NOTICE OF INTENT TO SUBMIT
A CLAIM TO ARBITRATION
UNDER SECTION B OF CHAPTER 11 OF
THE NORTH AMERICA FREE TRADE AGREEMENT

Kenex Ltd.

Investor

v.

THE GOVERNMENT OF THE UNITED STATES OF AMERICA
("United States")

Party

Pursuant to Articles 1116 and 1119 of the North American Free Trade Agreement ("NAFTA"), the Investor, Kenex Ltd., serves a Notice of Intent to Submit a Claim to Arbitration for breach of the United States' obligations under the NAFTA.

I NAME AND ADDRESS OF THE DISPUTING INVESTOR

Kenex Ltd.

24907 Winter Line Road
RR #8, Chatham
ONTARIO, CANADA N7M 5J8

II BREACH OF OBLIGATIONS

The Investor alleges that the United States has breached its obligations under Section A of Chapter 11 of the NAFTA, including the following provisions:

i) Article 1102 (National Treatment)
ii) Article 1103 (Most Favoured Nation Treatment)
iii) Article 1104 (the Better of National and Most Favoured Nation Treatment); and
iv) Article 1105 (Treatment in Accordance with International Law).

The relevant provisions of the NAFTA are:

> ***Article 1102: National Treatment***
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> ***1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.***
>
> ***2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.***
>
> ***...***
>
> ***Article 1103: Most-Favored-Nation Treatment***
>
> ***1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.***
>
> ***2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.***
>
> ***Article 1104: Standard of Treatment***
>
> ***Each Party shall accord to investors of another Party and to investments of investors of another Party the better of the treatment required by Articles 1102 and 1103***

Article 1105: Minimum Standard of Treatment

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

...

III FACTUAL BASIS FOR THE CLAIM

1. The Investor is a company incorporated under the laws of Ontario. The Investor manufactures, markets and distributes industrial hemp products, including whole hemp grain, hemp grain derivatives (such as refined hemp oil, hemp nut and hemp meal), hemp fiber and certified hemp seed, throughout North America.

2. The Investment, Kenex USA Ltd., is a company incorporated under the laws of Delaware. The Investment is owned and controlled by the Investor. Through the Investment, and acting on its own behalf, the Investor operates its business in the United States, and was seeking to increase the breadth and depth of its investments, until the actions of the United States, as described below, were imposed and deleteriously impacted upon its existing business and customer base.

3. Industrial hemp and marijuana are different varieties of the same plant species, *cannabis sativa L*. However, whereas marijuana typically contains between 3% and 15% of the psychoactive substance, tetrahydrocannabinol ("THC"), industrial hemp plants contain only non-psychoactive trace amounts of THC (less than 0.3%). While marijuana and synthetic THC have been controlled substances for decades, industrial hemp products have always been exempted from control under U.S. Federal legislation. Such exempted products include sterilized hempseed, hemp oil, hemp flour and hemp cake along with hemp fiber, and these all are legitimate commodities of trade, regardless of the trace THC content. Sterilized hempseed has been imported legally every year since the Controlled Substances Act went into effect.

4. Hemp seeds can be used directly as a food ingredient or crushed for oil and meal. Hemp seeds and flour are being used in nutrition bars, tortilla chips, pretzels, beer, salad dressings, cheese and ice cream, and as such are directly competitive with products such as flax, walnut, sesame and poppy seeds. Poppy seeds in particular are in a very similar position to hemp seeds, insofar as poppy seeds contain trace amounts of opiates that are controlled by the Controlled Substances Act in the U.S., but are specifically exempted from control along with their trace opiates. Hemp oil is being used in body-care products such as cosmetics, lotions,

moisturizers and shampoos where it competes with emollient ingredients like lanolin and jojoba oil, as well as in nutritional Essential Fatty Acid (EFA) omega-3/omega-6 dietary supplements where it competes primarily with flax, evening primrose and fish oil.

5. The Investor and the Investment subscribe to the Hemp Industry's "*TestPledge*" standards, which limit THC to 1.5 parts per million (ppm) in shelled hempseed and 5 ppm in hemp oil for food.[1] The most reliable scientific research currently available indicates that even the extensive daily use of products that comply with the *TestPledge* standards cannot lead to "confirmed positives" in urine tests for marijuana and do not cause any psychoactivity or other detrimental health effects in humans.

