment 21 to the MSA and the dates. The original letter was sent out in early 2003.

PRESIDENT NARIMAN: Amendment is what page? Amendment 21?

MR. KOVAR: It's formed with separate letter agreements with each company.

PRESIDENT NARIMAN: Oh. Oh.

MR. KOVAR: And the initial letter that went out to all the companies was in early 2003, and the responses from the company, and I think, if I'm not mistaken -- I can be corrected -- what the Claimants put up on the screen was one of those responses. I think it was Liggett's response. Those came in at different dates.

PRESIDENT NARIMAN: Roughly, 2003.

MR. KOVAR: Roughly, 2003, and some may have come in as late as 2004.

One other point of housekeeping --

PRESIDENT NARIMAN: And those other things you'll be giving us later --

MR. KOVAR: Yes, yes.

PRESIDENT NARIMAN: -- United States V Philip Morris --

MR. KOVAR: Yes.

PRESIDENT NARIMAN: -- decision of those courts --

MR. KOVAR: Yes. You'd like the decisions of the Federal Courts in those cases,

yes.

PRESIDENT NARIMAN: -- the Federal Court and the original case.

MR. KOVAR: Yes. One other piece of housekeeping. Mr. Violi -- we had offered to provide a copy, a full copy, of an e-mail of Mr. Hering's that the Claimants had used that had ellipses in it and so on. Mr. Violi objected, saying that this was discussed during the jurisdictional phase of the Tribunal, and the very question of whether the U.S. would produce that document had been discussed in the jurisdictional --

PRESIDENT NARIMAN: The two asterisks.

MR. KOVAR: Yes. It's a long transcript. But in our search of the transcript we couldn't find that -- that discussion between Mr. Violi and Mr. Klinefelter. What we found, which was starting around Paragraph 21 going -- Line 16 through about paragraph 22, Line 10 was --

PRESIDENT NARIMAN: What is Paragraph 21 of what?

MR. KOVAR: The transcript of the Jurisdictional Hearing.

PRESIDENT NARIMAN: Oh, of the Jurisdictional Hearing.

MR. KOVAR: Yes. We found that Mr. Violi had presented that document and quoted from it, but we couldn't find that there was a discussion of where it came from or whether there was another version of it. Perhaps there's a different area of the transcript. We couldn't find it. So if Mr. Violi has -- oh, the page number is 754, and it's Line 21 through Line 22.

PRESIDENT NARIMAN: Okay. Where are we at?

MR. KOVAR: It starts on Page 754 of the Jurisdictional Hearing. So if Mr. Violi has a different section of the Jurisdictional Hearing where he and Mr. Klinefelter had specific discussions, perhaps he could give us the page numbers, because we couldn't find it.

PRESIDENT NARIMAN: When his turn comes. Not now.

MR. KOVAR: Yes, that's fine. With that, I will ask you to invite Mr. Feldman to discuss 1101, the jurisdiction.

PRESIDENT NARIMAN: Feldman, yes.

MR. FELDMAN: Good afternoon, Mr. President, Members of the Tribunal.

I will now address two jurisdictional issues under NAFTA Article 1101(1). The parties in this arbitration agree that under Article 1101 14:08:18 this Tribunal has jurisdiction over Claimants' claims only if the Claimants have an investment in the territory of the United States and only if the challenge measures relate to the Claimants.

The parties disagree, however, on the following two issues:

First, whether the Grand River Claimants, namely, Grand River and its shareholders, Jerry Montour and Kenneth Hill, have an investment in the United States.

14:08:51 Second, whether the challenged escrow statutes, either in their original form or as amended, relate to the remaining Claimant Arthur

Montour.

As I will discuss, Claimants' Grand River Jerry Montour and Kenneth Hill have failed to demonstrate they have an investment in the United States, and thus do not qualify as investors under Article 1101(1). Given that failure to meet fundamental jurisdictional requirements under NAFTA Chapter 11, their claim should be dismissed in their entirety.

14:09:29 ARBITRATOR CROOK: Mr. Feldman --

MR. FELDMAN: Yes.

ARBITRATOR CROOK: -- just to be absolutely clear, you do not dispute that Mr. Arthur Montour has an investment in the United States.

MR. FELDMAN: Thank you, Mr. Crook. That's correct. We do not challenge Mr. Arthur Montour's investment in the United States. Thank you.

14:09:50 ARBITRATOR ANAYA: Further along those lines, I see that you dispute that the escrow statutes relate to him.

MR. FELDMAN: Yes.

ARBITRATOR ANAYA: But what about the complementary legislation?

MR. FELDMAN: Yes, thank you, Professor Anaya. Again, we do not -- we agree that the complementary legislation does relate to Arthur Montour. So our challenge under 1101 with respect to Arthur Montour is only that the Escrow Statutes do not relate to him.

14:10:25 Article 1101 is the scope and coverage provision of NAFTA Chapter 11. As stated by the Chapter 11 in the Methanex case, Article 1101 is, quote, "The Gateway leading to the dispute resolution provisions of Chapter 11. Hence, the powers of the Tribunal can only come into legal existence if the requirements of Article 11011 are met."

Plaintiffs in this case have brought claims under NAFTA Articles 1102, 1103, 1105 and 14:10:56 1110. Article 1101(1) permits such claims only to the extent that they relate to, first, investors of another party, or, second, investments of

another party in the territory of the party.

NAFTA Article 1139 defines "investor of a party" as one who, quote, "seeks to make, is making or has made an investment." And under Article 1101 the only investments covered by Chapter 11 are those located in the territory of another NAFTA party.

Accordingly, the only investors covered by Chapter 11 are those who are seeking to make, 14:11:44 are making or who have made an investment in the territory of another party.

ARBITRATOR CROOK: Mr. Feldman, at some point will you address the elements of their claim that seems to include investment in the plant in Ontario as part of their investment, will you -- will you be getting to that at some point?

MR. FELDMAN: I can address it. I know we have addressed it in our briefs, and I believe we cite the ADM case on this point, and actually 14:12:14 Mr. Sharp, in his presentation, will also address it.

I can say at this point the ADF case is

clear, that the damages under Chapter 11 must flow from the investment located in the territory of the host state. So for equipment located in Canada, that could not give rise to a claim for damages because it is not located in the territory of the host state.

ARBITRATOR CROOK: Are the Canada cattleman and Bayview Water District cases relevant for these purposes?

14:12:47 MR. FELDMAN: Thank you, Mr. Crook. They are directly relevant. In each case the Chapter 11 Tribunal rejected the claim on jurisdictional grounds precisely because the investors had failed to demonstrate any investment located in the territory of the host state.

The Bayview case involved Texas farmers who had been affected by the failure to receive water from Mexico, but the Texan farmers had no investment located in the territory of Mexico.

14:13:19 Similarly, in the Canadian cattleman case there was a border measure that was contested, and the Canadian cattleman had no

investment in the territory of the United States, so, again, in that decision the Chapter 11 Tribunal dismissed the case on jurisdictional grounds for failure to meet Article 1101 requirements.

Oh, excuse me. My references to ADF should have been to the ADM versus Mexico case.

Thank you.

Claimants assert multiple alternative

14:13:54 theories of a Grand River investment in the United States. Each of those alternative theories rest on one of the following three allegations:

First, that Grand River and Native Wholesale Supply have formed an association, which is constituted under the Seneca Nation Business Code; second, that Arthur Montour holds the Seneca trademark for the benefit of Grand River, and, third, that Grand River has provided, quote, "a revolving multi-million dollar inventory based

14:14:28 line of credit to NWS," meaning Native Wholesale Supply.

As I will discuss, each of these three

allegations is fundamentally flawed and does not support the existence of a Grand River investment in the United States.

First, Claimants allege the existence of a Grand River Native Wholesale Supply Association, which is purportedly constituted under the Seneca Nation Business Code, and, thus, according to Claimants, qualifies as an enterprise under subparagraph A of the Article 1139

14:14:58 Definition of Investment. But, as Professor Goldberg addressed, the Seneca Nation Business Code does not provide for the establishment of business organizations under Seneca Nation law.

Second, Claimants allege that Grand River has a beneficial interest in the Seneca trademark based only on Arthur Montour's bear assertion that he holds the Seneca trademark for the benefit of all Claimants in this arbitration. But as I will address, that allegation cannot be

14:15:27 reconciled with the plain language of the manufacturing agreement between Grand River and the predecessor of Native Wholesale Supply, Native

Wholesale Tobacco Direct, which merely grants Grand River a limited license to manufacture Seneca cigarettes under certain narrow conditions.

And Claimants' own legal expert under Investment Article 1139, Professor Mendelson, was unable to determine whether Mr. Montour's bear assertion that he hold the trademark for the benefit of Grand River refers to anything more than a moral obligation.

14:16:03 Claimants have provided no documentary support for the alleged Grand River beneficial interest in the Seneca trademark.

Third, with respect to Grand River's alleged inventory based line of credit Claimants have provided no documentary support for such a line of credit. Moreover, to make such a line of credit available to Native Wholesale Supply Grand River would have to retain ownership over the cigarettes it sells to NWS. But that would be

14:16:31 directly contrary to Grand River's sworn testimony in other proceedings where the company has made clear that it sells Seneca's cigarettes to Native

Wholesale Supply at all times on an FOB basis, Freight On Board basis, with title and risk of loss transferring to Native Wholesale Supply at Grand River's facility in Oswekan, Canada.

I will now discuss in greater detail how each of Claimants' alternative allegations of Grand River investment in the United States does not withstand scrutiny.

ARBITRATOR CROOK: Mr. Feldman, again, 14:17:10 to interrupt, I think they may have put in some other bits and pieces, and I wonder if you'll be addressing those as well. We've got the truck, the claim that there's $50 million tied up in escrow deposits, that Arthur Montour went out and did a lot of work to promote the brand, that they paid money to the trademark lawyer, and I was reminded last night that Grand River itself owns the Opal trademark.

Will you be addressing those various 14:17:38 things?

MR. FELDMAN: Yes, particularly with respect to the 50 million in escrow deposits, I

will have a fair amount to say on that.

With respect to the truck and the odds and ends, a lot of these different allegations ultimately go to the question of does Grand River have a legal interest in the Seneca trademark, the legal fees, for example, it goes to this interest; does Grand River have a legal interest in the Seneca trademark.

And, as I will discuss, Claimants have 14:18:05 been unable to show any legal interest, and the fact that Grand River may have spent some legal fees in some court cases that doesn't establish a Grand River legal interest in the Seneca trademark.

And the point of the definition of the investment under Article 1139, there are multiple subparagraphs, but all of those subparagraphs concern legal interests, and Professor Mendelson was retained by Claimants to look at this 14:18:36 investment issue, and specifically Professor Mendelson looked at the issue of whether or not Grand River has an interest in the Seneca

trademark.

And Professor Mendelson's conclusion was, well, it appears that Grand River may have -- or that Arthur Montour may be under some sort of moral obligation to hold the Seneca trademark for the benefit of Grand River, but Professor Mendelson was unable to identify any legal interest that Grand River has in the Seneca trademark.

But particularly with respect to the 14:19:08 alleged 50 million in escrow deposits, Mr. Crook, I will be discussing that at some length during the presentation.

First, with respect to the alleged enterprise under subparagraph A, the alleged Grand River NWS Association constitutes, according to Claimants, an enterprise under subparagraph A of the Article 1139 definition of investment. Under NAFTA Article 201, "enterprise" is defined as, 14:19:42 quote, "any entity constituted or organized under applicable law."

Thus Claimants assert that their

alleged Grand River NWS Association qualifies as an enterprise under the NAFTA Chapter 11 definition of investment because, according to Claimant, the association is constituted under the Seneca Nation Business Code.

But as addressed by Professor Goldberg in her expert rebuttal report, the Seneca Business Code does not provide for or govern the establishment of business organizations under 14:20:13 Seneca Nation law. Rather, quote, "all that the Business Code addresses is permission to do business within Seneca Nation territory for an entity that has already been formed under some other body of law."

Native Wholesale Supply, in fact, has been formed under some other body of law, namely, the law of the Sac and Fox Nation. The Sac and Fox Charter for Native Wholesale Supply is set out on the screen.

While NWS is constituted under the law 14:20:45 of the Sac and Fox Nation, NWS is licensed to do business within Seneca Nation territory under the

Seneca Nation Business Code. The Seneca Nation license for Native Wholesale Supply is set out on the screen.

As for Grand River, Claimants themselves assert that the company is constituted in Canada under Canadian law. No evidence has been provided by Claimants demonstrating that Grand River is even licensed to do business, much less constitute it under Seneca Nation law.

14:21:22 In an attempt to meet the requirements of Article 1139, Claimants simply assert that Grand River and Native Wholesale supply have formed an association together, and that the association is constituted under Seneca Nation law, but there is no such evidence in the record.

The fact that Grand River's importer and distributor, NWS, is licensed to do business on Seneca Nation territory does not mean that either NWS or any purported Grand River NWS

14:21:55 Association is constituted or organized under Seneca Nation law.

The alleged Grand River NWS Association

does not satisfy the definition of "enterprise" under NAFTA Article 201, which requires an entity to be, quote, "constituted or organized," end quote, under applicable law.

In any event, no such Grand River NWS Association is, in fact, even licensed to do business in Seneca Nation territory. Claimants, therefore, are forced to invent a licensing exemption to explain why this purported

14:22:31 association has no license.

But Claimants' alleged exemption, namely, for entities working in concert with a Seneca Nation Member who holds the license to do business on Seneca Nation territory does not, in fact, exist under the Seneca Nation Business Code.

Under Claimants' theory, Grand River is alleged to be working in concert with a Seneca Nation Member, Arthur Montour, whose company, NWS, is licensed to do business on Seneca Nation

14:23:02 territory, but Claimants do not even attempt to place their alleged exemption within any of the exemptions that are clearly set forth under

Article 2107 of the Seneca Nation Business Code, which is entitled Business License Exemptions.

Article 201 sets out six of those Business License Exemptions. Three of those exemptions concern businesses which gross less than $10,000 annually. A fourth exemption concerns activities by persons under age 18, which gross less than $3,000 annually. A fifth exemption concerns any entity owned by the Seneca

14:23:40 Nation, and the sixth exemption concerns persons, quote, "engaged in the ministry of healing by purely spiritual means or other recognized religious activity."

Clearly, the Business Code contains no exemption for entities working in concert with a Seneca Nation Member who holds a license to do business on Seneca Nation territory. Claimants put forward quite elaborate arguments in this matter in their attempt to establish a Grand River

14:24:11 enterprise in the United States.

But when Grand River makes representations in U.S. proceedings concerning its

U.S. operations, the facts suddenly become far more straight forward. As stated several months ago in sworn testimony by the president of Grand River, Steve Williams, quote, "Grand River does not maintain any place of business in any state."

Last week Claimants placed a great deal of emphasis on the inability of MSA states to obtain personal jurisdiction over Grand River. There's a clear reason why Grand River has at

14:25:03 times been successful in resisting personal jurisdiction in the U.S. Court. The company simply alleges that it has no presence in the United States, and does not direct its cigarettes into the United States. But given that position, Grand River cannot hold itself out in this arbitration as being part of some U.S.-based enterprise.

Claimants attempt to establish a Grand River NWS enterprise under subparagraph A of the

14:25:31 Article 1139 definition of "investment" should be rejected. Claimants' second attempt to establish a Grand River investment in the United States

relies on the allegation that Grand River has a legal interest in the Seneca trademark, which, according to Claimants --

PRESIDENT NARIMAN: In this case, is this one complaints or two complaints in the present proceeding? That means, does Grand River have a separate complaint from Arthur Montour?

MR. FELDMAN: Well, the Claimants consistently refer to themselves as --

14:26:12 PRESIDENT NARIMAN: No, I just wanted to know, are the complaints the same, or are they --

MR. FELDMAN: It's difficult to discern, because without exception the Claimants refer to themselves in this arbitration as Claimants.

PRESIDENT NARIMAN: That's what I'm saying. So, collectively, I mean, do we have to distinguish whether so and so has a cause of

14:26:32 action and so and so doesn't?

MR. FELDMAN: Yes. Thank you, Mr. President. You'll notice in our briefs we are

careful, where appropriate, to distinguish Grand River from Native Wholesale Supply, or to distinguish the Grand River shareholders, Jerry Montour and Kenneth Hill --

PRESIDENT NARIMAN: My point is, isn't this a distinction without a difference, or is that something -- for damages, maybe you are right but, I mean, on the question of liability does it make any difference?

14:26:57 MR. FELDMAN: Yes. In terms of jurisdiction, it's a critical difference because we do not challenge -- we do not assert that Arthur Montour does not have an investment in the United States.

PRESIDENT NARIMAN: That's what I -- that's what you said. That's why I'm asking you.

MR. FELDMAN: Yes, so -- yes, so for jurisdictional purposes it is a critical difference because we are challenging -- we are

14:27:16 challenging that -- our position is that Grand River has no investment in the United States. And so that is why we are careful in our briefs, where

appropriate, to distinguish Grand River from Native Wholesale, particularly under 1101 the differences are critical, and, as we'll walk through the analysis, it should be brought out that Grand River has not shown an investment in the United States.

PRESIDENT NARIMAN: I still don't follow. If Arthur Montour does have at least the rudiments of a claim --

14:27:52 MR. FELDMAN: Right.

PRESIDENT NARIMAN: -- he gets over that initial hurdle --

MR. FELDMAN: Yes.

PRESIDENT NARIMAN: -- of jurisdiction --

MR. FELDMAN: Absolutely.

PRESIDENT NARIMAN: -- whether it's an investment or not is later on we'll come to -- if he gets over that, does it make any difference

14:28:06 that the others don't? I just want to know from your --

MR. FELDMAN: Well, if -- if the

Tribunal does not have jurisdiction over Grand River's claim, then Grand River is no longer a part of the case.

ARBITRATOR CROOK: Mr. Feldman, is -- is the answer to the president's question the second part of the presentation you're going to give us here, which is, I take it, some of the contested measures do not relate to Mr. Arthur Montour?

