School of International Arbitration, Queen Mary,
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International Arbitration Case Law

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GRAND RIVER ENTERPRISES FIVE NATIONS LTD. ET AL.
V.
UNITED STATES OF AMERICA
AWARD

Case Report by Sana Onayeva[**]
Edited by Ignacio Torterola[***]

In an Award rendered January 12, 2011, under Chapter 11 of the North American Free Trade Agreement ("NAFTA"), the Tribunal found it lacked jurisdiction for certain Claimants' claims because these Claimants did not have an investment in the United States satisfying the definition of investment under Article 1139 of NAFTA. Jurisdiction was found as to the remaining Claimant's claims brought under NAFTA Articles 1102 (national treatment), 1103 (most-favored national treatment), 1105 (fair and equitable treatment) and 1110 (expropriation), but the claims failed on their merits.

Tribunal:	Mr. Fali S. Nariman (President), Prof. James Anaya, and Mr. John R. Crook.
Claimant's counsel:	Leonard Violi, Esq., Todd Weiler, Barrister & Solicitor, Robert J. Luddy, Esq., Windels Marx Lane & Mindorf, LLP, Chantell McInnes Montour, Counsel, Catherine MacInnes, Law Clerk, Inch Hammond, Professional Corporation.
Defendant's Counsel:	Harold Honggju Koh, Legal Adviser, Jeffrey D. Kovar, Assistant Legal Advisor, Lisa J. Grosh, Deputy Assistant Legal Advisor, Mark E. Feldman, Chief, NAFTA/CAFTA-DR Arbitration, Neale H. Bergman, Alicia L. Cate, Danielle K. Sharpe, Attorney-Advisers, United States Department of State.

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1. Facts of the Case

Grand River Enterprises Six Nations, Ltd. of Ohsweken (a corporation incorporated under the laws of Canada), Messrs. Jerry Montour and Kenneth Hill (Canadian nationals), and Mr. Arthur Montour, Jr., of Seneca Nations Territory, Perrysburg, New York (together "Claimants") brought an action against the various states of the United States of America, alleging that the 1998 Master Settlement Agreement (MSA) violated their rights under Chapter 11 of NAFTA.

The individual Claimants are all born in Canada and are members of indigenous peoples of First Nations belonging to the Six Nations of the Iroquois Confederacy, also known as Haudenosaunee.

Grand River is involved in the manufacture and sale of tobacco products. It is a federally incorporated company that manufactures tobacco products at its plant in Ohsweken, Ontario for sale in Canada and export to the United States.

Mesrs. Jerry Montour and Kenneth Hill are controlling stockholders of Grand River, with Mr. Jerry Montour holding 30% of the common shares and Mr. Hill holding 10%. Arthur Montour carries on a tobacco distribution business through his wholly owned company, Native Wholesale Supply Company (NWS).

In the 1990s more than 40 U.S. states' attorneys' general initiated litigation against major U.S. tobacco producers, claiming compensation for the states' costs of treating tobacco-related illnesses. The initial settlement required the issuance of U.S. federal legislation. However, subsequent negotiations sought a settlement not requiring the Congressional approval.

In 1998, several states' attorneys' general and major U.S. tobacco producers concluded and elaborated a settlement of the states' lawsuits, namely the MSA. Ultimately 46 states, the District of Columbia and five U.S. territories became parties (Settling States). Each Participating Manufacturer (PM) agreed to make cash payments in perpetuity, to extensive restrictions on advertising and other marketing practices, and to fund smoking prevention programs.

The MSA increased the costs of PMs and so PMs stood to lose market share to Non-Participating Manufacturers (NPM). The MSA sought to limit the NPM market share gain

from manufactures that adhere to the MSA. The requirement was that each Settling State was to adopt legislation which requires each NPM annually to place into escrow in the state a sum approximating the amount that it would have paid in respect of its taxed sales in that state had it joined the MSA. A NPM retains title to the escrowed funds; the funds remain in escrow for 25 years and can be used to pay any judgment against an NPM stemming from litigation by the state involving adverse health consequences of the NPM's product. All of the 46 states party to the MSA adopted escrow legislation.

Initially, the escrow legislation included the "allocable share" provisions that could significantly lower the amount escrowed for a given state. According to the "allocable share" provision, the NPM need not maintain in escrow in any state more than that state would have received in respect of that NPM's total sales over all MSA states, if the NPM were a PM. This provision greatly reduced the amount to be escrowed by NPMs that concentrated their sales in a few states.