6. The products that the Investor and Investment market and distribute in the United States comply fully with all applicable Canadian and American health and safety regulations. Non-psychoactive hemp products, which contain only trace amounts of naturally-occurring THC, are not currently – nor have they ever been – treated as controlled substances under the United States *Controlled Substances Act,* 21 U.S.C. §§802 et seq.. The Investor has built its U.S. business, and had plans to expand it, in reliance upon the fact that the statutory definition of "marihuana" clearly excludes industrial hemp products from regulation.[2]

7. Industrial hemp is widely regarded within the scientific community as an important and environmentally friendly renewable natural resource. Because of the promising benefits of hemp-based products, the Canadian Government has been sponsoring research and development in the industrial hemp industry since 1995. Based on the results and experiences in several European countries, the Canadian Federal Government permitted the commercial farming of industrial hemp in 1998. Industrial hemp can be grown without pesticides or herbicides and can be made into environmentally friendly products such ranging from paper and car parts to food, oil, plastics, building materials and clothing.

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1 Information on the TestPledge Program can be found at: www.testpledge.com.

2 The Investor built its business in reliance on well-settled U.S. law under the statutory definition of "marihuana", which definition excludes "the mature stalks of such plant, fiber produced from such stalks, oil or cake made from the seeds of such plant, any other compound, manufacture, salt, derivative, mixture, or preparation of such mature stalks (except the resin extracted there from), fiber, oil, or cake, or the sterilized seed of such plant which is incapable of germination." 21 U.S.C. §802(16).

3 This latter omission is significant in light of the substantial market lead achieved by Canadian hemp producers as part of a private-public partnership in which the Provinces of British Columbia, Ontario, Manitoba, Saskatchewan among others have invested millions of dollars in Canadian government sponsored research and development since 1995. Now that Canadian farmers and manufacturers are building a lead against US farmers, the US Government is creating an unfair trade barrier that places Canadian-based businesses at a competitive disadvantage.

8. Despite the numerous salutary health and environmental benefits associated with the use of industrial hemp products, two executive agencies of the United States, the Drug Enforcement Agency ("DEA") and the Office of National Drug Control Policy ("ONDCP"), have adopted a long-standing policy of opposition to their use for political (as opposed to legitimate, scientific) reasons. The DEA and ONDCP have enforced this unwritten policy through such acts as fighting proposed state legislation that would permit the use of industrial hemp products (including legislation in Colorado, Hawaii, Kentucky, North Dakota, and Minnesota) and in the DEA's vigorous legal defense of a recent lawsuit filed against it by the Kentucky Hemp Growers Cooperative Association. Such opposition has also been demonstrated by the DEA's use of Customs authorities to interdict cross-border trade in industrial hemp products from Canada (regardless of their safety or whether any legislative authority ever existed upon which such a policy could be based).

9. On August 9, 1999, and again on August 31, 1999, the US Customs Service, acting on the advice of the DEA, seized and confiscated a truckload of Canadian non-germinating sterilized hemp seed at the Windsor/Detroit border crossing which was being shipped by the Investor to the United States as birdseed to a large birdseed customer. The US Customs Service also ordered the recall of some 15 earlier shipments that had already been delivered to customers in the US and threatened Kenex with more than US$700,000 in fines. Customs Service Officials eventually released the shipment and rescinded their recall, apparently concluding that the DEA had no authority to order the seizure based upon trace THC content. However, by that time the shipment had become worm-infested.

10. The arbitrary seizure, recall and confiscation of these goods was taken without due process of law, most likely as part of the DEA and ONDCP's ongoing policy of terminating any trade in industrial hemp products – a policy stance which the U.S. Dept. of Justice (DOJ) has clarified to both DEA and US Customs is in fact not authorized under current law. Under this arbitrary and illegitimate policy, the DEA and ONDCP have discriminated against members of the hemp industry, such as the Investor and the Investment, in order to buttress their domestic battle with state governments that are attempting to foster growth of the industrial hemp business.

11. These arbitrary and discriminatory actions by US Customs have seriously impacted upon the ability of the Investor and the Investment to grow their business in the United States, in addition to causing the Investor to absorb tens of thousands of dollars of losses specific to the goods that were made subject to this action. These losses included cleaning, fumigating

and reselling the goods held (for over three months) at a discount; legal fees, and out-of-pocket expenses and lost management time.

12. More importantly, however, the actions of the DEA and US Customs Service have led customers and potential customers of the Investor and the Investment to conclude that they could not guarantee the reliability of their shipments, free from arbitrary and capricious US governmental seizure or other interference. As a result, the Investor and the Investment lost many customers in both the natural health food market and the birdseed market, including their largest customer (who simply took hemp out of their birdseed formulations – to be substituted with the products of Kenex's US competitors). This action also made the hemp seed that Kenex held in inventory, or produced after that date, far more difficult to sell into a market of declining prices (due to reduced demand caused by the actions of the DEA and US Customs authorities).