14:28:28 MR. FELDMAN: That's correct. As we'll discuss in the relating-to portion of the presentation, the challenged Escrow Statutes do not relate to Arthur Montour. So our position under Article 1101 is that Arthur Montour's claim can proceed with respect to the complementary legislation, but that the rest of the claim, Grand River's claim, Jerry Montour's claim, Kenneth Hill's claim, should be dismissed in their entirety, and Arthur Montour's claim, only as it

14:28:58 relates to the Escrow Statutes, should also be dismissed.

PRESIDENT NARIMAN: That means his

claim in respect of the complementary legislation would be legitimate.

MR. FELDMAN: Yes. Under Article 1101 we raise no objection with respect to Arthur's Montour's challenge to the complementary legislation.

PRESIDENT NARIMAN: Okay. Thank you. Continue.

MR. FELDMAN: Thank you.

14:29:19 Claimants' second attempt to establish a Grand River investment in the United States relies on the allegation that Grand River has a legal interest in the Seneca trademark, which, according to Claimants, constitutes an intangible property right under subparagraph G of the Article 1139 definition of "investment."

Subparagraph G includes, quote, "Real estate or other property, tangible or intangible, acquired in the expectation or used in the purpose

14:29:45 of economic benefit or other business purposes."

Again, Claimants' allegation of a Grand River interest in the Seneca trademark is based

solely on Arthur Montour's assertion that he holds the mark for the benefit of all Claimants in this arbitration. Claimants' own legal expert on this issue, Professor Mendelson, does not support Claimants' position that Grand River, Jerry Montour and Kenneth Hill have an intangible property interest in Arthur Montour's Seneca trademark.

Specifically, Arthur Montour's

14:30:17 assertion is, quote, "simply a statement of moral obligation or something more."

Professor Mendelson merely observes if Arthur Montour's assertion regarding the Seneca trademark, in fact, reflects something more than a moral obligation, then such an obligation, quote, "may well be capable," unquote of satisfying the definition of "investment" under subparagraph G, but there is nothing more.

Given Arthur Montour's lack of

14:30:49 documentary support for his allegation, as well as the failure of Claimants' own legal expert to commit to the argument, Claimants' argument

concerning Grand River's alleged legal interest in the Seneca trademark under subparagraph G should be rejected.

PRESIDENT NARIMAN: Do we have in whose name Seneca trademark is registered?

MR. FELDMAN: In the record, the Seneca trademark is clearly registered in the name of Native Wholesale Supply.

PRESIDENT NARIMAN: That's right,

14:31:14 Native Wholesale.

MR. FELDMAN: Yes.

PRESIDENT NARIMAN: So they -- they have the right to the money.

MR. FELDMAN: Yes, Native Wholesale, and Mr. Arthur Montour is the owner of Native Wholesale Supply. And I'll pick up on Mr. Crook's question about that Opal brand.

We have addressed in our briefs, in Claimants' initial Notice of Arbitration in their

14:31:27 Statement of Claim, in their Amended Statement of Claim, there was never any mention of the Opal brand. The first time we ever saw any mention of

the Opal brand was in their Memorial, and, as we argued in our briefs, we do not consider it to be a valid part of their claim.

Furthermore, Arthur Montour's bear allegation cannot be reconciled with the plain language of the cigarette manufacturing agreement between Grand River and the predecessor of NWS, Native Tobacco Direct.

The Cigarette Manufacturing Agreement

14:32:04 grants Grand River a limited license to use the Seneca brand name, quote, "for the sole purpose of manufacturing and delivery," unquote, of cigarettes under agreement.

Moreover, the agreement expressly prohibits Grand River from manufacturing Seneca cigarettes, quote, "except for expert from Canada."

Furthermore, the Cigarette Production

14:32:34 Agreement between Grand River and Tobaccoville imposes even greater restrictions on Grand River's license to manufacture Seneca cigarettes in Canada. Under that agreement, it is Tobaccoville

not Grand River that determines not only the quantity and timing of Seneca shipments, but also the particular tobacco blends and packaging that are to be used in those shipments. Specifically under the Cigarette Production Agreement, quote, "GRE shall produce for manufacturer/distributor" -- and that's Tobaccoville -- "the brand" -- meaning Seneca brand cigarettes -- "in such versions and packaging and such quantities and at such times as per the written request from manufacturer/distributor" -- again, that's Tobaccoville -- "to do so.

"The brand shall be produced using the tobacco blends and packaging as designated by manufacturer/distributor," again as designated by Tobaccoville.

The language of Grand River Cigarette Production Agreement with Tobaccoville is consistent with the sworn testimony by the president of Grand River, Steve Williams, with respect to the cigarettes produced by Grand River in Canada and sold by Grand River to Tobaccoville

in Canada. Quote, "Grand River never had any control of how or where these cigarettes were sold."

The president of Tobaccoville agrees. In his sworn testimony, Larry Phillips, the president of Tobaccoville, stated unequivocally that, quote, "GRE does not sell any cigarettes in the United States and has no input into where sales are made, to whom, in what volumes, or the pricing."

Thus Arthur Montour's bear assertion that he holds the Seneca trademark in the United States for the benefit of Grand River cannot be reconciled with the plain language of Grand River's manufacturing agreements with its U.S. distributors, nor can Arthur Montour's assertion be reconciled with the sworn testimony of the president of Grand River and the president of Tobaccoville. Under those manufacturing agreements and that sworn testimony, Grand River holds a limited license to manufacture Seneca cigarettes in Canada solely for export to the

United States.

And with respect to Grand River's exports of Seneca cigarettes to Tobaccoville, it is Tobaccoville, not Grand River, which determines not only the quantity and timing of Seneca shipments, but also the particular tobacco blends and packaging to be used with those shipments.

Accordingly, Arthur Montour's bear assertion that he holds the Seneca trademark for the benefit of Grand River simply cannot be reconciled with the evidence in the record. Last week, we heard multiple assertions from Claimants concerning a Grand River interest in the Seneca trademark, which not only are unsupported, but, in fact, directly contradicted by this evidence.

First, Claimants flatly stated that, quote, "Grand River owns a trademark right to the Seneca name and brand." That is incorrect.

Claimants also state that, quote, "This is not a company that merely sells cigarettes. It has the trademark." That is also in correct.

Grand River holds a limited license to

manufacture Seneca cigarettes in Canada for export to the United States. Arthur Montour, not Grand River, owns the Seneca trademark.

Second, Claimants assert under Grand River Cigarette Manufacturing Agreement, quote, "Every cigarette sold in the United States must be manufactured by Grand River or with Grand River's permission."

To the contrary, NWS does not need Grand River's permission to sell cigarettes in the United States. Under the plain terms of their manufacturing agreement it is NWS, not Grand River, that determines when shipments are to be made and in what quantities.

As stated in the agreement, quote, "manufacturer" -- that's Grand River -- "shall manufacture brands in a king-size, hinged-lid box version in such quantities and at such times as per the written request from distributor" -- and the distributor here was Native Tobacco Direct, and now Native Wholesale Supply -- "to do so.

"The brand shall be produced using the

tobacco blends and packaging as designated by distributor." So, again, distributor NWS.

With respect to Tobaccoville Grand River's president, Steve Williams, has made clear in sworn testimony that Grand River has no control over how or where Tobaccoville sells cigarettes in the United States.

Last week, Claimants also misrepresented our positions with respect to the Seneca trademark. First, according to Claimants, it is our position that Arthur Montour's trademark, quote, "is not asset and not an investment."

To the contrary, we have made clear in our briefs that Arthur Montour, not Grand River, owns the Seneca trademark, and that our challenge with respect to the existence of a U.S. investment applies only to three of the four Claimants in this matter; Grand River, Jerry Montour and Kenneth Hill. Again, we have not challenged the existence of Arthur Montour's U.S. investment.

The issue here is not whether Arthur

Montour's trademark constitutes an investment in the United States, but rather whether Grand River has a legal interest in that trademark, which Claimants have failed to establish.

Claimants further represent our position to be that if Arthur Montour does not hold the trademark for the benefit of all the Claimants, then, quote, "He does not even have the asset, the investment of that trademark."

Again, that is incorrect. We do not contest that Arthur Montour owns the Seneca trademark.

Accordingly, Claimants' assertion that Grand River has an intangible property right in the Seneca trademark under subparagraph G, Article 1139 definition of the investment should be rejected.

In addition, Claimants' failure to establish any interest in the Seneca trademark beyond its limited license to manufacture Seneca cigarettes in Canada has larger implication for their entire off-Reservation claim. As we've

discussed in our written submissions, Claimants have excluded Grand River's off-Reservation distributor, Tobaccoville, from their U.S. investment, and thus have excluded Grand River's off-Reservation sales from that alleged investment.

In response, Claimants asserted that their failure to include Tobaccoville within their alleged U.S. investment was irrelevant because Grand River has an intangible property right in the Seneca trademark, but Claimants ultimately have provided no evidentiary support for that alleged property right.

PRESIDENT NARIMAN: I'm going to interrupt you again. Is this really a jurisdictional issue, or is this the right to relief, who is entitled to what relief. I mean, once you admit that there's jurisdiction over a claim that Arthur Montour makes, and if all of them are in one claim, they're all Claimant one, two, three, four, five, whatever they are, is this really jurisdictional, or is that something

ultimately they have no right to relief? You can say all that. It has nothing to do with jurisdiction.

Once you admit -- I mean, if you've disputed that none of them are entitled to come before a Tribunal, but once you say there is -- once you say that they're entitled, one person, at least is entitled, then does it make a difference? Does it become a jurisdictional issue, or is it the Claimants' right to relief issue?

MR. FELDMAN: Thank you, Mr. President. Under Article 1101 is the scope and coverage provision of the chapter, and under Article 1101 only investors -- or investors on behalf of their investments. You must be an investor to bring a claim.

PRESIDENT NARIMAN: One of whom may or may not be an investor, is it possible to join such claims because you have never objected to the joinder of claim.

MR. FELDMAN: Under Chapter 11 claims can only be brought by investors, and in this case

there is only one investor. There are not four investors. The claim can only be brought by the one investor.

PRESIDENT NARIMAN: Okay. So the claim is brought by one investor, therefore, there's not a jurisdictional issue, it's an issue as to whether the others are not entitled -- have no right to relief. That's what I would have thought.

14:41:12 MR. FELDMAN: But, for example, Mr. President, we do have an objection with respect to Mr. Arthur Montour challenge of the Escrow Statutes. So it's our position that the Tribunal does not have jurisdiction to analyze the Escrow Statutes at all. The Tribunal only has jurisdiction to analyze the complementary legislation.

PRESIDENT NARIMAN: All right. It's all very complicated for me.

14:41:37 MR. FELDMAN: It is for all of us.

As we've discussed in our written submissions, Claimants have excluded Grand River's

off-Reservation distributor, Tobaccoville, from their alleged U.S. investment, and thus have excluded Grand River sales from that alleged investment.

ARBITRATOR CROOK: Mr. Feldman, excuse me. Can you run that by me again. I have a little trouble taking that particular argument on board.

MR. FELDMAN: Yes.

14:42:04 ARBITRATOR CROOK: I understand you're saying that they do not include Tobaccoville, which is a U.S. company in which they have no proprietary interest in investment. They have a contract with Tobaccoville, and Tobaccoville is supposed to do certain things.

MR. FELDMAN: Right.

ARBITRATOR CROOK: How does that equate to or result in their off-Reservation sales not being part of the investment? Can you run that by

14:42:31 again, please?

MR. FELDMAN: Yes. Thank you, Mr. Crook. Tobaccoville -- as Claimants framed

their case, Grand River has an exclusive on-Reservation distributor and an exclusive off-Reservation distributor. Their exclusive on-Reservation distributor is NWS. Their exclusive off-Reservation distributor is Tobaccoville.

Grand River includes NWS in their alleged U.S. enterprise. Grand River does not include Tobaccoville in their alleged U.S.

14:42:59 enterprise. Under Chapter 11, the question is what is the investment? The claim involves the investment. Claimants have made no attempt to include Tobaccoville, and thus no attempt to include all of Tobaccoville's off-Reservation sales within their investment.

Now, the Claimants' response on this point is, well, we don't need to do that because we hold the trademark. It's our Seneca trademark. But, as we've demonstrated, that is just not true.

14:43:26 PRESIDENT NARIMAN: Who's this "we"?

MR. FELDMAN: I'm sorry. The Claimants argument is Grand River owns the Seneca trademark,

but, as we've seen by the evidence in the record, that's not the case. Arthur Montour, Native Wholesale Supply, owns the Seneca trademark. So Grand River cannot include -- include these off-Reservation sales on their claim in this Trademark Hearing when they fail to support any legal interest in the Seneca trademark held by Grand River.

Does that answer your question?

14:44:00 ARBITRATOR CROOK: I'll ponder it. Thank you.

MR. FELDMAN: Okay. Okay.

Claimants's third allegation is that Grand River has made an inventory based line of credit available to NWS, and that this purported line of credit satisfies three separate subparagraphs under the Article 1139 definition of investment. Specifically, Claimants assert that the alleged Grand River line of credit

14:44:27 constitutes, first, a loan to an enterprise under subparagraph D2; second, a commitment of capital in the territory of a party under subparagraph H1,

and, third, intangible property under subparagraph G.

ARBITRATOR CROOK: Mr. Feldman, can I go back? I think I've got it now. Let me see if I understand you. I'm not saying I agree with it, I just want to see if I understand it.

MR. FELDMAN: Yes.

ARBITRATOR CROOK: That you are arguing that so far as Tobaccoville is concerned, the -- the relationship between Grand River or Grand River and its owners in Canada is simply a relationship of expert and sale, no more.

Is that the argument?

MR. FELDMAN: That's Claimants' very allegation in this case, yes.

ARBITRATOR CROOK: I understand. But then you're saying it is, in essence, just a straight export sales proposition, it is -- it's not an investment.

MR. FELDMAN: That's correct.

ARBITRATOR CROOK: That's your argument.

MR. FELDMAN: Yes.

ARBITRATOR CROOK: I understand it. Thank you.

MR. FELDMAN: Just to walk through it once more, the Claimants' response on that point is, well, Grand River owns the Seneca trademark so this import export relationship, in fact, isn't an obstacle to us to establish an investment.

Our answer to that is, well, there's no evidence in the record that Grand River owns the Seneca trademark.

ARBITRATOR CROOK: Okay. Thank you.

MR. FELDMAN: First, to qualify as a loan to an enterprise under subparagraph D2, the loan must have an original maturity of at least three years.

In his first witness statement, Jerry Montour stated that the alleged inventory based line of credit made available to NTD and NWS had, quote, "no fixed maturity date." Apparently realizing the line of credit with no fixed maturity date would not satisfy the three-year

duration requirement under subparagraph D2, Mr. Montour attempted to revisit that allegation in his second witness statement. In that statement Mr. Montour now asserts that, quote, "It was our expectation that it" -- the line of credit -- "would be necessary for approximately five years."

But Mr. Montour's expectation does not create a fixed maturity date. The fact is that the line of credit had no fixed maturity date. In any case, even assuming that Mr. Montour's assertion established the existence of a fixed five-year maturity date, that allegation cannot be reconciled with Mr. Montour's prior testimony in this matter.

Mr. Montour cited no documentation in support of his initial assertion concerning the no fixed maturity date of the line of credit, and again cited no documentation in support of his follow-up assertion that the line of credit would be necessary for approximately five years.

Claimants have a clear incentive for

relying on bear assertions of expectations rather than documentation to support their alleged business obligations and relationships, such as the alleged inventory based line of credit. Such lack of documentation enables Claimants by mere say-so to alter the terms of their alleged obligations and relationships in order to arrive at a set of facts that is tailored to their particular legal needs in this arbitration. Such shifting allegations are made possible by Claimants' refusal in this arbitration to provide documentary support for even the most basic aspect of their alleged business relationships and business obligations.

Claimants defend that refusal by asserting that their alleged, quote, "association and business arrangement is perhaps more common to Native American social norms than the formalistic rituals of European Western business practice.

But there is nothing formalistic about requiring Claimants who are demanding over a quarter of a billion dollars from U.S. taxpayers

to provide documentary support for the most basic elements of their alleged business obligations and business relationships, such as the original maturity date of Grand River's alleged inventory based line of credit.

Claimants alleged loan to enterprise under subparagraph D2 should be rejected.

PRESIDENT NARIMAN: If Grand River had said that they were licensees for the purpose of manufacture of Seneca cigarettes for export from Canada and not that they were the owners of the trademark, then that claim would be in -- if they had said that.

MR. FELDMAN: Mr. President --

PRESIDENT NARIMAN: I'm asking you.

MR. FELDMAN: Mr. President, there's an important distinction for Chapter 11 purposes between an exporter and an investor. An investor must have investment, in this case, in the United States, in the host state. An exporter simply exporting goods does not establish an investment in the host state. And we heard from Claimants

last week. Claimants agreed that mere trade without more does not establish an investment under Article 1139 so a mere exporter-importer relationship is insufficient, and the parties agree on that point.

ARBITRATOR ANAYA: Mr. Feldman?

MR. FELDMAN: Yes.

ARBITRATOR ANAYA: Just to be clear on this point that you're making, you're saying that there is no loan, but in the absence of any documentation we should not even inquire any further, that we should have a straight rule requiring documentation for any loan?

MR. FELDMAN: We're looking for the terms of this loan because, especially with respect to D2, the terms are critical for establishing whether or not there is an investment. If there's no documentation of the terms of the loan, that should be the end of the inquiry.

ARBITRATOR ANAYA: Well, why is that necessarily the case? Can't we establish the

terms by the oral testimony or other kind of evidence?

MR. FELDMAN: Well, but what we've seen is that when the Claimants have attempted to establish terms through, say, the witness statements, what comes out in the witness statements are inconsistencies.

ARBITRATOR ANAYA: But that's a matter of evaluating the evidence on our part. So we can evaluate the evidence, you're just saying in the absence of the documentation?