After the implementation of MSA, the PMs increased their prices and were subject to MSA restrictions on advertising and other marketing practices. This led to substantial reduction in PMs' sales and market share and an increase in NPMs' sales and market share. There was undisputed evidence that the total market share of NPMs like Grand River grew to 8.1 % of the U.S. market in 2003. The states participating in the MSA responded to the growth of NPMs' sales by intensifying the enforcement of their escrow laws. In 2001 and early 2002, they began to enact "complementary legislation" (referred to by Claimants as "contraband laws") to strengthen enforcement of the escrow laws. These statues required the attorneys general to maintain lists of NPMs not in compliance with the escrow laws, and prohibited state stamping agents from placing tax stamps on cigarettes from non-complying manufacturers. The cigarettes not stamped for sale became subject to forfeiture and contraband. Beginning in 2003, states also began to amend the escrow laws to repeal the "allocable share" provisions.

In 1998, when the MSA was concluded, the Claimants' Grand Seneca brand had not yet been created, and thus, it had no US market share. However, in 2002, the Claimants adopted a marketing strategy intended to take advantage of the allocable share provisions. They determined to limit the off-reservation marketing of cigarettes to a limited group of states, and to bring Grand River into compliance with those states on a "without prejudice basis". In 2002, Grand River concluded a Cigarette Production Agreement with Tobaccoville USA, Inc., a U.S.-owned corporation. Under the agreement, Grand River would manufacture Seneca brand cigarettes to Tobaccoville's specifications, and Tobaccoville would have exclusive rights to distribute those cigarettes off-reservation in the United States. This strategy succeeded for several years.

The Claimants alleged that implementation of the MSA's restrictive measures, including the repeal of the "allocable share" provision and subsequent loss of off-reservation sales, and enactment of Contraband laws by the states violated their right under NAFTA Articles 1102

(national treatment), 1103 (most-favored national treatment), 1105 (fair and equitable treatment) and 1110 (expropriation).

2. Legal Issues Discussed in the Decision

a) Jurisdiction under Articles 1101, 1139 and 201 of NAFTA (¶¶ 79, 85, 87, 91, 107, 109, 110, 112, 116, 117, 122)

The Tribunal decided that it lacked jurisdiction over the claims of Jerry Montour, Kenneth Hill and Grand River involving off-reservations sales since the Claimants' investment does not satisfy the jurisdictional requirements of a claim under NAFTA Article 1101. In addition, they did not have any investment in the United States by way of enterprise, loan, property or other investment conforming to the definition of Article 1139.

NAFTA Article 1101 only applies to investors of one NAFTA Party who seek to make, are making, or have made, an investment in another NAFTA Party. However, the only substantial investment of the Claimants (Grand River, Jerry Montour and Kenneth Hill) is the manufacturing plant in Canada. A sale of Claimants' cigarettes to Tobaccoville for distribution in the United States cannot be considered a part of their investment since Tobaccoville is a U.S.-owned and controlled entity.

Furthermore, the Tribunal decided that three Claimants, Jerry Montour, Kenneth Hill and Grand River, do not have an enterprise under NAFTA Articles 1139 and 201. In order for an investment to constitute an enterprise it should exist in a form of business association with its own juridical personality that is constituted and organized under applicable law. The Claimants "Cigarette Manufacturing Agreement" authorizing Grand River to manufacture Seneca cigarettes and Grand River's distribution agreement with Tobaccoville do not show the existence of an enterprise under NAFTA, but rather a mutually beneficial business. Grand River does not have a place of business in the United States, nor any staff, property or sales agents in any state. It is a Canadian manufacturer and exporter that conducts business with US distribution companies.

The Tribunal also rejected the Claimants' proposition that they have an investment in the United States under NAFTA Article 1139, in a form of financing that Grand River extended to Arthur Montour's U.S. distribution companies in connection with inventory purchased from Grand River. The Tribunal concluded that NAFTA Article 1139 excludes from its definition of investments "the extension of credit in connection with a commercial transaction, such as trade financing," unless a loan is (i) to an enterprise if "the enterprise is an affiliate of the investor", or (ii) "where the original maturity of the loan is at least three years".

The Tribunal concluded that a Native Wholesale Supply, the corporation owned by Arthur Montour, is an independent corporation. In order for Arthur Montour's corporation to constitute an affiliate of Grand River it has to be "effectively" controlled by it. Although NAFTA does not define "affiliate", the Tribunal relied on Black's Law Dictionary that defines an "affiliate company" as one "effectively controlled by another company".