13. Since August 1999, the ONDCP has continued to take steps to frustrate Kenex's ability to carry on its business in the United States, including the issuance of further letters of instruction to US Customs officials in December 1999 and March 2000 requesting seizure of hemp seed and oil (despite the DOJ's clear interpretation that such seizures are illegal under current law), and another detention of birdseed at the Windsor/Detroit border in March, 2001. Such actions have imposed a cloud of doubt on the business of the Investor and Investment, whose customers require that the products they purchase will be delivered consistently on time. It is not possible to build a customer base, much less retain existing customers, under such a cloud.

14. As a direct result of the DEA and ONDCP's policy of harassment, Kenex's food product sales have continued to drop, and plans to launch a new product earlier this year at a Baltimore trade show have been completely quashed.

15. In furtherance of this policy, the DEA has taken the following steps, which constitute an effective ban any domestic or foreign trade in many industrial hemp products, including those produced, marketed and distributed by the Investor and the Investment:

    (a) Harassment of the legal and legitimate trade in products marketed, distributed and sold by the Investor and the Investment in the territory of the United States, including the outright seizure of goods by US Customs officials;

    (b) Issuance of an "Interpretive Rule", 66 Fed. Reg. 51530 (Oct. 9, 2001), that effectively amends the existing legislation that it

purports to interpret, having the effect of including hemp seed and oil containing organic, naturally-occurring trace amounts of THC on Schedule I of the Controlled Substances Act, which DEA then further asserts overrides the explicit Congressional exemption of hemp seed and oil from the Controlled Substances Act. This measure results in a *de facto* ban on the hemp food products produced, marketed and distributed by the Investor and its Investment in the United States;

(c) Promulgation of a "Proposed Rule", 66 Fed. Reg. 51535 (Oct. 9, 2001), that would amend DEA's regulations to produce the same result as the Interpretive Rule, having the effect of permanently memorializing its ban on all trade in hemp food products containing any amount of trace miniscule THC, even though such a ban is clearly beyond the scope of the DEA's legislative authority; and

(d) Promulgation of an "Interim Rule". 66 Fed. Reg. 51539 (Oct. 9, 2001), that exempts a limited number of industrial hemp products from the Interpretive Rule and the Proposed Rule so long as they cannot possibly result in any THC entering the human body – a standard which has no basis in science or law.

16. The DEA and ONDCP have maintained their policy of harassment without any valid regulatory or statutory authority, as evidenced in the fact that these agencies have consistently advocated the need for regulatory changes in order to successfully ban all foreign and domestic trade in industrial hemp products. None of the steps taken to implement this policy have been subjected to the kind of public notice and comment procedures that are the hallmark of United States federal administrative law and is contrary to the letter and the spirit of the statutes under which these agencies are permitted to regulate. Moreover, these actions have never been submitted to the notice and publication requirements contained within NAFTA Article 718,[3] and have been pursued without affording due process rights to affected businesses such as the Investor or its Investment.

17. The DEA and ONDCP have attempted to justify an effective ban on all products containing miniscule trace amounts THC to US legislators as being necessary "in order to preserve the integrity of the US drug testing system." They have done so without any regard to the fact that the Hemp Food Industry's TestPledge standards program offers a regulatory model that completely addresses such concerns.

18. Remarkably, the DEA has taken all of these steps to ban trade in any hemp food product even though ONDCP, DEA and U.S. Customs officials have explicitly discussed in internal meetings that:

> "[I]f the US adopts a zero tolerance policy, there may be ramifications for international trade. Canada is the only country that now puts the THC content on the label. In short, the US would possibly be treating our trading partner differently than another."

19. The DEA has provided a "120 day grace period" in its Interim Rule that provides businesses until February 6, 2002 to eliminate all existing inventories before the ban is made final and complete. Because of the imposition of the DEA's measure, the Investor and its Investment have suffered considerable losses in terms of manufacturing, marketing, distribution and product development costs. These losses will become even more substantial as the Investor and Investment are forced to dispose of existing inventory in advance of the February 6, 2001 deadline.

20. The DEA has developed these measures in secret. Prior to issuance of the measures, the DEA refused all attempts and requests by the Investor and the hemp industry organizations in which the Investor is an active member for conclusive evidence that the DEA's policy (as expressed in these measures) was supported in either domestic or international law.