MR. FELDMAN: Right. When Claimants bring a claim for hundreds of millions of dollars against the United States, you expect to see some documentation.

ARBITRATOR ANAYA: Right. Okay.

MR. FELDMAN: Claimants' alleged inventory based line of credit likewise fails to establish an investment under subparagraph H1 of Article 1139, which includes within the definition of investment a, quote, "commitment of capital in the territory of a party."

As you can see on the screen, subparagraph H1 of the Chapter 11 definition of investment includes, quote, "interest arising from the commitment of capital or other resources in the territory of a party to economic activity in such territory, such as under contracts involving the presence of an investor's property and the territory of the party, including turnkey or construction contracts or concessions. Claimants assert that the inventory baseline of credit allegedly made available by Grand River constitutes such a commitment of capital in the territory of the United States."

Again, Claimants provide no documentation supporting the existence of their alleged line of credit, and again Claimants exploit that lack of documentation by tailoring their allegations to meet their particular jurisdictional needs in this case.

In Jerry Montour's first witness statement, Mr. Montour asserted that Grand River has made available, quote, "financing by providing

NTD and later NWS with access to an inventory loan."

In his second witness statement, however, Mr. Montour asserts apparently with subparagraph H1 in mind, that the financing made available by Grand River constituted a, quote, "substantial capital commitment in the United States."

PRESIDENT NARIMAN: Which Montour?

14:52:41 MR. FELDMAN: Right. This is Jerry Montour.

PRESIDENT NARIMAN: But you are not cross-examining. You have not asked any questions.

MR. FELDMAN: That's correct.

PRESIDENT NARIMAN: No, I'm just saying, so this goes virtually unchallenged.

MR. FELDMAN: Mr. President, we're pointing out inconsistencies between the

14:52:57 statements.

PRESIDENT NARIMAN: Right. But if there were inconsistencies, then you could have

called him and pointed all this out, and he may have had an explanation or he may not.

MR. FELDMAN: Yes. Mr. President, we submit that the inconsistencies speak for themselves.

PRESIDENT NARIMAN: You have to call him. Why didn't you call him? There's no explanation why you didn't call him. I was expecting him to come into the box, and you would

14:53:16 cross-examine him at some length. That was my expectation.

ARBITRATOR CROOK: So, Mr. Chairman, are we to adopt a rule that any witness who is not cross-examined, their evidence is to be taken as true?

PRESIDENT NARIMAN: My question is to Mr. Feldman, not to you. We can discuss it later. My question is for him.

MR. FELDMAN: Yes. Mr. President, I

14:53:37 would point out that we have a legal expert in this case, Professor Goldberg from UCLA Law School, who put in two expert reports, was not

called for cross-examination.

PRESIDENT NARIMAN: Why wasn't Jerry Montour who is a very important witness in this chase? He has been deposed, according to you, in contradictory terms. It's not a question of whether his evidence should be accepted or not accepted since you're commenting on it. I wouldn't have put all this to you. You're saying there are inconsistencies. How can the

14:54:07 inconsistencies be reconciled unless you call him? That's a normal rule.

MR. FELDMAN: Mr. President, our submission is that this is, in part, a result of -- it is precisely because there's a lack of documentation, that what you get are inconsistencies about the terms of these alleged obligations.

PRESIDENT NARIMAN: Okay.

MR. FELDMAN: Okay. Grand River's

14:54:30 alleged capital commitment in the United States cannot be reconciled --

PRESIDENT NARIMAN: This is a

jurisdictional issue. This was an important circumstance for you. It was jurisdictional. You say dismiss the claim at the very start. Don't go into it at all because of this, and yet you don't examine it. There's no explanation why you didn't call him. He was here. He was present all the time last week.

MR. FELDMAN: Mr. President, it is the Claimants' burden to establish jurisdiction in the

14:54:57 case and to meet the requirements of Article 1101.

PRESIDENT NARIMAN: Again, let's not go there. Jurisdiction, you're pointing out inconsistencies, and yet you're not accepting the position that you failed to call him for cross-examination. You're entitled to cross-examine him, to point out inconsistencies, and he has a right to say, if he can, that there are these explanations for these inconsistencies. All right. Okay.

14:55:27 MR. FELDMAN: Okay. Thank you.

Grand River's alleged capital commitment in the United States cannot be

reconciled with its sworn testimony in U.S. Court proceedings. As the president of Grand River made clear in those proceedings, Grand River sells Seneca cigarettes to NWS and Tobaccoville, quote, "at all times on an FOB basis with title and risk of loss, transferring to these third parties at Grand River's facility in Oswekan, Canada."

Claimants' own damages expert, Mr. Wilson, confirmed this very point last week, which you can find at Page 586 of the transcript.

Thus, any inventory imported into the United States by those third parties is owned by those third parties, not Grand River. Because Grand River owns no inventory in the United States, Grand River cannot make any inventory based line of credit available to NWS.

Grand River has shown no commitment of capital in the territory of the United States, and Claimants' allegation of investment under subparagraph H1 should be rejected.

Finally, Claimants alleged inventory based line based credit does not constitute

intangible property under subparagraph G of Article 1139.

As I discussed, Claimants have failed to provide any documentary evidence of such a line of credit, which in any event could not be reconciled with the sworn testimony of Grand River's president in U.S. Court proceedings, that Grand River sells Seneca cigarettes to Native Wholesale Supply at all times on an FOB basis with title and risk of loss transferring in Canada, not in the United States, and, therefore, has no inventory in the United States on which to base a line of credit.

I would briefly note, and in response to Mr. Crook's question, that Claimants raised yet another alternative argument last week in their attempt to establish a Grand River investment in the United States, namely, that an alleged $50 million in escrow deposits constitutes an investment under Article 1139.

This allegation fails on a number of levels. No mention is made of this purported

$50 million in escrow deposits in either Professor Mendelson's report on the investment issue, or in Mr. Wilson's damages report. That is not surprising, given that a manufacturer retains ownership over its escrowed funds and receives interest on the funds as it is earned.

And in any event, most, if not all, of the funds would appear from Claimants' allegations to be the property of Tobaccoville, not Grand River, nor do Claimants address whether the alleged $50 million in escrow deposits have been made as of 2004 when they filed their claim.

Notably, in their Memorial, which was filed in 2008, Claimants refer to only 29 million in escrow deposits, and as we address at page 64 of our counter Memorial, Claimants had asserted without discussion that Grand River's escrow deposits would meet the definition of investment under subparagraphs G and H of Article 1139, but those subparagraphs do not concern property that is set aside to comply with the legal obligation concerning potential future liabilities.

Claimants' alternative theory of investment should be rejected.

For the reasons I have discussed, each of Claimants -- and before I conclude, I would refer -- Mr. Crook had asked about the leased truck. Again, these are odds and ends that the Claimants are attempting to cobble together. The truck in no way shows any legal interest of -- again, that Grand River might have in the Seneca trademark, no enterprise in the United States. Again, it is a throw-away the Claimants have included.

PRESIDENT NARIMAN: According to you, a deposit is not an investment?

MR. FELDMAN: No. In this case, an escrow deposit -- first of all, the claim under Chapter 11 -- your damages need to flow from your investment. And Claimants haven't articulated any theory of damages with respect to an escrow deposit account in which funds are sitting untouched. Grand River owns those funds. There would be no theory of damages -- setting aside

escrowed funds into an account, there's no theory of damages in this case of how those funds were taken from --

PRESIDENT NARIMAN: Yes, but those funds can also be diminished if there are claims for health reasons, et cetera, against the state that can be drawn upon, so it's not their money as such.

MR. FELDMAN: Right. But,

15:00:14 Mr. President, we find it significant that Claimants' damages expert never addressed these escrowed funds. It's not part of their damages claim --

PRESIDENT NARIMAN: No, we're dealing with jurisdiction claim. We are not talking o damages. You maybe right, they're not entitled to damages. I'm only asking you on jurisdiction. The escrow amount, whether it's 29 million or 50 million, make it as 29 and not as 50, but if it is

15:00:38 29 million, that's a substantial sum, which has been set apart by them in a particular country, and you have to tell us why this doesn't satisfy

the definition of investment.

MR. FELDMAN: Thank you, Mr. President. Under Chapter 11, there needs to be a nexus between your investment and your damages.

PRESIDENT NARIMAN: Oh. Okay.

MR. FELDMAN: It's significant to us that if there's no theory of damages with respect to these funds, there's no nexus to the investment.

15:01:06 PRESIDENT NARIMAN: Okay.

ARBITRATOR ANAYA: Just so I'm clear, you're saying that there's no investment, in addition to saying there's no nexus. Can we find there's an investment and no nexus to the damages?

MR. FELDMAN: Our position is that because Claimants have identified Article G and H to Article 1139. And I would say on this point, -- and Professor Mendelson agrees -- Article 1139 sets out what is known as an exhaustive list -- an

15:01:34 exhaustive list of investments. If a particular set of facts does not fit within one of the sub paragraphs of Article 1139, there is no investment

under Chapter 11. The two provisions the Claimants refer to are subparagraph G and subparagraph H. Claimants offer no analysis of why escrowed funds would fit into one of these subparagraphs, and we would submit that for a tobacco manufacturer to be complying with a legal allegation to put funds in an escrow account, that that does not fall within either subparagraph G or subparagraph H. It is -- as Professor Gruber

15:02:15 said, it is a form of forced savings. It is completely unrelated to their theory of the case, which involves the impairment to the Seneca brand, impairment to Seneca sales.

There's no nexus between their theory of the case and this allegation of an investment based on these escrowed funds, and we don't see it falling under subparagraph G or subparagraph H, and Claimants made no attempt to place it under those subparagraphs.

15:02:41 ARBITRATOR ANAYA: So we have to get into the theory of the case in order to determine whether an escrow is an investment. Can we just

look at that, look at its character, the deposit in the escrow?

MR. FELDMAN: I mean, again, Claimants have thrown a lot of alternative theories, but their theory of the case is the Seneca brand, the impairment to the Seneca brand lost profits from that. And if there is no nexus, it simply takes away from the credibility of the argument that funds placed in an escrow account would

15:03:11 nevertheless fall within the definition of investment. There needs to be some articulation of how your investment has been harmed, and there is no articulation here in the damages report of how this purported investment of escrow deposits has been harmed by any state action in this case.

PRESIDENT NARIMAN: That goes to damages, you're right. That goes to damages. We're just now on the jurisdiction point.

MR. FELDMAN: Yes, and the

15:03:30 jurisdictional point is --

PRESIDENT NARIMAN: And the jurisdictional point is, is it an investment. It

says any property tangible, intangible, whatever it is.

MR. FELDMAN: RIGHT.

PRESIDENT NARIMAN: A deposit deposited for a particular purpose where it may not all be returned. Some of it may be returned due to contingencies that arise. It may or it may not.

MR. FELDMAN: Again, we think it's significant that Claimants retained an expert to analyze the investment issue in this case. They retained Professor Mendelson. Professor Mendelson looked at many, many alternative theories of investment. Professor Mendelson never looked at this question of escrow deposits as an investment under Article 1139.

PRESIDENT NARIMAN: No, but is that any denial that there was such an escrow deposit, which is attributable to one of the Claimants?

MR. FELDMAN: Mr. President, we would also point out that when Claimants were asked this week to what extent do those deposits belong to Tobaccoville versus Grand River, we didn't hear a

crisp response. We have seen no documentation, again, of these amounts and these escrow deposits, which appear to have been 29 million with the Memorial, now they appear to be 50 million. We don't know when these deposits were made, were they made in 2004 when this claim was filed. We don't have information on these deposits.

PRESIDENT NARIMAN: Surely, you can find out from the -- I don't understand.

MR. FELDMAN: But, Mr. President, I mean, this is Claimants' claim. They need to establish their investment.

PRESIDENT NARIMAN: I'm not on establishment. You said, I don't know. I cannot find out.

Of course, you can find out if you want to.

MR. KOVAR: Mr. President, these would be bank accounts in the name of Grand River, and they have not put in evidence of these bank accounts. How can they make a claim of escrow without showing us the bank account information?

ARBITRATOR ANAYA: Okay. So you're saying different things here. It seems like now you're saying they haven't shown there was an investment.

MR. KOVAR: There's two issues.

ARBITRATOR ANAYA: Well, I mean, you're saying different things, and you're avoiding the question of whether or not you think this is an investment by now saying that they haven't shown this as an investment. But before you said this is not an investment.

MR. FELDMAN: Right. That's what we argued in our counter Memorial.

ARBITRATOR ANAYA: Yes, but when I asked you, please elaborate why do you think it's not an investment, you said because they haven't shown us that it's not an investment.

MR. FELDMAN: Thank you. Professor Anaya, the subparagraphs they put forward are subparagraphs G and H.

PROFESSOR ANAYA: Okay.

MR. FELDMAN: So we can look at --

let's look at G, real estate or other property tangible or intangible, acquired in the expectation or used for the purpose of --

PRESIDENT NARIMAN: Used.

MR. FELDMAN: -- for the purpose of economic benefit or other business purposes.

Now, here we have Grand River on their theory complying with a legal obligation to set aside funds to be used for potential future judgments or settlements. They're complying with a legal obligation. We don't see that as falling within subparagraph G.

ARBITRATOR ANAYA: Couldn't you say that's for business purposes because it's preconditioned under the statutory scheme for doing business of the kind they want to do?

MR. FELDMAN: We see this as -- it's like a payment of tax. It's a compliance with a legal obligation. This isn't investing in a factory.

ARBITRATOR ANAYA: But the states have said this is not a tax; am I correct?

MR. FELDMAN: That's correct. The point being this is a manufacturer complying with a domestic legal obligation.

MR. KOVAR: Mr. -- Professor Anaya, even if you were to find that you thought it complied with the terms, let's look at the record.

PROFESSOR ANAYA: Yes.

MR. KOVAR: If you have $50 million on deposit in the United States and you're asking this Tribunal to find jurisdiction on that basis, wouldn't you have put in the banking information? Wouldn't you have shown the documents? Because it's just as likely that Tobaccoville owns this money.

ARBITRATOR ANAYA: Now, we understand that point.

PRESIDENT NARIMAN: There's nothing in the record. Okay.

MR. FELDMAN: For the reasons I've discussed, each of Claimants' alternative allegations of a Grand River investment in the United States is without documentary basis and

fundamentally flawed.

PRESIDENT NARIMAN: I just want to know from the Memorials, have you denied that there was this escrow deposit?

MR. FELDMAN: Mr. President, we responded in our counter Memorial on this point.

PRESIDENT NARIMAN: And you said that we don't admit that there were such deposits? Have you said that?

MR. FELDMAN: No, we simply say that this kind of escrow deposit would not satisfy --

PRESIDENT NARIMAN: Ah, that's right. That's not what Mr. Kovar is saying. Did you saying anywhere that we deny or we put them to strict proof that they have deposited because we have no knowledge that they have deposited. Good point. Then Mr. Kovar's point is correct, they don't put anything in the record to satisfy that.

MR. FELDMAN: Right. We're approaching -- I mean, there are two points here. One is the textual point, and the other is simply the evidentiary point.

PRESIDENT NARIMAN: Yes. Yes, I see. You are referring to the letter.

MR. FELDMAN: In our counter Memorial we address the textual point of the two subparagraphs.

PRESIDENT NARIMAN: But you have not said they deposited 29 million or 50 million.

MR. FELDMAN: But, Mr. President, we said again and again a failing to document their claim, and this is, again, another example of failing to document a claim.

ARBITRATOR ANAYA: Do you now contest that they deposited this amount? I understand you're saying they didn't document it and they should have, but do you contest now --

MR. FELDMAN: Well, i mean, a key question is, to what extent do these funds belong to Grand River, to what extent do they belong to Tobaccoville.

PRESIDENT NARIMAN: That's a good point. That's a separate point. But you contest that the group of Claimants, they have not

contested 29 of 50 million.

MR. FELDMAN: We just haven't seen evidence of it.

ARBITRATOR ANAYA: So then you contest it.

MR. FELDMAN: Yes.

PRESIDENT NARIMAN: Yes, that's right. Sorry we took you off.

MR. FELDMAN: Okay. That's okay. I'm summing up.

For the reasons I've discussed, each of Claimants' alternative allegations of a Grand River investment in the United States is without documentary basis and fundamentally flawed. First, with respect to Claimants' purported Grand River NWS Association, which is alleged to be constituted under the Seneca Nation Business Code, that code does not provide for or govern the establishment of business organizations under Seneca Nation law. Second, with respect to the alleged Grand River interest in the Seneca trademark, that allegation is based on nothing

more than Arthur Montour's bear assertions that he holds the Seneca trademark for the benefit of the Claimants in this arbitration.

The assertion is plainly inconsistent with the evidence in the record concerning Grand River's limited license to manufacture Seneca cigarettes in Canada. And Claimants' own legal expert is unable to determine whether Mr. Montour's assertion refers to a moral

15:10:46 obligation or something more.

Third, with respect to Grand River's alleged inventory-based line of credit, Claimants have provided no documentary support for such a line of credit which in any event would be impossible according to the sworn testimony by the President of Grand River in U.S. court proceedings. That testimony makes clear that at all times Grand River sells Seneca cigarettes to Native Wholesale Supply, FOB Ontario, meaning the

15:11:13 title and risk of loss transfer in Canada, not the United States.

Claimants' Grand River Jerry Montour

and Kenneth Hill have failed to show that they have an investment in the territory of the United States and thus fail to qualify as investors under Article 1101.1. Their claims should be dismissed in their entirety.

The remaining Claimant, Arthur Montour, does have an investment in the United States, namely Native Wholesale Supply, as well as the Seneca trademark, but Claimants have failed to

15:11:41 show that the Escrow Statutes relate to Arthur Montour --

PRESIDENT NARIMAN: I'm sorry. What according to you is Arthur Montour's investment because you admit he has an -- according to you, what is the investment of Arthur Montour?