Based on the evidence that was presented by Claimants, the Tribunal also concluded that the inventory loans provided by Grand River to Arthur Montour's corporation have "no fixed maturity date", thus it cannot be asserted that their maturity is over three years which is required for it to fall under the exception of Article 1139 noted above. Therefore, the Tribunal rejected Claimants' assertions that inventory loans may constitute an investment under Article 1139, and found that those loans did not fall under the exceptions under Article 1139.

The Tribunal rejected other arguments presented by Claimants that they have an investment in the United States in a form of: (a) money deposited into escrow accounts in some U.S. states; (b) collaborative efforts of the Claimants to create and promote the intellectual property associated with the Seneca brand; and (c) other modest expenditures of Grand River. The Tribunal concluded that Claimants did not establish an investment that falls within one or more categories established by Article 1139; there was no evidence that Claimants have investment in the United States either in a form of enterprise, loan, property, or other interest within the strict definition of the investment under Article 1139.

The Tribunal upheld jurisdiction over Arthur Montour; it concluded that he has an investment in the United States that satisfies the requirements of NAFTA Article 1101 and 1139 since he owns a substantial tobacco distribution business in the United States, as well as the Seneca trademark, and he has made substantial marketing efforts and expenditures to promote the brand in the United States.

b) NAFTA Article 1110 – Expropriation and Legitimate Expectations (¶¶ 127, 128, 141, 144, 148, 152)

The Tribunal next decided on the claim of expropriation of Arthur Montour's investments under NAFTA Article 1110. The Claimant argued that the MSA-related regulatory actions by

the states are inconsistent with his reasonable expectations as an investor and also constitute the expropriation of a substantial portion of his investments.

i) Reasonable Expectations: First Nations Status

The Tribunal held that the disputed measure by the states were not inconsistent with Arthur Montour's reasonable expectations as an investor under NAFTA Article 1110. The Claimant contended that as a member of one of the First Nations in North America, he had reasonable expectations to be excluded from states' regulatory measures, as under the Jay Treaty and US domestic law he was immune from states' regulation.

The Tribunal interpreted the reasonable expectations in the NAFTA context as "expectations upon which an investor is entitled to rely as a result of representations or conduct by a state party". Thus, reasonable expectations protected by NAFTA are those representations made unambiguously by the State. The Tribunal decided that Arthur Montour being an experienced investor in a tobacco business should have known that trade in tobacco products has historically been the subject of state regulations and thus, he could not legitimately expect to be free from restrictive MSA measures applied by the states.

ii) Expropriation Claim

The Tribunal held that Arthur Montour's claim of expropriation failed since he did not establish expropriation within the scope of NAFTA Article 1110.

In its reasoning, the Tribunal relied on previous NAFTA decisions defining expropriation under Article 1110 as a "complete or very substantial deprivation of owner's rights in the totality of the investment" and dismissing claims of expropriation where claimant remained in possession of an ongoing business.

The Tribunal decided that Arthur Montour's claim could not constitute an expropriation under Article 1110 since the alleged expropriation is related to a part of his ongoing investment and Arthur Montour retained the ownership and control over it.

c) Claims of Violations of Articles 1102-1103 – National and Most-Favored National Treatment (¶¶ 159, 160, 169)

The claims of denial of national or most-favored national treatment addressed only off-reservation sales in the United States of cigarettes manufactured by Grand River in Canada. However, the Tribunal established that it has no jurisdiction over the claims of Grand River, Jerry Montour and Ken Hill involving off-reservations sales.

Despite the fact that Arthur Montour did not submit a separate claim of denial of national or most-favored nation treatment the Tribunal decided, for the purpose of completeness, to scrutinize whether such a claim can be sustained.

The Tribunal decided that a claim related to denial of national treatment and most–favored nation treatment if brought by Arthur Montour, could not be sustained because there is not enough evidence to show a violation of NAFTA Articles 1102 or 1103.

After examining all the evidence and materials of the case, the Tribunal concluded that the states' enforcement measures were applied not only to Arthur Montour's business but to all other similarly situated investors, and none of them received better treatment. Thus, missing a comparator to assess who was accorded better treatment, the Tribunal was prevented from considering any further issue in this regard.