21. The DEA has even refused an official request from the Government of Canada to provide "all scientific and other relevant material used for the development, interpretation, and eventual implementation" for its measures. Such refusal constitutes an intentional breach of NAFTA Article 1803(2), demonstrating that the DEA is not acting in accordance with the *pacta sunt servanda* rule – which is a fundamental expression of the international law principle of good faith.

22. The DEA failed to undertake any of the necessary steps under either the United States *Administrative Procedure Act*, 5 U.S.C. §553, or international law, to properly consult the Investment or provide it with a meaningful opportunity to work with the DEA to find a way to realize its legitimate regulatory goals without unnecessarily destroying the business of the Investor and its Investment.

23. The ultimate impact of these measures will be nothing short of an absolute ban on trade in the hemp food products manufactured, marketed and distributed by the Investor and its Investment in the United States. These measures accordingly breach the NAFTA in the following ways:

    a) The Investor and the Investment will be accorded less favorable treatment than that which is accorded to their competitors from the

United States or other countries operating in like circumstances with the Investor and the Investment. These competitors make and market products, such as those based on poppy seeds or flax oil, and have benefited from less restrictive regulatory standards than the hemp products of the Investor and the Investment. For example, the DEA has arbitrarily chosen not to impose an absolute ban on poppy seed products, even though they contain trace amounts of opiates that would also constitute statutorily prohibited narcotics if produced with significantly higher concentrations. There is no legitimate reason why the DEA would ban products containing harmless trace amounts of THC but exempt poppy seed products from similar treatment. Such arbitrary conduct is contrary to NAFTA Articles 1102, 1103 & 1104;

b) The United States has violated the international law principles of transparency, good faith and proportionality in its treatment of the Investment. Such conduct constitutes an unreasonable, unjustified and arbitrary interference with the Investor's ability to establish, expand, manage, conduct or operate its investments, which the United States has agreed to provide foreign investors in addition to whatever treatment is required under international law. Such treatment is required to be provided to the Investment under NAFTA Articles 1105 and 1103;

c) The measures have been applied to the Investment in an arbitrary and capricious manner, without sufficient notice or consultation, and in a manner that is substantively unfair and inequitable. Such treatment is contrary to the "fair and equitable" standard of treatment that the US has agreed to provide to foreign investments and which is required under customary international law. Such treatment is required to be provided to the Investment under NAFTA Articles 1105 and 1103;

d) The US has agreed to be bound by international treaty obligations that reflect the international law principle of proportionality, such as the World Trade Organization Agreement on Sanitary and Phyto-sanitary Measures. These "WTO" obligations require the USA to base its proposed measures on sound science, and to ensure that they are no more trade-restrictive than necessary to achieve a legitimate regulatory goal. When a NAFTA Party fails to honor its international law obligations in a manner that breaches a standard of "fair and equitable treatment," and such failure has a direct impact upon a NAFTA investment in its territory, that Party breaches the NAFTA Article 1105 obligation to treat NAFTA investments in accordance with international law. Such treatment

is required to be provided to the Investment under NAFTA Articles 1105.

22. Implementation of these measures has and will continue to result in considerable losses and harm to the Investor and the Investment, including – but not limited to – the following:

a) loss to Investor and its Investment of a substantial portion of their customer base, goodwill and market for the hemp products;

b) loss of revenues from the sale of hemp food products;

c) loss of potential investment capital;

d) loss of returns on capital investments made by the Investor and the Investment in developing and serving the industrial hemp market;

e) loss of out of pocket expenses, legal fees and other expenses relating to fighting the proposed measure.

IV ISSUES

1. Has the imposition of these measures had the effect of according less favorable treatment to the Investor or its Investment than that which is accorded to investors or investments from the United States or from other countries, in breach of Articles 1102, 1103 or 1104 of the NAFTA?

2. Does the DEA and the ONDCP's continued treatment of the Investment fall below the standards required under international law, including the "fair and equitable treatment" standard, in breach of NAFTA Article 1105, as affected by the application of NAFTA Article 1103 and the principle of MFN treatment reflected in NAFTA Article 102(1)?

3. If the answer to either of the above questions is yes, what is the quantum of compensation that should be paid to the Investor as a result of the inconsistency of the measures with the US's obligations under the NAFTA?

V RELIEF SOUGHT AND DAMAGES CLAIMED

The Investor claims damages for the following:

1. Damages of not less than US$20,000,000.00 as compensation for the damages caused by, or arising out of, the US's measures that are

inconsistent with its obligations contained within Part A of NAFTA Chapter 11;

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

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

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

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

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

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