MR. FELDMAN: Arthur Montour has an enterprise, Native Wholesale Supply, and he has intangible property, the Seneca trademark.

PRESIDENT NARIMAN: He has -- that's

15:12:00 how you put it.

MR. FELDMAN: Yes. Yes.

PRESIDENT NARIMAN: Okay.

MR. FELDMAN: As you can see on the screen --

ARBITRATOR CROOK: Or perhaps not.

PRESIDENT NARIMAN: There's some problem with the screen.

Okay, it's coming.

MR. FELDMAN: Thank you.

NAFTA Chapter 11 applies to measures relating to investors of another party.

15:12:17 PRESIDENT NARIMAN: This is the second part of it.

MR. FELDMAN: Yes, yes, and this will be brief -- and/or investments of investors of another party in the territory of the party.

Deposit obligations under the Escrow Statutes apply only to tobacco product manufacturers, as that term is defined under the Statutes. So long as the manufacturer intends for their cigarettes to be sold in the United States,

15:12:38 only the manufacturer and not in a U.S.-based importer, distributor, or reseller qualifies as tobacco product manufacturer under the Escrow

Statutes.

There is no question in this case -- indeed, it is one of Claimants' fundamental allegations, that Grand River intends for its cigarettes to be sold in the United States. Thus there's no question that only Grand River and not any U.S.-based distributor such as Native Wholesale Supply qualifies as a tobacco product manufacturer under the Escrow Statutes.

15:13:09 Accordingly, only Grand River and not Native Wholesale Supply is subject to deposit obligations under the Escrow Statutes. The Escrow Statutes therefore do not relate to the owner of Native Wholesale Supply, Arthur Montour, as required under Article 1101.1.

In response Claimants' assert that, "Obviously, all of the measures at issue in this case are being applied to all of the Claimants."

In support of that representation,

15:13:37 Claimants assert that, "Currently, Arthur Montour and NWS are personally facing three active lawsuits under the Escrow Statutes of Idaho, New

Mexico, and California." Neither of those statements are correct.

The lawsuits brought by the states of Idaho, New Mexico, and California have each been brought under state complementary legislation, not state Escrow Statutes.

As you can see, California's lawsuit was brought under its tobacco directory law, which is another name for California's complementary legislation.

Idaho's complaint similarly was brought under the state's complimentary act.

And New Mexico's lawsuit, likewise, was brought under the state's directory law.

Unlike deposit obligations under the Escrow Statutes which apply only to tobacco product manufacturers as that term is defined, the complementary legislation applies to any person holds, owns, possesses, transports, or imports cigarettes that the person knows or should know are intended for distribution or sale in violation of the statute.

As an owner, transporter, and importer of such cigarettes, NWS is subject to the complementary legislation and those measures therefore relate to NWS and its owner, Arthur Montour, but NWS is not subject to deposit obligations under the Escrow Statutes, and thus the Escrow Statutes does not relate to NWS and its owner, Arthur Montour.

Accordingly, under Article 1101, the claim of Arthur Montour challenging the Escrow Statutes in either their original or amended form should be dismissed. Arthur Montour's claim should be permitted to go forward only to the extent it challenges the complementary legislation.

PRESIDENT NARIMAN: I didn't follow this. The complementary legislation is complimentary to the Escrow Statutes, I thought.

MR. FELDMAN: That's correct. We've heard testimony from the state Attorneys General this week that the complementary legislation also stands alone as a public health provision allowing

the states to monitor in this case the flow of cigarettes.

PRESIDENT NARIMAN: That's where the states says it stands alone, the complementary legislation is legislation to further put forward the -- what the Statutes wanted to do.

MR. FELDMAN: To assist -- to assist in the enforcement.

PRESIDENT NARIMAN: To assist in the enforcement. That is what it is inextricably relate. If there was no statute there would be no complementary legislation. That's why the phrase complementary legislation -- that's why I want to know -- if you are disputing that Arthur Montour has no claim whatsoever against the Escrow Statutes. I just want to understand your claim --

MR. FELDMAN: Yes, and the reasons for that is that the Escrow Statutes apply only to tobacco product manufacturers.

PRESIDENT NARIMAN: And he is not.

MR. FELDMAN: And he is not.

ARBITRATOR CROOK: Mr. Feldman, I'm

sorry to go back and belabor the issue of the escrow payments, but I just pulled up Claimants' reply going through their rebuttal arguments on jurisdiction, and the only reference I see to the escrow obligations is in Paragraph 98, which says that with Grand River's assistance, Tobaccoville has borrowed approximately $5 million to fund its post Allocable Share Amendment escrowed obligations as well as an additional $6 million in 2008. And it goes onto explain that Grand River assisted in this by taking a subordinate position in inventory that was held by Tobaccoville, and that the Claimants go on: This may not in and of itself constitute investment in the territory of the United States, I wonder, do you have a judgment on that? Is taking a subsidiary position in inventory held by your distributor -- is that an investment.

MR. FELDMAN: According to Claimants, it is not and we would not dispute them on that point.

MR. KOVAR: Mr. Crook, just to be

clear, that inventory that they're talking about, they can't take a subordinate position in it because Grand River doesn't own it anymore they sold it FOB Ohsweken Ontario. They can't use it in the way that they're claiming they use it. Again, they're trying to have it both ways. It's gone. It's owned by Tobaccoville.

PRESIDENT NARIMAN: Is Tobaccoville a Claimant?

15:18:17 MR. FELDMAN: No, they're not.

ARBITRATOR ANAYA: If you don't mind I would like to go back to the point that President Nariman was raising.

I understand the argument or I understand that it is not Native Wholesale Supply that's legally obligated to deposit the escrows, but are we to equate such a legal obligation with the phrase related to.

MR. FELDMAN: Thank you Professor

15:18:52 Anaya.

I think the Methanex case is instructive on them.

In Methanex, the measure at issue was a ban on a gasoline oxygenate, and the Claimant manufactured a component of that oxygenate and the Tribunal found that the challenged machine it not relate to the Claimant because the ban -- they were not subject to the banned. They were certainty affected by it, but the ban was for an oxygenate. They did not manufacture the oxygenate; they merely manufactured a component.

15:19:23 So, the NAFTA cases have been helpful in bringing out that simply being affected by a measure is not enough. You need tub subject to the measure, and the Claimants agree with that, and Claimants have argued, and we have on the slide here that their position is that all of the Claimants have -- that all of the challenged measure have been applied to all of the Claimants in this case, and in fact, as we discussed, that's just not the case.

15:19:50 ARBITRATOR ANAYA: I recall your discussion in the Methanex case in your briefs, but isn't there a difference that there you're

talking about a relation, or an alleged relation, that arises from the structure of the market as opposed to here where the relation arises from the legal connections within a statutory scheme, within a single statutory arrangement?

MR. FELDMAN: Right. I think the way that we would analyze it is that, with respect to the Escrow Statutes, the question is, who is subject to the escrow obligation, and in this case

15:20:29 that's Grand River.

ARBITRATOR ANAYA: No, I understand that. I mean, that's the difference, but I'm not sure it gets us -- it seems the terms related to if it was meant to apply so strict terms, different terminology would have been used. Relating to, if it's a single statutory scheme or sufficiently integrated statutory scheme an investor applies to one part of it and it's affected by the other, why isn't that related to?

15:20:54 It's not simply by virtue of the structure of the market itself and business relationships that arise organically apart from the statutory scheme.

MR. FELDMAN: Right. The Methanex case is helpful in using terminology of a legally significant connection, in terms of what is relating to demand. There need to be a legally significant connection.

ARBITRATOR ANAYA: That's my point. The legally significant connection here is in the relationship between the complimentary statutes and the Escrow Statutes as opposed to simply

15:21:24 market conditions dictating the relationship.

MR. FELDMAN: Right. And I think the way we would analyze Escrow Statutes is again, where are those -- to whom are the escrow obligation attaching.

ARBITRATOR CROOK: Just in answer to further thinking about Professor Anaya's question, which is a very interesting one, isn't that the Internet case? Wasn't that the issue that was presented there? Did not the gentleman who was

15:21:48 selling by Internet off the reservation in upstate New York --

MR. FELDMAN: The Scott Maybee.

ARBITRATOR CROOK: Yes, Scott, did he not make essentially this argument, that he could not be subjected to the contraband or complementary legislation because he wasn't subjected to escrow, and what did the court do with that?

MR. FELDMAN: Thank you, Mr. Crook.

Correct. Recently, in the Scott Maybee decision in Idaho the court was very clear that the complementary legislation stands alone, and so that, certainly while the complementary legislation is assisting in the enforcement of the Escrow Statutes, it does have its own identity separate from them.

ARBITRATOR ANAYA: That's an argument on this, but I see that as a very different context. He's being prosecuted under the complimentary statutes.

MR. FELDMAN: Yes, and here we have Native Wholesale -- claims being brought by Native Wholesale under the complimentary statutes, as well.

Okay. Thank you.

PRESIDENT NARIMAN: Thank you.

MR. FELDMAN: For the reasons I discussed, Claimants Grand River, Jerry Montour, and Kenneth have failed to demonstrate that they have an investment in the United States and thus do not qualify as investors under Article 1101.1.

Given that failure to meet fundamental jurisdictional requirements under NAFTA Chapter 11, their claims should be dismissed in its entirety.

With respect to the remaining Claimant, Arthur Montour, Claimants have failed to demonstrate that the Escrow Statutes relate to him as required by Article 1101.1, and thus his claim, to the extent it challenges those measures, should be dismissed.

And again, we raise no objection under Article 1101 concerning Arthur Montour's claim with respect to the complementary legislation, although we do of course challenge that claim on the merits.

Thank you.

PRESIDENT NARIMAN: Thanks very much.

MR. KOVAR: Mr. President, can I ask if you would invite Mr. Sharp to address you on damages.

PRESIDENT NARIMAN: At a convenient time, 15 or 20 minutes, you can stop. We're going to have a tea break.

MR. SHARPE: Thank you. That's halfway through.

Thank you, Mr. President and members of the Tribunal. I will now address Claimants' failure to prove their damages claim.

Yes, and this portion of our presentation addresses confidential business information, although I guess this is Mr. Kaczmarek, our damages expert, in the back, but I don't think there are any members of the public here.

(End of open session. Confidential business information redacted.)

CONFIDENTIAL SESSION

MR. SHARPE: In this arbitration, Claimants seek up $268 million in damages, but they made no serious effort to prove their claim. They dedicated three cursory paragraphs of their reply to damages. They virtually ignored the issues during that merits hearing and as you know, at the last minute they dropped their cross-examination of the United States damages expert who was here and available to testify.

PRESIDENT NARIMAN: Who did they drop?

MR. SHARPE: Mr. Kaczmarek, the United States damages expert in this case.

I plan to discuss what Claimants were required to prove as well as their failure to carry that burden of proof. And let me please begin with the legal standard.

Under Articles 1116 and 1117 of the NAFTA, Claimants must prove that their investments have incurred loss or damage by reason of or arising out of a specific breach of the NAFTA.

Chapter 11 Tribunals have confirmed

that compensable losses must be proximately caused by the breach complained of and cannot be excessively speculative.

The S.D. Myers Chapter 11 Tribunal confirmed that, "The burden is on the Claimant, SDMI, to prove the quantum losses in respect of which it puts forward its claims."

It added, "Compensation is payable only in respect of harm that is proved to have a sufficient causal link with the specific NAFTA provision that has been breached." The economic losses claimed by SDMI must be proved to be those that have arisen from a breach of the NAFTA and not from other causes.

The ADM Chapter Eleven Tribunal added, "Any determination of damages under principles of international law require a sufficiently clear, direct link between the wrongful act and the alleged injury in order to trigger the obligation to compensate for such injury."

We submit that these points are not disputed by the parties.

Claimants here have failed to prove that they suffered any damages, let alone that a breach of the NAFTA clearly and proximately caused the damages they alleged.

Claimants' valuation methodologies are inappropriate; their calculations are demonstrably flawed; and the evidence they presented is inadequate, unauthenticated, uncorroborated inconsistent, and even, at times, contradictory. This is plainly evident, we submit, from the damages report prepared for the Claimants by Mr. Wilson.

On the screen is the table from Navigant's rebuttal report that sets out the changes in Mr. Wilson's calculations, from his first to his second report. We saw this table last week during the cross-examination of Mr. Wilson.

As you know, Mr. Wilson's primary damages estimate decreased dramatically from his first to his Second Expert Reports. At the top of this table is the growth scenario, and under that

scenario, Mr. Wilson assumed that Grand River and NWS would double their on-Reservation market in the first four years of the forecast and then double it again every eight years, forever, even overtaking sales of Marlboro and Camel cigarettes. Based on this "modest growth rate" as Mr. Wilson calls it, he initially estimated that Claimants would suffer about $248,700,000 in damages.

Now, below that is the no-growth scenario which assumed a steady stream of cigarette sales forever, despite a declining U.S. market of cigarettes of 2 to 4 percent every year. Based on this assumption, Mr. Wilson estimated that Claimants would suffer about $173,600,000 in damages.

MR. VIOLI: Mr. Chairman can, I ask where in the record the reference is? That's all, I want to search the reference so I can follow. The reference to Marlboro and projecting sales greater than Marlboro or Camel. I just need that reference.

MR. SHARPE: You can look at Navigant's

First Report at Paragraph 120.

PRESIDENT NARIMAN: Go on.

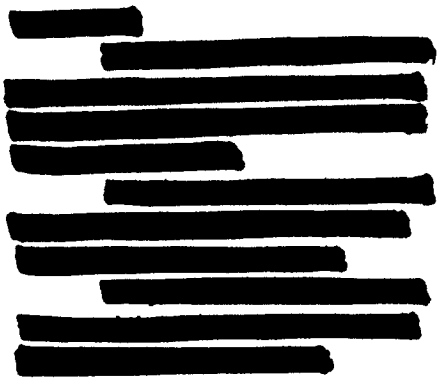
MR. SHARPE: Thank you, Mr. President.

In his Second Report, Mr. Wilson reduced those figures to about $97.2 million in the growth scenario and the $74.9 million in the no-growth scenario.

And as Mr. Wilson slashed Claimants' principle damages claim by about 60 percent, or by $100 to $150 million. Why? Because Navigant pointed out four errors, serious errors, in Mr. Wilson's damages to calculations.

The flaw number one, Mr. Wilson grossly misstated the profits Claimants' earned by ignoring costs of manufacturing and distributing cigarettes for on-Reservation sales.

This graphic from Navigant's expert report compares Navigant's on-Reservation profit estimates under MCI on the left, with Mr. Wilson's estimates on the right. [redacted]



As he testified last week, it's largely because Mr. Wilson calculated Claimants' profit without assuming any costs incurred by NWS. Mr. Wilson claims he didn't realize NWS would incur this cost, apparently because NWS told him as much. He testified "When we talked to NWS initially, it did not appear that there were really variable costs of any substance."

15:31:22 We find this inexplicable, given Mr. Wilson's testimony, that, "The financial statements we received from NWS included some

detailed cost breakdowns."

Navigant, of course, didn't have the advantage of discussing NWS's operations with management but it was obvious that NWS would incur costs. What business doesn't incur cost?

Mr. Wilson went on to testify, "We continued that communication with NWS concerning costs after we got Mr. Kaczmarek's report and identified some costs."

15:31:57 Again, it's rather surprising that a valuation expert would require another valuation expert to tell him he that can't calculate profits unless you account for the cost of doing business -- all cost: Variable cost, fixed cost, taxes.

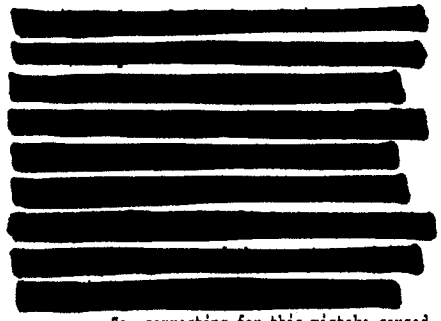
ARBITRATOR CROOK: Mr. Sharp, excuse me, do I understand correctly then that Mr. Wilson's First Report left out the cost of the cigarettes that NWS was then distributing? Is that one of the variable costs he left out?

15:32:27 MR. SHARPE: He didn't cover any costs of any sort, direct cost, variable cost.

Now, returning to the graphic, Navigant

pointed out that Mr. Wilson had failed to account for costs totalling $4.67 per carton. Correcting for this single error caused Mr. Wilson to reduce Claimants' damages claim by $76 million.

As noted, and as you can see in orange,



15:33:13 So, correcting for this mistake caused Mr. Wilson to reduce Claimants damages claim by a further $36 million.

Flaw number two: Mr. Wilson projected lost cigarette sales based on GRE's 2005 sales

15:33:41 figures, but as we discussed last week he failed to account for the usual spike in off-Reservation cigarette sales in the fourth quarter of 2005.

Towards the end of 2005, purchasers stocked up on cigarette sales in anticipation of large cost increases beginning in 2006, and this spike skewed Mr. Wilson's forecast for off-Reservation sales.

As you can see from the slide prepared by Navigant, Navigant made a 25 percent reduction in 2005 sales to account for these accelerated purchases.

In his Second Report, Mr. Wilson

15:34:15 acknowledged the accelerated purposes but rather than reducing its forecast by 25 percent, he reduced it by 18 percent. In any event, even 18 percent reduction caused Mr. Wilson to reduce Claimants' damages claim.

PRESIDENT NARIMAN: What is the measure of damages according to you in a case like this? Forget all this, Wilson said this and he later he amended it. What should be the measure of damages?

15:34:41 MR. SHARPE: I think it's very difficult to say in this case, because of the --

PRESIDENT NARIMAN: No, what is the

measure -- the true measure of damages means what you would have sold or earned or -- what is the measure?

MR. SHARPE: The measure of damages for the investment is precisely the difficulty of quantifying. This was Navigant's struggle during their First Report. They said, what are we trying to evaluate? You have said that your investment is NWS plus some portion of GRE's sales in the United States, but they're doing it backwards. They've tried to identify losses and then they've constructed their investment around those losses.