The Tribunal thus rejected Arthur Montour's arguments based on his privileged status as First Nations trader and his connected exclusion from the MSA-related measures.

d) Claims under Article 1105 – The Customary Standard of Fair and equitable Treatment (¶¶ 175, 189, 190, 191, 192, 204, 205, 209, 210, 212, 213, 217, 219, 223, 227, 228)

Arthur Montour contended that the measures taken by various states violated his right to fair and equitable treatment as required under NAFTA Article 1105.

i) The Applicable Law under Article 1105

The Tribunal held that "Article 1105 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard treatment that must be given to covered investment". The Tribunal concluded that whatever treatment Arthur Montour received from the States, it did not raise to the level of infringement of the fair and equitable treatment standard under Article 1105.

ii) Specific Claims under Article 1105

(1) First Claim under Article 1105:

The first claim was dismissed because it was related to off-reservation sales, and rested on the contention that the customary minimum standard requires protection of the Claimant's reasonable expectations regarding the stability of the legal framework for off-reservation marketing of Grand River's cigarettes. The Tribunal does not have jurisdiction regarding Keneth Hill's, Jerry Montour's and Grand River's claims relating to off-reservation sales.

(2) The Second Claim under Article 1105:

The Tribunal dismissed the Claimant's second claim on the ground that it did not establish a breach of the customary international law minimum standard of treatment of aliens.

The second claim maintained that Article 1105 includes an obligation of non-discrimination against special or disadvantaged groups, giving rise to related obligations on U.S. states to "proactively consult Claimants, as First Nation Investors with commercial activities likely to be significantly affected by their measure". This claim is relevant to Arthur Montour, and to that extent lies within the Tribunal's jurisdiction.

The Tribunal concluded that it has not been shown that either the text of Article 1105 or the customary minimum standard includes the more specialized prohibitions and requirements involving indigenous people. In fact the duty of states to consult with indigenous peoples is featured in the UN Declaration of the Rights of Indigenous People. The Tribunal interpreted this provision as the states duty of consultation with governments of Indian tribes whose sovereign interests had been affected by the measures related to MSA. However, the governments of Indigenous People had not been consulted on the MSA measures and it cannot be construed that Arthur Montour, being an individual investor was granted the authority to represent the First Nations communities.

(3) The Third Claim under NAFTA Article 1105:

Since the Claimant contended that the fair and equitable treatment under Article 1105 encompasses the duty of the Respondent to respect the rights of Indigenous People under the Jay and other treaties, various human right instruments and US Constitution provisions affecting Indian commerce, the issue that the Tribunal had to address "is whether the asserted legal protections are imported into the minimum standard of protection owed to foreign investments under customary international law and thus under Article 1105."

The Tribunal concluded that the standard of fair and equitable treatment under Article 1105, which is a customary international law standard, does not entail other legal protections that may be available to investors under other sources of law. Thus, the Tribunal dismissed the third claim.

(4) The Fourth Claim under Article 1105:

The Tribunal dismissed the fourth claim, which alleged that the enactment by the state legislatures of the Escrow laws under the MSA constitutes the denial of justice under the NAFTA Article 1105.

The Tribunal held that under international customary law and previous NAFTA Tribunals' decisions, the denial of justice embraces the failure of the Host State's judicial system to render due process to aliens. The Tribunal also found that the Claimants' contentions relating to the enactment of the Escrow laws are barred by NAFTA Articles 1116(2) and 1117(2). And thus, that claim is outside of the Tribunal's jurisdiction.

The Tribunal dismissed the claim that was raised by Claimants at the hearings that the amendments relating to the Allocable Share injured their off-reservations sales. The claim is outside of the Tribunal's jurisdiction since it does not have jurisdiction over claims of Kenneth Hill, Jerry Montour and Grand River.

The Tribunal dismissed Article 1105 claim relating to Arthur Montour because he did not argue that he was subject to the denial of justice and that his treatment by the US courts did not conform to the Article 1105, despite the fact that he was involved in various litigations in the United States.

3. Decision

The Tribunal decided that it does not have jurisdiction over the claims of Grand River, Jerry Montour and Kenneth Hill because these Claimants did not have an investment in the United States and thus did not meet the jurisdictional requirements of a claim under NAFTA Article 1101. The Tribunal also dismissed Arthur Montour's claims in their entirety since the Respondent's conduct did not involve any breach of Articles 1102, 1103, 1105 or 1110 of NAFTA. The Tribunal concluded that each Party was required to bear its own costs and half of the costs and expenses of the proceedings.