And as Navigant pointed out, this is totally contrary to the way --as Navigant pointed out, this is very odd, and I think in response to Mr. Crook's question last week to Mr. Wilson, he acknowledged that he's never seen a case like this.

ARBITRATOR ANAYA: And specifically refresh me on this, what are the losses attributable to, allegedly?

MR. SHARPE: I'm sorry. Could you --

ARBITRATOR ANAYA: What are the lost profits attributable to allegedly, according to the Claimants, as you understand it.

MR. SHARPE: Yes, as I understand Claimants' claim, Claimants are alleging that their investment is the Seneca brand in the United States, and lost profits on their sales is the proxy for the damage to their brand.

ARBITRATOR ANAYA: Lost profits as a result of?

MR. SHARPE: The challenged measures.

ARBITRATOR ANAYA: By what mechanics? I guess I'm trying to understand what the mechanics are, the measures would affect this. You referred to the causation factor so what is the alleged causation as you understand it.

MR. SHARPE: As I understand it, the Claimants assert that the challenged measures in this case caused 100 percent of the lasted sales to the Seneca brand, and so the measure of damages for Claimants is all of their lost sales in the United States based on their forecast going

forward.

Now, we'll get to the two problems with this. One is, the Seneca brand as the investment and the second is the causation issue, but if I'm not mischaracterizing Claimants' arguments, that's my understanding of their essential damages claim.

ARBITRATOR ANAYA: Do you -- you will address the causation.

MR. SHARPE: Yes. Thank you, Professor Anaya.

If we could move on, flaw number three, Mr. Wilson projected lost on-Reservation cigarette sales from 2006 figures, but as he acknowledged last week, in testimony, he failed to account for actual cigarette sales when projecting so-called lost sales.

As you can see from the slide, there was significant on-Reservation sales and indeed sales increases in 2007 in Idaho, Nevada, and as we'll see on the following slide, in California.

In Nevada, for instance, Mr. Wilson calculated damages over $31 million for lost sales

from 2003 to 2008, but Claimants' own data shows that sales in Nevada remained reasonably steady during that time. Claimants in fact now no longer seek any damages for so-called lost sales in Nevada from 2003 to 2008.

Likewise, as you can see from this slide, which is taken from Mr. Wilson's rebuttal report, Claimants' on-Reservation sales increased in California every year since 2004 from 18 million cigarettes to 39 million to 80 million cigarettes to 88 million cigarettes, and then sales -- sorry, Professor.

PRESIDENT NARIMAN: Despite the amendments which they complain about --

MR. SHARPE: Precisely.

PRESIDENT NARIMAN: -- their sales, instead of being reduced, kept an even keel. That means even in terms of that percentage they remain the same.

MR. SHARPE: You said despite the amendments but you might even say because of the amendment, right? The effect of the challenged

measures increased prices off-Reservation. Why are people going on-Reservation to buy these cigarettes? It's precisely because they're cheaper, and so -- it's not -- you could say it's not to spite but because of.

PRESIDENT NARIMAN: Because.

MR. SHARPE: Now, Mr. Wilson hasn't taken it into account and Navigant hasn't factored this into its damages analysis but Navigant has raised this as a concern.

Mr. Wilson has acknowledged his mistake and he dropped Claimants' so-called lost profits for California and he accounted for actual sales in Nevada and Arizona and Idaho, and this reduced Claimants' damages claim by a further $15 million.

Now, you heard last week Mr. Wilson say that this was a mere oversight. He said that mere hours before he completed his July 2008 report, Claimants finally supplied him with historical on-Reservation sales information. This is what he said:

"And then, finally, if you actually

look through the text of the original report, when we discuss the on-Reservation sales, there is a line at the end of the paragraph that indicates they're offset by actual sales that occurred. Due to a last hour change we did not do that offset, so there's significant change because of something we intend to do and ended up not getting done, because we didn't get the data at the time to be able to do it."

This explanation we submit is demonstrably false for two reasons.

First, it contradicts Mr. Wilson's own report. I put appendix B on the screen to Mr. Wilson's First Report which lists the documents he reviewed in preparation of his report. The six bullet points states, "NWS sales reports, 2000 to 2007." Note that this is the precise data that Navigant looked at but Navigant observed there --

PRESIDENT NARIMAN: So he had that data with him.

MR. SHARPE: Yes.

In addition, I would point you to the bottom of the page where it says "interviews with NWS, GRE, and Tobaccoville personnel." Our question is, did Mr. Wilson fail to ask Claimants in Tobaccoville about on-Reservation sales before submitting its report and, even more curiously, did Claimants fail to read Mr. Wilson's report before submitting it and claiming these are improper claiming for the sales.

Second, Mr. Wilson submitted a revised version of his First Report, one month after he submitted his initial report. On the screen is a letter from Claimants' counsel to the United States --

PRESIDENT NARIMAN: Was that after your report?

MR. SHARPE: One month after his own report.

PRESIDENT NARIMAN: His own report?

MR. SHARPE: Yes, he says, we received this information in the last hours and we would have incorporated it and we intended to

incorporate it bu unfortunately, apparently, we didn't have time.

So here's a letter from August 7, 2008, or about one month after Mr. Wilson submitted his July 10th expert report.

It states: "Dear Mark, I enclose three disks that contain the following: Materials for Gordius Consulting" -- that's Mr. Wilson's then-employer, as he acknowledged -- "two, materials from Micra, and three, revised expert report of Gordius Consulting. The revised Gordius report reflects the correction of any calculation errors discovered by Gordius during the process of post submission quality control. Any changes made in the numbers are reflected in the relevant tables and carried through the report."

If you then look at Exhibit 7, revised to Mr. Wilson's First Report, we see that Mr. Wilson continued to claim more than $123 million dollars for so-called lost profits on-Reservation, including in California and Nevada.

So, even if Mr. Wilson actually received Claimants' on-Reservation sales information mere hours before he submitted his first report, we find it in excusable for him not to have corrected that in his Second Report one month later.

Even more extraordinary, we find, is Mr. Wilson's explanation last week for his failure to make this correction. He testified, "And we would have accounted for actual sales in the revision but we knew we would have a rebuttal so there was very little point in just providing more documents that we knew would likely change when we had to respond to Mr. Kaczmarek's evaluations of our damages.

Consider the implications of this statement. Mr. Wilson knew that there was error in excess of $50 million in his damages calculation which he had every opportunity to correct in his revised first report but he consciously chose not to make the correction because, in his words, there was very little

point.

PRESIDENT NARIMAN: He would do it in rebuttal.

MR. SHARPE: He would do it in rebuttal.

In our opinion, this submission casts serious doubt on Mr. Wilson's credibility as a damages's expert.

Mr. Wilson's testimony last week also highlighted problems with the Claimants' so-called investment in markets claim. As you will recall, Claimants initially sought $38 million dollars for equipment in Canada which they purchased to serve the U.S. market solely.

As initial matters, Mr. Crook observed last week a Claimant can't claim for last profits and for the equipment used to generate those lost profits, as that constitutes double accounting. Mr. Crook also identified today this is inconsistent with the Bayview and Canadian cattlemen cases which established that under NAFTA Chapter 11, Claimants can only recover for damages

for investments in the territory of the host state.

Mr. Feldman also noted the ADM Case, which in the award at Paragraph 273, states as follows:

"Under Article 1101.1" --

PRESIDENT NARIMAN: Your point 3 is very significant. You have said they failed to consider actual sales figures when projecting lost sales; that's very significant.

MR. SHARPE: That's correct. We consider it very significant, yes.

ADM. "Under Article 11 1011 of the NAFTA the only investments covered by Chapter Eleven are investments made in the territory of the host state, and Chapter 11 Tribunals have rejected claims for damages to investments made outside of the territory of the host state even if those investments were designed to serve markets in the host state. This means that the protection applies to measures relating to investments of investors of one party that are in the territory

of the party that has adopted or maintained such measures."

"In a case such as the one at bar. This would exclude investments of ADM and TLIA located outside of Mexico, even if such investments are destined to promote fructose sales in Mexico."

But even if we set aside these two fundamental problems that Mr. Crook identified, Claimants failed to demonstrate that the equipment was purchased solely to serve the U.S. market and that it couldn't be used for other markets.

PRESIDENT NARIMAN: I want to know, what does this mean, failed to consider actual sales figures when projecting lost sales? According to you, what does that show?

MR. SHARPE: Mr. Wilson initially projected lost sales --

PRESIDENT NARIMAN: I know, but what does it show? If he failed to consider actual sales figures and put lost sales without considering actual sales figures what would you

say so such a report?

MR. SHARPE: If you're calculating damages for lost sales in California, for instance, but you haven't actually suffered any lost sales, then you have -- you're whole damages report is intrinsically flawed. You have to look at whether you've made sales. Mr. Wilson assumed zero sales on the assumption -- because he believed that there were no sales in those states, yet his report says he looked at NWS sales information 2000 to 2007. How could he not have observed, as Navigant did, that there were sales in California, Nevada, and other states during that time? This is a very serious flaw in his report.

PRESIDENT NARIMAN: Yes it is.

MR. SHARPE: Returning to the investment in markets, on the screen is an e-mail to Grand River from Sandra Weisbrod, a senior manager at Mr. Wilson's firm. She states, quote --

PRESIDENT NARIMAN: Whose Seneca

trademark is this?

MR. SHARPE: Ms. Weisbrod is a colleague of Mr. Wilson from his firm. She is sending an e-mail to the Claimants:

"We are still waiting on the discussion on the 2002 invoices not yet found for the equipment listed below. I need to know whether this equipment was purchased solely to meet the needs of the U.S. market or if GRE would have purchased said equipment for plant efficiency, economies of scale, normal non-U.S. growth, et cetera."

In Second Report, Mr. Wilson states, "Upon further investigation and having received additional data, I concur that the appropriate investment value of the incremental fixed asset cost is lower just above USD 24 million. Now, during cross-examination, here's how Mr. Wilson described the process: "It was simply a matter we had additional conversations more or less confirming that that 38 million was what we expected it to be and it became clear to me very

quickly in talking to the accountants that the train had gone off the tracks and that their understanding of what incremental costs were not what I needed it to be."

So apparently --

PRESIDENT NARIMAN: That maybe a characterization of his report, also, gone off the track.

MR. SHARPE: We believe that's the case.

Apparently, Mr. Wilson learned very quickly that Claimants had erroneously sought to recover millions of dollars which they were not entitled. He thus reduced this portion of Claimants' damages claim from $38 million to $24 million. But despite Mr. Wilson's claims to have received additional, justifying this $24 million claim, Claimants still haven't introduced any evidence showing that this equipment was purchased solely to serve the U.S. market.

PRESIDENT NARIMAN: Is it convenient or are you going to finish?

MR. SHARPE: If you could give me a couple of --

PRESIDENT NARIMAN: No, no problem. Five minutes more.

MR. SHARPE: Just a couple more minute and then we'll be at a convenient spot, just about halfway.

Mr. Wilson, in fact, acknowledged last week that there is no such evidence in the record. I'll quote this exchange.

"QUESTION: Did you produce evidence that would allow the Tribunal independently to determine the $24 million claimed for this equipment is solely to serve the U.S. market?"

"ANSWER: I'm not sure how I would do that. You know, that's a nice theory."

"QUESTION: So in theory it would be nice if there were documents that showed that this equipment exclusively served the U.S. market but to your knowledge there are no documents that demonstrate that this equipment exclusively serves the U.S. market."

"ANSWER: I don't think there would ever be that kind of information for any asset. I don't have that piece of information because in fact there would never be that piece of information unless someone saw fit to create it and say, we need to buy this for the U.S. market."

"QUESTION: Did someone see fit in this case, to your knowledge, to put in a report saying, I met with Mr. Wilson, I work for GRE, and I can attest that this equipment exclusively serves the U.S. market for the following reasons."

"ANSWER: I don't know the answer to that question."

There is, in fact, nothing in the record whether testimonial or documentary evidence showing that this equipment exclusively serves the U.S. market, nor have Claimants introduced any evidence demonstrating they couldn't sell this equipment or use it for their other markets, including for those U.S. states in which their sales are flourishing, such as California and New York.

In fact, during Mr. Wilson's testimony, he highlighted this very flaw in Claimants' case. He said, "And I would go so far as to say I think the Arbitration Tribunal should probably look at that $24 million roughly and evaluate what amount that you feel is relevant to what they don't have anymore. In other words, relevant to the markets that they lost. It's virtually impossible for me to do that because, for instance, the 100s maker that I talked about earlier makes 100s cigarettes. You sell those in New York but you also sell them in Arizona. Clearly, you can't sell them in Arizona anymore, but you can still sell them in New York. So, some portion of that asset probably hasn't been lost, and it's just impossible because I can't evaluate from the Tribunal's standpoint what percentage of that value is relevant to the loss of the Arizona market, of the Nevada Market, of the Idaho market, of the five original states off-Reservation."

Given Mr. Wilson's acknowledgement that it was impossible for him as a valuation expert to

establish the $24 million claim, why did he advance it? And he answered as follows: "The first and easiest answer is I was instructed by counsel that they needed that number, that that was part of the legal claim that I referred to probably quite inarticulately as being their personal investment and I can't really take it beyond."

It's surprising that an independent expert would support a damages claim that he knew couldn't be supported by evidence simply because he had been instructed by counsel to produce a number.

PRESIDENT NARIMAN: This is an answer to what question?

MR. SHARPE: This was answer to a question put to Mr.

PRESIDENT NARIMAN: No, the question. Have you got that?

MR. SHARPE: Yes, I have.

PRESIDENT NARIMAN: 635.

MR. SHARPE: Okay. Thank you.

The specific question was by Mr. Crook, and this goes to the investments in market and the double counting of why he put forward this claim. He said, Mr. Crook stated -- "Now, I have always been taught by experts like you that you can't do that, that you can either claim for the discounted value of lost profits or you can claim for the loss of investment, but to do otherwise is double counting. Now, can you explain to me why it's not double counting here?"

PRESIDENT NARIMAN: Okay. Are you halfway?

MR. SHARPE: I think we can stop here and I'll take it up after the break.

PRESIDENT NARIMAN: 10 past 4:00.

(Whereupon, at 3:53 p.m., the hearing was adjourned until 4:10 p.m., the same day.)

MR. SHARPE: Thank you, Mr. President.

I just wanted to quickly summarize the main errors that Mr. Wilson acknowledge in his second report before I get to the principle problems of his report.

As you can see from the next slide, after Navigant pointed out these four errors that Mr. Wilson made he had to reduce the Claimants' damages claim by 61 percent in the growth scenario and 57 percent in the no-growth scenario or by about $100 to $150 million.

PRESIDENT NARIMAN: This second report was within one month, you say?

MR. SHARPE: No, no. That was the revision to Mr. Wilson's first report.

PRESIDENT NARIMAN: The revision. So, when was the second report, after your --

MR. SHARPE: Yes, after Navigant submitted its first report, Mr. Wilson --

PRESIDENT NARIMAN: Can you give us a date of first report.

MR. SHARPE: Mr. Wilson's first report was July 10, 2008.

PRESIDENT NARIMAN: July, 2008. And second report, roughly?

MR. SHARPE: His second report was March 3, 2009.

PRESIDENT NARIMAN: And your report of your witness, your witness which was in between --

MR. SHARPE: Yes, Navigant's first report December 22, 2008.

PRESIDENT NARIMAN: Navigant's first is December.

MR. SHARPE: December 22, 2008.

PRESIDENT NARIMAN: And second?

MR. SHARPE: May 13, 2009.

This next slide highlights the sequential impact of these changes that Mr. Wilson had to make in his second report, based on Navigant's criticisms, its failure to account for any of NWS costs; its failure to account for GRE's indirect cost; its failure to account for the spike in 2005 sales; its failure to look at NWS's actual sales data; and its failure to exclude claims for equipment in Canada that he acknowledged didn't solely serve the U.S. market.

As we noted, Mr. Wilson corrected some of his most glaring errors, but as Navigant observed, Mr. Wilson made a number of other

errors, including overstating so-called lost sales, understating actual sales, miscalculating the discount rate, and misallocating costs between their U.S. and Canadian operations.

Navigant's supporting evident maintains unchallenged and thus unrebutted in this case.

Correcting for these additional problems reduced Mr. Wilson's revised damages estimate from $97 million to zero dollars. Claimant simply had not demonstrated that they suffered any damages as a direct result of the challenged measures in this arbitration.

This should, perhaps, come as no surprise, given Mr. Wilson acknowledge last week that Claimants are "competing favorably" in states in which they claim to have been shut out of and have repositioned their business as, he said. And that's at Page 638 of the transcript.

But even if the challenged measures actually caused the damages that Claimants allege, they couldn't recover for those damages based on Mr. Wilson's calculations, because there's a

fundamental problem with his valuation approach.

As I suggested earlier, Mr. Wilson purports to value the damage to Claimants' investments by measuring the diminished value of the Seneca and Opal brands in certain markets in the United States, but he never establishes that the Seneca and Opal brands have value to begin with, and he never proves any damages to the brands themselves. Instead, Mr. Wilson assumes that the Seneca and Opal brands have value simply because people by products with the Seneca and Opal labels on them. In fact, Mr. Wilson assumes that the brands are so valuable as to represent 100 percent of the value of the Claimants' enterprise in the United States.

Navigant pressed Mr. Wilson to provide evidence of the Opal cigarettes actually have brand value but he declined to do so. He said, "It seems rather mundane to be asking whether a brand of cigarettes with millions of dollars in sales has value and whether it enhances the value of Claimants' other brands and products." But

then Mr. Wilson acknowledged the critical point stating, "The better measurement using this inappropriate logic would be to compare the premium charged for the Seneca brand cigarette over generic cigarettes. This provides at least some measurement of the value of the brand, however inadequate."

Mr. Wilson then dismisses this suggestion. He states, "however the very question is not particularly insightful or helpful since it questions the obvious," but it's far from obvious that the Seneca brands has any value that's separate from the Claimants' underlying product. In fact Navigant established that Claimants' discount cigarettes are very similar to generic cigarettes, as they have minimal brand loyalty and compete almost exclusively on the basis of price.

Mr. Wilson himself concedes this very point. As you can see from the slide, he acknowledged that "market shares for discount and deep discount cigarettes are three or more times as responsive to own price changes, price movement

not covered by external factors such as taxes as our premium market shares."

Even when we look at companies whose brands are less responsive to own price changes, which is indication of brand value, we see that brand represent only a fraction of the value of the company. You can see from the slide according to industry sources, even world-famous brands like Coke and Disney represent about two thirds of the value of the those companies. Marlboro, McDonalds, and Nike represent about half the value of those companies. Even the Apple brand represent barely a fifth of the value of that company, and Apple, of course, has spent hundreds of millions of dollars over the few decades establishing its brand value in the United States.

The notion that the Seneca and Opal cigarettes constitute 100 percent of the value of the Seneca and Opal products in the United States is simply not credible. But even if we assumed that the Seneca and Opal brands are more valuable to Claimants than the Coke and Marlboro brands are

to those companies, there's still a fundamental problem with Mr. Wilson's analysis: He simply assumes that the challenged measures caused 100 percent of the reduction in sales that the Claimants' complain of.

Mr. Wilson never considers that other factors beyond the challenged matters have contributed to Claimants' alleged lost sales and thus lost profits.

Even Claimants themselves acknowledge that many other factors may be responsible for reduction in sales.

As you can see from the slide, Claimants state in their reply, "There is simply no means of accurately assessing which of the following factors in any given state contributed in what specific amount to the overall mean reduction in tobacco use nationally. Local and state smoking bans or usage restrictions, changes in consumer tests and preferences, public advisory campaigns, availability of cessation therapy programs, and the price-setting aspects of the MSA

in a given state, as well as the various tax changes that will have been made in various jurisdictions over the same period."

Claimants themselves thus reject Mr. Wilson's assumptions that the ASA measures necessarily caused all the Claimants' lost sales and lost profits.

But again, let's assume that Claimants are wrong and that Mr. Wilson is right and that the challenge measures caused all of the alleged reductions in Claimants' sales, the Tribunal still should reject Mr. Wilson's damages calculations for two reasons.

First, the evidence on which he relies is wholly inadequate.

And second, he made serious errors in calculating those damages.

Let me say a few words about the inadequacy of the Claimants' evidence. Navigant has summarized the state of the evidence that Mr. Wilson has relied on in Navigant's rejoinder report: "Nearly every data element of

Mr. Wilson's analysis, sales volumes, sales price, unit cost, et cetera, is internally inconsistent, is in conflict with other data, or has changed dramatically often without explanation since Mr. Wilson's first report."

Navigant offers three illustrations -- problem with Claimants' data.

Problem number one, there are large discrepancies between the sales volumes that Mr. Wilson used for his damages analysis and those reported by the Claimants to the states for purposes of making their escrow deposits.

Navigant prepared the comparison on this slide from Claimants' own data. In the left column after the states is the sales volume information that Mr. Wilson used for purposes of this arbitration. In the middle column, it's the sales volume information that Claimants provided to the various states for purposes of making escrow payments.

As you can see, for use in this arbitration, Mr. Wilson overstated the sales

volume in 2005 by 14 percent; apparently, to exaggerate the revenue that Claimant supposedly generated that year.

Mr. Wilson also understated the sales volume in 2006 by 15 percent, apparently to exaggerate the impact of the challenged measures on Claimants' sales. In total, Mr. Wilson distorted the Claimants' alleged lost sales by 31 percent. And note that this figure is based on Claimants' own evidence.

In his testimony, Mr. Wilson said, outside of an amazing coincidence, I can't imagine that the numbers would be exactly equal. You're by definition going to have delays that occur between GRE and its distributors. That may be true, but it's irrelevant here because the source of the data in both columns is the same: It's Tobaccoville. Thus, no reporting delay could account for the discrepancies. It's clear one or both of the data sets is simply not correct.

Problem number two, in Mr. Wilson's rebuttal report he claimed to have obtained new

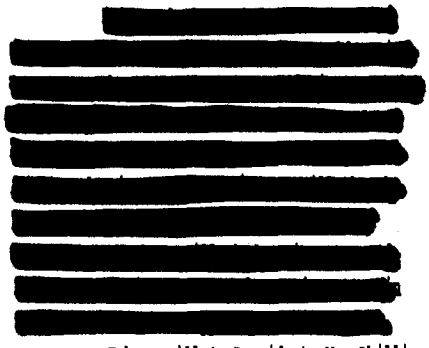
and more accurate Tobaccoville sales date at that which had the convenient effect of increasing Claimants' damages claim, but as Navigant stated in its rejoinder report, "We examined this so-called new data and found that it is not new or more accurate in any sense. Whoever provided the data, Mr. Wilson, Claimant, or Tobaccoville, appears to have simply taken the old data and made ad hoc modifications with no explanation."

In fact, Mr. Wilson seems to have modified his old data in order decrease the volume of actual sales in the five original states by 79.4 million cigarettes in 2007, and this had the effect of increasing so-called lost sales and inflating Claimants' alleged damages.

I would note Navigant's testimony in this regard remains unrebutted.

Problem number three, there are huge discrepancies between the sales from Grand River to Tobaccoville and from Tobaccoville to its customers. As you would expect, there will always be some discrepancies depending on whether

Tobaccoville is building up or drawing down its inventory, but as you can see from this slide, Navigant found discrepancies millions of cartons and cigarettes.



Tobaccoville's President, Mr. Phillips, testified in this case that Tobaccoville did not even exist until 2002 and did not begin selling Seneca cigarettes until the summer of 2002.

If you look at the data from 2005 to 2007, you see the opposite problem. Grand River reportedly sold vastly more cigarettes to Tobaccoville than Tobaccoville sold to its

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customers. [redacted]

[redacted]

The suggestion that a wholesaler like Tobaccoville is warehousing two years supply of Grand River-made cigarettes again strikes us as highly implausible.

Claimants have never explained these massive discrepancies which occur in every year.

Mr. Wilson highlighted the problems with Claimants' own data during his testimony last week. He said, "Our goal was to try to get the best information and unfortunately we're dealing with companies that don't necessarily track their sales all the way to individual states in some cases. They would track them to a regional distributorship and it's just not in their nature. They have clients in those states and are able to build it up back up, but in the normal course of business these aren't the types of data that they normally keep."

He further testified, "These are companies that deal in handwritten notes. They

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don't have a multimillion dollar accounting system and oftentimes that's how they communicate."

We find it in incredible that Claimant seeks to recover hundreds of millions of dollars for lost sales in individual states when Claimants' own damages expert acknowledges the absence of state-by-state sales information that's accurate.

United States called for Claimants to provide their audited financial statements for the years ending 2006-2007. Those statements could have helped the parties' experts as well as the Tribunal resolve these inconsistencies and contradictions in the underlying data.

Mr. Wilson, however, initially appeared to reject that basic proposition. He was asked:

"QUESTION: Do you think that audited financial statements would assist the Tribunal in deciding any damages that might be appropriate to award to Claimants?"

"ANSWER: Absolutely not."

He was then asked:

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"QUESTION: Did you request NWS's audited financial statements for the years ending 2006, 2007, and 2008?"

"ANSWER: We did and we received them."

PRESIDENT NARIMAN: Reviewed them.

MR. SHARPE: "We reviewed them," thank you.

The financial statements that we received from NWS included some detailed cost breakdowns.

PRESIDENT NARIMAN: What does that mean answer -- no -- did you request, yes, and they didn't supply or they supplied? What does it mean?

MR. SHARPE: This means that Mr. Wilson requested --

PRESIDENT NARIMAN: Audited statement.

MR. SHARPE: Yes. And NWS, according to Mr. Wilson, produced those audited financial statements.

PRESIDENT NARIMAN: Did produce?

MR. SHARPE: Did produce to Mr. Wilson

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but did not produce in this arbitration.

PRESIDENT NARIMAN: What does it say after the dot, dot?

MR. SHARPE: We did after we received them.

PRESIDENT NARIMAN: No, no we did and we reviewed them. Does it say anything?

MR. SHARPE: Yes, 591.

PRESIDENT NARIMAN: 591, day 2. Let's see.

I mean, is there anything worthwhile on this point or is your dot, dot correct?

MR. SHARPE: Well, I can read the -- it's "we did and we reviewed them."

The next question after that is:

"QUESTION: You did and you reviewed them, and did you produce them with your rebuttal report?"

"ANSWER: My understanding is they were produced. I don't know that they were part of what -- I mean, we had the financials -- maybe I should restate that. The financial statements

that we received from NWS included some detailed cost breakdowns but -- and we have looked at -- some of them are audited, some of them are viewed" --- he goes on --

MR.VIOLI: Are you sure those haven't been produced, Jeremy?

MR. SHARPE: Yes, they have not been produced. Years ending 2006, 2007, 2008.

MR. VIOLI: There's only 2006.

16:28:19 MR. SHARPE: Sorry?

MR. VIOLI: There's no 2007. We produced every audited financial statement.

MR. SHARPE: I'm just quoting Mr. Wilson's testimony.

MR. VIOLI: Well, you completed it now (off microphone.)

PRESIDENT NARIMAN: No, no. According to you, have they produced audited financial statements on record for 2006, 2007 and 2008?

16:28:38 MR. SHARPE: No.

MR. VIOLI: For 2006, we did.

MR. SHARPE: Years ending -- financial

--

MR. VIOLI: Mr. President, you asked NWS --

MR. SHARPE: That's correct.

MR. VIOLI: You said 2006.

MR. SHARPE: No, there are no audited financials --

PRESIDENT NARIMAN: Okay take it down and I'll look at it later, if you want.

16:28:58 ARBITRATOR CROOK: It's a fact question the Tribunal can determine.

PRESIDENT NARIMAN: 2006, 2007, and 2008, no audited financial statements filed.

MR. SHARPE: No years ending 2006, 2007, or 2008, that's correct.

PRESIDENT NARIMAN: Although, according to you, Mr. Wilson -- it was produced before Mr. Wilson and he saw them -- he reviewed them.

MR. SHARPE: That's his testimony.

16:29:23 That's his testimony.

I'll just read this again. He answered, "We did and we reviewed them. The

financial statements that we received from NWS included some detailed cost breakdowns." We would submit that's already an acknowledgement of one benefit of audited financial statements: They can provide detailed cost breakdowns.

Mr. Wilson highlighted other benefits last week. He testified, "I think audited financial statements would represent that the controls in place were better. It would represent

16:29:51 that the accounting for the revenues were according to generally accepted accounting principles, or GAAP."

He added, "Essentially the difference between audited and unaudited financial statements, if we are speaking about United States GAAP and it generally applies across countries, is that an independent auditor comes in and reviews the financial statements and in performing that review, they perform statistical testing to make

16:30:22 sure that the numbers are 'correct,' and they sign off on the statements as being correct."

Thus, according to Mr. Wilson's

testimony, a company's audited financials should be more reliable because they're independently reviewed, corroborated through statistical testing, and conform to established accounting principles generally accepted in the United States and around the world.

Interestingly, Mr. Wilson also noted last week, "The only reason NWS has financial statements is because they have a loan and the

16:30:49 bank requires them to file the financial statements." So, apparently NWS's bank requires audited financial statements as a condition of lending it money, and yet Claimants here demand a quarter of a billion dollars from the United States --

PRESIDENT NARIMAN: Without financials --

MR. SHARPE: Correct.

The United States submits that, based

16:31:08 on the quality of the evidence in the record and the absence of audited financial statements, there is no way for this Tribunal fairly to award

Claimants any damages.

I'll just say a few final words about Mr. Wilson's alternative damages theory, which purports to calculate the present value of Claimants' increased escrow deposits under the Allocable Share Amendments.

Like Mr. Wilson's principal valuation theory, his alternative valuation theory seeks to capture damage allegedly caused to Claimants' U.S. investment. As you well know, the use of alternative valuation approaches is common. It allows appraisers to test their methodologies and data. When different valuation approaches produce similar results, the appraiser can be confident of his or her results, and by contrast wildly divergent valuations indicate problems with the appraiser's valuation methodologies or data.

Mr. Wilson's alternative valuation produced results 550 percent greater than his principal valuation. The notion that two methods that purport to quantify damages resulting from the same disputed measures can diverge 550 percent

is not supportable. But even if Mr. Wilson's alternate damages theory actually corroborated his primary damages theory, the Tribunal cannot rely on it, as we believe it's seriously flawed.

According to Mr. Wilson, Claimants are entitled to recover the difference between the amounts they're required to pay under the Allocable Share Amendments and the amounts they claim they would have paid in escrow to the five original states had they been afforded so-called volumetric exemptions.

There are three main flaws with Mr. Wilson's alternative valuation theory.

First, it assumes that Tobaccoville, not Grand River, is responsible for making escrow deposits. As you just heard from Mr. Feldman, Tobaccoville is not a party in this arbitration and Claimants cannot claim damages on its behalf.

Second, under Mr. Wilson's theory, the Allocable Share Amendments damage Claimants indirectly. As you can see from the slide, Mr. Wilson states, "The ASA forces Tobaccoville to

raise prices and thus lose significant market share, damaging Claimants through lost sales."

Claimants injury, Mr. Wilson suggests, stems from Tobaccoville's need to raise prices on Claimants' product. Mr. Wilson thus assumes that the challenged measures is it not proximately cause Claimants' injury. As such, as we established at the beginning of this presentation, they're not compensable under the NAFTA.

Third, Mr. Wilson estimates the value of the so-called volumetric exemption by calculating the present value of the increased escrow costs that Tobaccoville could avoid rather than calculating the profit, the present value of the incremental profits, that Tobaccoville could earn as a result of the exemption.

As Navigant testified, the incremental cost is not reasonable proxy for the incremental profits that Claimants could generate.

The challenged measures increase the costs of producing cigarettes which cause Claimants to raise their prices which may be

passed on to their customers. Much of the impact of the challenged measures, therefore, is borne by the Claimants' customers and not by the Claimants themselves.

The value of the exemption the Claimants claim is not the cost that might be imposed on Claimants' cigarettes, it's the profits the Claimants allegedly would lose if they were not accorded the exemption. So, Mr. Wilson's alternative valuation theory from am economic standpoint is completely nonsense.

Mr. President and Members of the Tribunal, Mr. Wilson's damages calculations are on their face unsound. United States tax payers are being asked to pay hundreds of millions of dollars for demonstrably erroneous claims based on evidence that has not been made available and that is unauthenticated, uncorroborated, inconsistent, and, as noted, even contradictory. Claimants have failed to meet their burden of proving damages and we submit their claim should be dismissed.

If there are no further questions from

the Tribunal, I would ask that you call on Mr. Kovar.

PRESIDENT NARIMAN: Thank you. Okay. Mr. Kovar, now what?

MR. KOVAR: Documents.

Mr. President and Members of the Tribunal, we tried to make a concerted effort to put our presentation into the truncated schedule that the elements have given us, and we're now at the end.

Last week, Mr. President, you requested both parties to address certain questions raised by the Claimants about three categories of documents that the Claimants assert have been wrongfully withheld from them in this proceeding.

These categories are, first, documents being generated in connection with arbitration proceedings between various tobacco companies and the states.

Second, documents that have been produced in litigation brought by Grand River against originally 31, I think, now 30 states

Attorneys General that have allegedly not been made available in this proceeding.

And three, unknown documents relating to what has been described as NAAG's Grand River working group, which are believed by Claimants to exist and be relevant and material to this proceeding.

I would like to address these points in order, and to do so it's necessary first, if I may, review how the production of documents was handled in this case.

I'll start at the beginning. At first, the parties agree that the IBA rules on the talking of evidence in international arbitration would govern questions of discovery in this case. Article 3 of the IBA rules requires that any request for the production of documents include a "Description of a requested document sufficient to identify it," or "a description in insufficient detail, including subject matter, of a narrow and specific requested category of documents that are reasonably believed to exist."

By contrast, Claimants' document requests in this arbitration were sweeping, not narrow and specific, and there were 27 of them.

Examples included, all documents concerning the negotiation drafting implementation or enforcement of the MSA's provisions that relate to SPMs or NPMs; that was Request Number 1. And all documents concerning analyses or descriptions of sales or sales levels of OPMs, SPMs, and NPMs for the period 1997 through the present. That was Request Number 9.

Now, Claimants represented to the Tribunal last week that they had requested documents relating to the GRE working group; this is not true. The document request highlighted by Claimants, Request Number 6, sought "all documents analyzing, comparing, or summarizing the operation, effect, and enforcement of the Escrow Statutes as amended by the Allocable Share Amendment either in respect of Claimants' in particular or concerning other tobacco industry members both as a class or as a whole."

Now, the United States objected to Claimants' document requests on several grounds, including the grounds the questions were insufficiently specific, that they were overly broad, and that they were unduly burdensome. The Tribunal agreed and rejected the Claimants' document requests as not being in conformity with the IBA rules.

The Tribunal directed the United States to produce, within 30 days, documents within our possession or control that the United States considered to be relevant and material to the outcome of the case and that the United States considered should not be excluded under one of the grounds listed in Article 9.2 of the IBA rules.

PRESIDENT NARIMAN: I just want to know that those documents which were mentioned by Mr. Luddy in his opening which are tab documents mentioned in Tab 9, 10, 12, et cetera, by whom were they produced, by you or by them?

MR. KOVAR: Which documents?

PRESIDENT NARIMAN: Tab 9, 10 and 12,

the earlier document and so on.

MR. KOVAR: You mean from the --

PRESIDENT NARIMAN: From the Claimants' documents.

MR. FELDMAN: From the core bundle.

PRESIDENT NARIMAN: Core bundle, core bundle. Sorry. Core Bundle Tab 9, 10, 11, 12 who produced them? I just want to know.

MR. LUDDY: I think it's Tabs 4, 5, 6, and 7 if we're talking about the NPM adjustment proceedings?

PRESIDENT NARIMAN: No, no, no those NAAG things. The NAAG minutes, et cetera, the earlier things, 9, 10, 11, 12.

MR. KOVAR: Do you want to answer that, Mark, now or do you want to take a minute?

PRESIDENT NARIMAN: Yes, if you can just tell us who produced, whether you produced it or they themselves produced it.

MR. FELDMAN: Thank you, Mr. President the documents we produced had certain Bates numbers on them that--

PRESIDENT NARIMAN: Just tell us. We'll accept what you're saying. Who produced this?

MR. FELDMAN: Looking at the documents, it does not appear we produced the document.

PRESIDENT NARIMAN: Oh, you didn't produce this.

MR. FELDMAN: But based on the --I don't see the Bates number that was on our document production on the documents.

PRESIDENT NARIMAN: None of them 9, 10, 11, 12, they were all produced by the Claimants.

MR. LUDDY: Yes.

MR. VIOLI: That's right.

MR. FELDMAN: Yes that's correct.

MR. KOVAR: As far as we can tell.

PRESIDENT NARIMAN: But they were relevant documents. Why didn't you produce them? They were certainly relevant.

MR. KOVAR: Well, this is what we're addressing now, Mr. Chairman.

PRESIDENT NARIMAN: No, I'm saying they

were relevant, because some part of the case -- why were they not -- my question is, why were they not produced by you, because that was the order which you consider -- consider means reasonably consider relevant and material. They are relevant and material, in my view.

MR. KOVAR: If I may, I'll answer the question.

The Tribunal's order on document production placed the United States in a somewhat unusual position of having to produce documents without the guidance of any particularized requests that would, as required by Article 3 of the IBA rules, either identify specific documents or at least provide a sufficiently detailed description of a narrow and specific category of documents.

PRESIDENT NARIMAN: That's the order. Our order is clear.

You may be right that it may not be in conformity with something or the other, but it said, which the Respondent considers -- this is

your own highlight -- relevant and material to the outcome of the case.

MR. KOVAR: That's right.

PRESIDENT NARIMAN: You just tell us that 9, 10, 11 and 12 are not at all relevant or material to the outcome of the case or they are just, as you may have described them, correctly or incorrectly, picking up out of millions of documents a few, three or four, like that. That was your characterization of these documents.

MR. KOVAR: Mr. President, there's no way we could have represented that we would find every potentially relevant documents, particularly since the Claimants claims have changed so often --

PRESIDENT NARIMAN: And there's no compliance. I'm sorry, Mr. Kovar.

MR. KOVAR: No, no, let me continue, if I would, Mr. Chairman.

Given that we were producing documents without the guidance required by Article 3, we made it a point to be completely transparent with

the Tribunal and with the Claimants about how we had gone about gathering the documents we produced in 30 days.

We made clear that the documents we produced were from NAAG and that they had formerly been produced in U.S. litigation in response to documents request that were similar to those put forward by Claimant in this arbitration.

We also indicated that we were withholding certain documents on confidentiality grounds, certain other documents on privilege grounds.

We further indicated --

PRESIDENT NARIMAN: That doesn't answer my question, I'm sorry.

I want to make it very specific, which the Respondent considers relevant and material to the outcome of the case. Now, they have produced, from where, we don't know, and would you -- is it your contention that they're not all relevant, not at all material, and that you could not have considered them relevant or material when they

refer to NAAG and about the amendments and so on?

MR. KOVAR: Mr. Chairman, on the basis of your order, I don't know that we would have found the documents.

PRESIDENT NARIMAN: With what?

MR. KOVAR: On the basis of the Tribunal's order, I don't know that we would have found those documents; that's the point I'm trying to make. There could be hundreds of thousands of potential documents out there that bear some relevance to some issue.

And as we've seen --

PRESIDENT NARIMAN: Then perhaps we should have ordered from 1 to 22 to be disclosed --

MR. KOVAR: Mr. Chairman --

PRESIDENT NARIMAN: We didn't deliberately because we though that American style -- discovery does not apply to these proceedings therefore we said, leave it to you and your good sense as to what you consider material. Now, NAAG documents are certainly material and relevant.

Why aren't they produced?

MR. KOVAR: Mr. Chairman, there could have been a huge number of potentially even indirectly relevant documents.

PRESIDENT NARIMAN: Did you produce any NAAG documents?

MR. KOVAR: Yes, we did I'm about to explain that, if I would.

PRESIDENT NARIMAN: Yes, but then why not this? This is my point.

MR. KOVAR: Mr. -- Tribunal, we further indicated to the Tribunal and to the parties, and to the other party that the confidential documents included sensitive business information --

PRESIDENT NARIMAN: These are not confidential.

MR. KOVAR: No, no, I'm just trying to give a full picture of what we did. We were as transparent as we could be, Mr. Chairman. Their document request did not comply with the IBA rules.

PRESIDENT NARIMAN: I'm only asking one

question, and if you want to answer it, answer it -- no, please --

MR. KOVAR: I'm trying to.

PRESIDENT NARIMAN: Yes, please. Yes, try to answer it if you can. If you can't, it's all right.

MR. KOVAR: I don't mean to argue.

PRESIDENT NARIMAN: Did you not consider these documents which are tab numbers whatever they are which were produced by Luddy, are relevant to the outcome of the case? Are they totally relevant?

MR. KOVAR: Well, Mr. Chairman, if you look at them today, they may be relevant, but I'm not making representation that we saw those documents in the 30 days that we produced the documents that we -- in compliance with the Tribunal's order.

ARBITRATOR ANAYA: Are you saying you didn't know these specific documents existed? Is that --

MR. KOVAR: I don't know. I can't

answer that question.
PRESIDENT NARIMAN: That's very troublesome.
ARBITRATOR ANAYA: Can anybody answer that question in the government?
PRESIDENT NARIMAN: Somebody has to answer.
MR. VIOLI: They've been in this proceeding before.
16:46:53 MR. FELDMAN: I can say I -- I've seen Document 11 I believe that we did produce Document 11 in our production, although the Bates number from our production is not reflected in this particular document --
PRESIDENT NARIMAN: That's why I asked you first before I asked --
MR. FELDMAN: Right. And again, I'm relying -- I'm looking for the Bates number. So, I don't see our Bates number.
16:47:12 MR. KOVAR: They could have gotten the same document from some --
PRESIDENT NARIMAN: If you can have

someone answer the question.
MR. KOVAR: They could have gotten the document from some other source and not used the Bates numbered document.
But in any case, because of the unusual aspect of this discovery, we provided this level of detail about how we got the documents, because we wanted --
PRESIDENT NARIMAN: The problem is some
16:47:33 NAAG documents are disclosed, some NAAG documents are not disclosed. I mean, there is no -- either you say no NAAG documents should not be disclosed because they are not relevant, I understand that, but if some NAAG documents which you yourself disclosed are relevant, these are certainly relevant and material. That's my view.
ARBITRATOR CROOK: Well, Mr. Kovar, do I understand that your document production, which, as I recall, was about so, was, if not at all, at
16:48:08 least a significant volume of material that had previously been disclosed to the Claimants in various of their civil litigations against the

states?
MR. KOVAR: Not to the Claimants, no.
PRESIDENT NARIMAN: Not the Claimants?
MR. KOVAR: They had been produced in two other domestic lawsuits where the discovery requests had been similar to the Claimants.
We made all that clear in our production so that the Tribunal and the party could see how we had gotten the documents, how we
16:48:36 had collected them in 30 days as we had been ordered to do and which is a very fast time.
PRESIDENT NARIMAN: Please, Mr. Kovar, the allegation is not against you or any of the members of your team.
We are dealing with a corporate entity. We are dealing with the United States of America as a Respondent, and the direction is what it is, as you find it.
Now, you have disclosed which you
16:49:02 considered relevant and material, what you call NAAG documents broadly. Now, there are other NAAG documents which were produced by them which were

not disclosed.
I only want to know whether you consider those documents as not relevant or material. Simple question.
MR. KOVAR: I don't know the answer to that, Mr. Chairman.
PRESIDENT NARIMAN: Okay. That's all. All right.
MR. KOVAR: We provided the details
16:49:29 because we wanted you to know exactly how we were complying with the Tribunal's order.
Now, the Claimants objected to our document request -- to our document production and they proposed a new production order. They argued among other points that our production ignored -- and I'll quote them, "ignored significant categories of relevant and material documents requested by Claimants."
In response, we noted that Claimants
16:49:53 had continued to make no effort to scale back their sweeping document requests and instead were simply trying to revive those same requests that

were inconsistent with the IBA rules by raising objections to our document production.

We further noted that Claimants themselves had identified NAAG as the most likely source for documents responsive to their requests, and that was the source of these documents we produced. We also emphasized in our response that the Tribunal had ordered the United States to produce documents that the United States considered relevant and material to the outcome of the case and not excluded by Article 9.2 of the rules.

PRESIDENT NARIMAN: That only compels me to ask you -- I can't ask the United States of America. I have to ask you, because you are appearing for the United States.

MR. KOVAR: I understand that.

PRESIDENT NARIMAN: If Mr. Koh was appearing, I'd have asked him.

MR. KOVAR: We pointed out in our response, Mr. President, that the Tribunal did not require the U.S., in the short time provided to

comply, to conduct searches for documents corresponding to "issues" put forward by the Claimants and that Claimants believed to be relevant and material to the outcome of the case. That would have been another way to direct us to do this, but it the wasn't the way the Tribunal directed us to do it.

PRESIDENT NARIMAN: We will rely on your good faith. You're a massive entity, very respected entity and we rely upon you to give whatever is relevant and material.

You can say, yes, we forgot, or we didn't do it or we didn't see it, but short of that if you have disclosed NAAG documents, then you should have said we have all the NAAG documents, come and inspect them if you like. They may be relevant material some of them may be material or relevant. These according to you, that's why I asked you, and you said I can't answer it whether these are relevant and material because if they are relevant and material, then you have not disclosed them. Sorry.

MR. KOVAR: Well, one of the things we pointed out, Mr. President, is that it was the Claimants' refusal to scale back the request that resulted in the rejection of their request by the Tribunal.

PRESIDENT NARIMAN: We rejected it but we made an order which you may consider erroneous, but we did make an order.

MR. FELDMAN: Mr. President, I would emphasize as Mr. Kovar was pointing out, we had a general order from the Tribunal to produce documents that we considered relevant and material to the outcome of the case.

Looking at Article 3 of the IBA rules, this was not the amount of guidance that is required under the IBA rules. And so we found ourselves, as Mr. Kovar addressed, in the unusual situation of having to respond to an even more general request. And it was precisely because we didn't have the guidance that we required that we were completely transparent with the Tribunal and with the parties about precisely what we had done.

We had approached NAAG, the Claimants indicated that NAAG would be the most likely source for relevant documents. We approached NAAG, conferred and learned from NAAG that they had recently produced two set of documents in domestic litigation in response to requests similar to those put forward by the Claimants in this matter.

Given that we were completely transparent with the Tribunal about precisely what we had done, and we were transparent precisely because we didn't have the guidance, we didn't have particular requests to act upon. And that's why we were transparent to let everyone know precisely what had been done. And then Claimants then offered objections and we had back and forth on their objections. Ultimately, their objections were rejected by the Tribunal but the point is that we wanted all the parties and we wanted the Tribunal to be fully aware of precisely what we had done in response to an order that when you look at Article 3 placed us in the kind of

situation that's not contemplated by Article 3 of the IBA rules.

PRESIDENT NARIMAN: My question remains unanswered, I'm sorry. I must tell you that I'm quite outspoken. But I feel you have not answered, I tell you it's not answered.

MR. KOVAR: We understand that, Mr. President. This is our explanation about why and we don't know which of the documents we did not produced, but if there's any of the four documents not produced in the production, this is the reason we didn't produce it. It was not in the set of documents produced to explain as to why we produced it. Unfortunately, we didn't get the guidance as required by the IBA rules.

PRESIDENT NARIMAN: You never asked us for guidance on the order. You're right, IBA rules don't provide. It could have been a wrong order or a right order, but you didn't say, look, it's not possible for us to tell you what is relevant and material. In fact, pursuant to this order, you proceeded what you thought was relevant

and material, which was NAAG correspondence. But this correspondence, communication are not produced. There's no explanation why.

MR. KOVAR: I'll just finish describing what happened.

ARBITRATOR CROOK: Let me clarify one point. Mr. Kovar.

Mr. Feldman, you think that at least one of these documents may have been in your production. Has anybody gone back and trolled through the massive documents to see whether the others were.

MR. FELDMAN: Thank you, Mr. Crook. We would need to check but just glancing at Document 11, it does appear that that was one of the documents we produced.

PRESIDENT NARIMAN: For this litigation?

MR. FELDMAN: For this arbitration, yes.

And I'm informed that number ten is not a NAAG document.

MR. KOVAR: One of the four is not a NAAG document and one of the four we clearly produced. The other two we're not sure about.

MR. VIOLI: Nine was not produced. It was in the federal case. Do you want to hear this?

PRESIDENT NARIMAN: Yes.

MR. VIOLI: Nine was not produced in this case. It was produced in the federal case by the New York Attorney General.

Number 10 was not produced in this case. Number 11 had been previously produced, so they produced a copy in this case and it doesn't have the attachments. Number 12 was not produced in this case.

ARBITRATOR CROOK: Mr. Violi, you had the documents to the previous litigation.

MR. VIOLI: No, I had the copies from another lawyer. They obtained it. I don't know from where. The other e-mails were not produced between Michael Hering and the Oklahoma Attorney General.

ARBITRATOR CROOK: You can explain this all tomorrow.

MR. VIOLI: Or tonight?

ARBITRATOR CROOK: If you want to begin your final presentation tonight?

MR. VIOLI: No, I won't speak to it. I don't think I need to.

MR. KOVAR: I'll get back to -- this is the history, how the document discovery proceeding.

Tribunal rejected the Claimants' demand for additional discovery, based on their new order, proposed order. And accepted our offer to provide a privilege log, which we did.

We subsequently learned that the documents we were holding on privilege grounds recently were produced to Grand River in the New York litigation. So given that development we produced the documents in this arbitration.

Claimants later attempted to reopen discovery issues a few more times and each attempt was rejected by the Tribunal. We can recall -- I

recall the dates for you, the Tribunal letter is dated January 28, 2008, where the Tribunal said it closes the question of production of documents. February 4, 2008, and then April 18, 2008, and finally on February 4, 2008, Tribunal said the same thing in response to request to reopen. Request of production of documents is closed.

Now, Claimants assert that the United States prevented them from access to documents that would prove their case. Given their inability to demonstrate the legal and factual basis for their claims on the voluminous record in this case, and their other litigation involving the MSA regime, we think that's not surprising. Rather than building a case on evidence, we think they're now attempting to build it on simple assertions. The hint the Tribunal should draw adverse inference proving their allegations of conspiracy and discriminatory conduct.

Claimants are wrong about the three categories of documents the Tribunal asked the parties to address. They have misstated what

actually occurred with respect to these documents and they've wildly mischaracterized what's in them. Moreover, the Tribunal has repeatedly rejected similar requests by the Claimants in the past and declared discovery closed. Astonishingly Claimants have feigned in this proceeding surprise about NAAG's GRE working group.

In order to suggest the documents were wrongfully withhold, despite the fact that Claimants' attorneys have known about the working group since at least September 28, 2007, and they never previously brought it up in this litigation and never previously brought it up in their discovery requests. Never.

But here they pretended that they had never heard of it before. There's accordingly no legitimate basis for any adverse inference against the U.S. which has simply complied in good faith of the Tribunal's orders in a transparent way.

The first two categories of documents the Tribunal requested us to address are covered by confidentiality orders. Just a certain

business confidential and other documents are subject to confidentiality agreement in this arbitration, it's not at all unusual in American litigation for the parties to agree to treat certain categories of documents and information as confidential in the litigation.

In fact, Rule 26 C 7 of the Federal Rules of Civil Procedure specifically provide for a party to seek from the court a protective order providing that a trade secret or other confidential research development or commercial information not be revealed or be revealed only in a designated way.

Often the parties stipulate to such a protective order or confidentiality order which is then entered by the court and enforced throughout the litigation. Indeed, Claimants have designated large portions of their evidence, including documents and entire witness statements, in this arbitration as confidential, and the parties have entered into a confidential agreement to govern the use of that confidential evidence in the

arbitration.

This information is, therefore, not available to the parties in litigation in other courts involving Claimants. Claimants opposed discovery very strongly in other courts. Now, let me start with the litigation in federal court in New York you asked about, which originally was commenced in 2002 by Grand River, at that time 31 state attorneys general, challenging the escrow statute on various constitutional grounds and federal Antitrust laws.

PRESIDENT NARIMAN: Say again.

MR. KOVAR: New York litigation Grand River versus Pryor. That lawsuit is currently pending on parties cross-motion for summary judgment. I understand the court has scheduled hearing on the motions for March 5th is my understanding.

PRESIDENT NARIMAN: There's one judgment in this?

MR. KOVAR: There are also Court of Appeals decisions.

PRESIDENT NARIMAN: Against Grand River, no?

MR. KOVAR: I would have to defer on the details to my colleagues.

MR. FELDMAN: Certain claims thrown out. Two claims survive in the New York action.

PRESIDENT NARIMAN: For Grand River?

MR. KOVAR: Yes, this is Grand River's case against the states.

17:02:01 PRESIDENT NARIMAN: What is the claim?

MR. FELDMAN: Surviving claims I understand it there's U.S. antitrust claim and there is a commerce clause claim under the U.S. Constitution.

PRESIDENT NARIMAN: What was thrown out?

MR. FELDMAN: There was an Indian commerce clause thrown out. A number of others, I'd have to go back and check.

17:02:21 PRESIDENT NARIMAN: That's in your counter Memorial Tab 121?

MR. FELDMAN: Yes.

PRESIDENT NARIMAN: Let me note this, if you don't mind.

(Pause in the Proceedings.)

PRESIDENT NARIMAN: Sorry, go ahead.

MR. KOVAR: There's been confidential order in place since the New York lawsuit.

PRESIDENT NARIMAN: This one?

MR. KOVAR: Yes. It protects evidence produced by Grand River, as well as evidence

17:02:59 produced by the states.

PRESIDENT NARIMAN: Evidence but the order isn't confidential, is it?

MR. KOVAR: Yes.

PRESIDENT NARIMAN: The order passed in this suit, the claim?

MR. KOVAR: The actual decision of the court.

PRESIDENT NARIMAN: The decision.

MR. KOVAR: As far as I'm aware, it's

17:03:15 public.

PRESIDENT NARIMAN: Which is in volume eight of Page 121. Okay.

MR. KOVAR: Now, the confidentiality order under the Federal Rules of Civil Procedure protects evidence produced by both parties. The states have been subjected to extensive discovery in that litigation. I've been informed that they've produced 53,790 pages of documents.

In addition, Grand River's attorneys including our friends here, have deposed at least six assistant attorneys general. MSA independent

17:03:49 auditor and the chief counsel of the NAAG tobacco project in that litigation.

PRESIDENT NARIMAN: Who asked for the confidentiality order?

MR. KOVAR: Both sides. The states produced vast majority of this material without any claim of confidentiality. The two principle exceptions are the notices of the MSA independent auditor, which contains sales data from participating manufacturers, PMs and they're

17:04:14 required by Section 11 A 1 of the MSA be kept confidential. And certain documents relating to the significant factor arbitration proceedings

which I will discuss in a moment.

Claimants have also had access to the auditor notices under the confidentiality agreement in our Chapter 11 arbitration, so they're on the record in this case.

Tribunal should also know, plaintiff Grand River claimed confidentiality for major portion of the documents it produced in the New York Federal Court, as well as for the greater

17:04:43 part of the deposition transcripts of its officers, Arthur Montour and Tobaccoville's president.

Next, there is the arbitration proceeding called the significant factor proceeding, as Mr. Hering and Professor Gruber explained this arbitration is between the original participating manufacturers, the OPMs and the states and it occurs pursuant to the MSA when there's an OPM market share lost.

17:05:10 Under the terms of the MSA an economics firm is appointed to determine whether the MSA was, quote, significant factor contributing to the

market share lost, unquote. As we've heard this involves econometric modeling in which the economics firm compared the world as it would have been without the MSA, as the world exists with the MSA. Very highly technical economics modeling.

There have been contested proceedings each year under this provision in 2003, 2004, 2005 and 2006, and in each one of those the OPMs have prevailed over the MSA states. The parties have agreed not to contest the issues for the years 2007 through 2009. The states and OPMs agreed in 2002 to have identical confidentiality orders covering this significant factor proceeding entered into five State courts to govern the treatment of sensitive commercial information used in those proceedings.

Those orders were entered in 2005 just before the first contested proceedings began. We can provide a copy of those orders, if you thought it was necessary. The orders define as, quote, confidential information any information, documents or materials that a party reasonably and

in good faith believes constitute or contain proprietary and competitively sensitive information, disclosure of which can cause competitive injury.

The orders provide that information designated as confidential by a party may be disclosed only to a limited set of persons, may be used only for significant factor proceedings and that any person disclosing such information in a manner not authorized by the orders will be subject to sanctions for contempt of court.

PRESIDENT NARIMAN: Any of these significant factor proceedings, have they proceeded to an award by the --

MR. KOVAR: Yes, they were, and I'll get to it.

PRESIDENT NARIMAN: Sorry.

MR. KOVAR: There's also a category of, quote, highly confidential information which is information is so proprietary or competitively sensitive the disclosure would likely cause irreparable competitive injury. Highly

confidential information is treated even more restrictively than confidential information. The sensitive information that these orders protect are exclusively those of the OPMs and they have a strong interest in keeping it confidential. They would not have disclosed it but for its use in that significant factor set of proceedings.

If we turn back to the New York federal case against the states brought by Grand River, Grand River versus Pryor, Claimant Grand River demanded that the defendant states produce discovery in the New York court what the magistrate judge in that court described as, quote, voluminous documents from the significant factor arbitrations.

The states as required by the significant factor confidentiality orders notified the OPMs of this request which then appeared and they then all appeared before the magistrate, the OPMs opposing that production. The magistrate eventually ordered the production of large numbers of significant factor documents. Certain

proprietary data, as well as the economics firms final determinations, this is what you had asked about, for 2003, 2004 and 2005.

Naturally, almost all of this information was produced subject to a confidentiality order in the New York case. In early 2008, Dana Bieberman, an attorney in the New York Attorney General's office, wrote to Mr. DeHong, who's an attorney in Mr. Luddy's firm, transmitting in several batches significant factors documents to Grand River's counsel. We have copies of these letters. Documents produced to Claimants' attorneys including the economic firms determinations for 2003, 2004, 2005 in unredacted form. Subject to the confidentiality requirements of the significant factor proceeding, which are enforceable by the U.S. District Court.

At the same time the redacted, i.e. with confidentiality removed, redacted 2004 and 2005 determinations were also produced to Grand River free of any confidentiality restrictions. In fact, the 2003 final determination has been

public and freely available in redacted form since 2006 much earlier than this production in 2008.

Now, what has been redacted from these determinations is proprietary and commercially sensitive information of the OPMs, but even without that information, the redacted determinations clearly layout what issues the economics firm considered. What the parties's contentions were and how the firm resolved those issues. For reasons I cannot understand, Claimants' counsel suggested they had never received these documents.

Here's an excerpt on the screen from last Thursday's transcript during Claimants' cross-examination of Professor Gruber. You asked Mr. Nariman, I think all of this is pretty useless for us, at least for me for this reason. We're deprived of knowing what the arbitrators decided. I mean, what's the use of your opinion of a but for world, what you say, what ultimately was the decision in the case may have had some relevance to us, but since that is closed to us, all this is

pretty useless, at least in my view.

I then interjected and said, "Mr. Chairman, just to clarify the decision of the arbitrator is a public document with certain econometric data redacted. Thank you, but it's never been introduced by the Claimants."

Mr. Violi then said "I don't think the 2004 document has ever been redacted or unredacted."

Now, if the Tribunal wishes to review any of the determinations or other redacted significant factor documents, we'd be happy to provide them, even though, as I will discuss in a moment, we don't believe they're relevant or material to the issues before the Tribunal.

In short, Grand River has been free since 2006 to use the redacted 2003 determination. And since March of 2008, to seek arrangements to use the redacted -- since March 2008 to use redacted 2003, 2004, 2005 determinations in this arbitrations and they should not be suggesting otherwise.

Moreover, with respect to the unredacted documents and information from the significant factor proceedings that were produced to Grand River's counsel in the New York case in 2008. Subject to the confidentiality order in that case, they contain or constitute highly sensitive competitive information such as data on pricing and sales volume.

As you can imagine, Claimants' Grand River and NWS would not want similar information about their businesses to be made available without confidentiality protections. However, even though this material is subject to confidentiality protections in U.S. District Court in New York, Grand River has had the opportunity since 2008 to petition the court to submit such documents or portions thereof as part of their evidence in this arbitration.

PRESIDENT NARIMAN: Therefore, they must have concluded that this is irrelevant for these proceedings. That's your point.

MR. KOVAR: I cannot speak for the

Claimant. You could draw that inference.

PRESIDENT NARIMAN: Draw that inference.

MR. KOVAR: It was not until February 2009, eight months after receiving the significant factors materials that Mr. Luddy began proceedings in the New York Federal Court to amend the confidentiality order to allow him to introduce certain excerpts from Professor Gruber's significant factor report for use in this hearing.

Now, now the OPMs and the states in that case and the Respondent United States in this proceeding, we all worked out an arrangement with Claimants' counsel to permit that to happen, provided the excerpts were given appropriate confidentiality treatment in this arbitration.

In this respect, it's important to note that the significant factor excerpts initially proposed by Grand River's counsel for use in this arbitration were even narrower than the four documents that are now included in the Claimants' core bundle from the significant factor

proceedings related to Professor Gruber.

It was the states that pressed for broader significant factor excerpts to be used in this arbitration, so the Tribunal could have a better sense of the context in which Professor Gruber's statements were made.

We were informed by the New York Attorney General's office that this one time that I've just identified is the only time in this Federal Court case that Grand River sought permission to use any confidential significant factor documents or information in this arbitration, and on that occasion the states agreed to it and we helped facilitate it.

So there simply is no basis whatsoever for Claimants to cast aspersions on the states or on Respondent United States in this Chapter 11 proceeding with respect to those documents from the significant factor arbitration and the federal lawsuit and we ask the Tribunal to take note of this fact.

PRESIDENT NARIMAN: That's why you

described it as wild and reckless allegations in previous --

MR. KOVAR: Yes, sir.

In any case, if the Tribunal were to review redacted significant factor determinations which have been readily available to the Claimants to submit as evidence since 2006 and 2008, you'd readily see why nothing in the significant factor proceedings sheds important light on the claims now before the Tribunal.

This is where you just stole my language. Mr. Violi makes what I called wild allegations that those proceedings would have materially affected your decision on whether competition was affected by these measures, whether we Claimants were harmed by these measures, and third, whether they were truly needed.

We submit that's not so. If it had been so, why didn't they submit the redacted versions to start.

MR. VIOLI: It does not say the

determinations, I'm talking about the supporting documents from the states. Please don't mischaracterize me. You said I misrepresented to the Tribunal, now you're saying wild and reckless allegations. Let's keep it civil.

MR. KOVAR: Mr. Tribunal, I just quoted what I said the other day.

First, the significant factors proceedings had nothing to do with the complementary legislation. Second, they had nothing to do with Grand River or its behavior or how the state applied the measures to Grand River or whether the challenged measures were needed. As I've already mentioned and as Dr. Gruber testified, significant factor arbitrations involved econometric analyses which the parties in the economics firm created artificial models.

What the world would have liked look liked without the MSA and compared it with the world it existed with the MSA to calculate how much difference was explained by the MSA. To explain the Escrow Statute and entered into the

analysis, it was at high level of generality. And involved the calculation of the marginal costs of different classes of manufacturers.

Claimants have tried to use Professor Gruber's reports to impeach his testimony in this arbitration, but we would submit his cross-examination showed that Claimants failed in this effort perhaps because they didn't understand what Professor Gruber's significant factor report was all about.

In sum, we believe there's no reason for the Tribunal to draw any inference adverse to the respondent from the fact that the unredacted significant factors determinations or other documents from those proceedings have not been placed in evidence in this arbitration.

Last, I would like now to turn to the question whether there should have been documents related to the Grand River working group produced in this case. Claimants' counsel represented they only just learned during this proceeding there was a Grand River working group coordinated by NAAG.

And they would have the Tribunal believe there's something secret and underhanded about NAAG, about NAAG members forming a working group to coordinate common issues. In fact, Claimants' counsel stated last week that if he had known about the existence of a working group, he would have specifically requested documents about it. This is from the transcript.

Mr. Violi said, "Now I submit we did not know it was called the Grand River working group, so I did not ask for all documents of the Grand River." You can't ask for that which you don't know. But we know there was a working group. Wouldn't the Respondent have seen it if they knew there was a Grand River working group to produce those in good faith to the other side. They have not even, absent our request because we didn't know working group existed, even absent that didn't they have an obligation to produce that to the Tribunal and us.

Last week is not the first time Claimants have heard of the GRE working group.

And these are some other quotes where they said this. Mr. Weiler said, we didn't know there was a working group, so I would agree with you, Mr. Crook, it was definitely not in our statement of claim because we didn't find out about it until yesterday. And Mr. Violi said and these are not all at the same time obviously, and now we find out there's a working group. And Mr. Violi said in his cross-examination, are you familiar with the GRE working group, and he also said I will make representation to the Tribunal that I have seen document called the Grand River working group and it has a list of attorneys general.

Let's look at the facts. Claimants documents produced yesterday for the first time in this proceeding are dated 2007, and 2008. And they proved that Claimants knew about the working group at least as early as September 28th, 2007. That is before they filed their Memorial and their reply in this case.

As you can see, the privilege log from the state of Nebraska which was produced yesterday

was received by Claimants' counsel by September 28th, 2007. The next document which was the Levine deposition taken by Mr. Violi is dated May 2008.

Now, Respondent cannot certainly account for why Claimants would have stated last week more than once they never heard of the GRE working group and yesterday produced a document they received on September 28, 2007, with many references to the GRE working group and the transcript of the deposition dated May 2008 where Claimants' counsel asked specifically about the GRE working group.

Moreover, let us recall that there's nothing mysterious about this working group, Mr. Hering and Mr. DeLange testified that NAAG has many such working groups, including on specific common issues and sometimes focused on specific companies such as Grand River, Philip Morris and so on. Mr. DeLange stated his recollection was formed relating to Claimant Grand River after Grand River led a lawsuit against the 31 state

attorneys general in 2002. Such coordinator response was necessary to defend the state's interest. Because the Federal Court wanted to receive single coordinated response from the defendants, rather than 31 different responses.

Claimant's counsel suggest the working group may have discussed issues beyond the New York lawsuit and Claimants' 2007 document suggests the state of Nebraska suggest the working group to have begun on a smaller scale the previous year, 2001.

Assuming this is true, what does it prove. Idaho assistant Attorney General Brett DeLange testified given the multiple states in which Grand River has failed to pay escrow obligations and NWS is involved in selling Seneca cigarettes not on state directories which escrow sometimes have not been paid. It would be natural for the state attorney's general to coordinate through the NAAG how they're dealing with illegal sales of Senecas. Indeed, assistant attorneys general Eckhart, Thomson and DeLange all testified

that they spoke to their counterparts in other states on such or similar matters, and coordinated common legal issues through the NAAG.

What adverse inference may the Tribunal draw from this?

Claimants claim the documents related to Grand River working group will show, and I quote, over zealous prosecution of them by this group in support of abuse of right claim. The Claimants did not put forward any abuse of right claim as of June 2007 when the parties made their document productions.

Given that fact, together with the Tribunal's rejection of Claimants' sweepingly overbroad document request and the fact later when Claimants brought five additional requests for document productions, they never specifically mention that they wanted documents related to the GRE working group. Never.

The United States simply had no guidance, much less an obligation, in our view, under the IBA rules to search for documents

related to any alleged effort on the part of the state to coordinate the prosecution of Grand River. Such documents would not have been material to the outcome of the case as it existed in June 2007.

The absence of particularized abuse of right claim in June 2007 is confirmed by the proposed order submitted by the Claimants when they objected to our production of documents in October of 2007. That proposed order included sweeping categories of documents. The proposed order made no mention of abuse of right and it made no mention of the GRE working group even though they had known since the previous month that the GRE working group existed, but they never mentioned it.

It is precisely this kind of fishing expedition that the IBA rules do not permit and the Claimants' objections and proposed order were rejected by the Tribunal. Indeed, when Mr. Weiler spoke about the abuse of right last Thursday, Members of the Tribunal pointed out that that

seemed like a new claim. Mr. Weiler first claimed there was an entire section of their Memorial addressing their abuse of right. Then he admitted the term was mentioned in Claimants' pleadings at most a few times.

In justification, he claimed that Claimants learned the previous day that Mr. Eckhart, this is his term, freelancing in his correspondence with the Nevada foreign trade zone and there was a state working group focusing on Grand River that they didn't know about.

With all due respect, Claimants cannot retroactively enlarge Respondent's discovery obligation by raising new claims and then seek to have adverse inference drawn against the U.S. by not having documents to fit those new claim.

The United States complied openly and transparently and we believe in good faith with the Tribunal's order which gave significant direction to us, the U.S., to determine which documents were material and relevant to the outcome of Claimants' case as it was then

formulated.

It would not be reasonable or just to apply adverse inferences based on Claimants' entirely hypothetical and we would submit it's conspiratorial case.

Now, the Tribunal will be able to come to its own conclusions on this issue after reviewing the record and hearing the testimony of the three state officials who made some of the key decisions that Claimants question. If the states were acting in good faith and enforcing the statutes, the fact that some of them exchanged ideas relating to enforcement doesn't convert their good faith into bad faith.

In fact, any reasonable person would expect law enforcement authorities would cooperate when confronting what they viewed as systematic violations of their statutes. I'll finish. To sum up.

To sum up, our document production in this case was carried out within the 30 day period and without guidance from Claimants, required by

Article 3 of the IBA rules. Given our lack of guidance we made a particular point to be transparent with the Tribunal and Claimants how we complied with the Tribunal's order.

Claimants' objected on several occasion to our document production and the Tribunal rejected those objections in each instance. We ask no adverse inference should be drawn here. Thank you very much.

17:26:22 PRESIDENT NARIMAN: Thank you. Have you got those cases that you mentioned, United States versus Philip Morris? I want them.

MR. FELDMAN: Mr. President, I'm informed the decisions are quite long. We can point them out. We can have them made available for you in the morning.

PRESIDENT NARIMAN: Morning, don't forget. Two sets.

MR. FELDMAN: Yes.

17:26:52 PRESIDENT NARIMAN: Both of them.

MR. KOVAR: Mr. President, that concludes our case, if you don't have any

additional questions to ask.

PRESIDENT NARIMAN: Thank you very much. 8:00 o'clock tomorrow. Thanks very much.

(Whereupon, at 5:27 p.m., the hearing was adjourned until 8:00 a.m., the following day.)

CERTIFICATE OF REPORTER

I, John Phelps, RPR, CRR, Court Reporter, do hereby certify that the foregoing proceedings were stenographically recorded by me and thereafter reduced to typewritten form by computer-assisted transcription under my direction and supervision; and that the foregoing transcript is a true and accurate record of the proceedings.

I further certify that I am neither counsel for, related to, nor employed by an of the parties to this action in this proceeding, nor financially or otherwise interested in the outcome of this litigation.

JOHN PHELPS, CSR, RPR, CRR