

THE INTERNATIONAL LAW GAZE:

THE PLAIN VICTORY OF TOBACCO PLAIN PACKAGING LEGISLATION IN *PHILIP MORRIS ASIA V AUSTRALIA*

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The legal regime on the protection of foreign investment through international investment agreements passed a very important test recently with the award rendered by an arbitration tribunal (the tribunal) adjudicating the dispute between Philip Morris Asia and Australia (*Philip Morris Asia v Australia*, Award on Jurisdiction and Admissibility, 17 December 2015. <https://www.pcacases.com/web/view/5>). The origin of the controversy was the adoption of tobacco plain packaging legislation by the latter in 2011, which Philip Morris regarded as a violation of the standards of protection provided for in the Agreement between the Government of Hong Kong and the Government of Australia for the Promotion and Protection of Investment, signed on September 15, 1993 (the BIT). According to Philip Morris, the legislation barred the use of intellectual property on tobacco products and packaging and had, therefore, substantially reduced the value of Philip Morris's investment in Australia. Fearing that Australia's example would start being followed by other nations, Philip Morris did not hesitate in requesting far-reaching relief orders from the tribunal: suspension of the plain packaging legislation and compensation that could be of the order of billions of Australian dollars. (*PMA v Australia*, para. 8). The tribunal concluded that Philip Morris had carried out an

abuse of process, that its claims were inadmissible and, consequently, that the tribunal was precluded from exercising jurisdiction to settle the dispute. (*PMA v Australia*, para. 588).

The dispute became a central focus for the criticism of international investment agreements in general on the basis that they constrained host States' regulatory powers to adopt measures aimed at protecting the public from health and environmental risks, among others. The threat of this particular litigation from a multinational corporation was not taken lightly by States. The criticism did not lack reasons. In fact, New Zealand had considered enacting similar legislation in 2012 but decided to suspend the process in 2014 in light of Philip Morris's litigation. It has resumed it in September. The so-called regulatory chill was then a reality, and during the negotiations of the Trans-Pacific Partnership Agreement (TPPA) the negotiating States specifically addressed this threat head on in Article 29.5, with a tobacco carve-out, in the following terms:

A Party may elect to deny the benefits of Section B of Chapter 9 (Investment) with respect to claims challenging a tobacco control measure of the Party. Such a claim shall not be submitted to arbitration under Section B of Chapter 9 (Investment) if a Party has made such an election. If a Party has not elected to deny benefits with respect to such claims by the time of the submission of such a claim to arbitration under Section B of Chapter 9 (Investment), a Party may elect to deny benefits during the proceedings. For

greater certainty, if a Party elects to deny benefits with respect to such claims, any such claim shall be dismissed.

PMA v Australia is then another piece in this complex puzzle. The award does not address the merits of Philip Morris's claims, but it sets limits to its ability to get access to the automatic international dispute settlement mechanisms contemplated in international investment agreements.

Before proceeding, it is important to mention that these agreements provide for a set of standards of protection for investors who are nationals of one of the parties to the treaty operating in the territory of any of the others. Such standards usually include national treatment, fair and equitable treatment, and full compensation in the event of direct or indirect expropriation. Not less important is that, in principle, disputes between foreign investors and host States can be taken before an international tribunal without investors having to exhaust all judicial remedies before the host State's courts. The reason for this international investment system was and has been that foreign investors and their capital-exporting States fear that domestic courts may have a bias against foreign claimants and make a determination in favour of their own State. Whether or not this is a credible fear regarding all States is a different matter. In any case and, thanks to international investment agreements, foreign investors get immediate access to an impartial international dispute settlement mechanism.

This is one of the benefits that Philip Morris has seen curtailed as a result of the award: whenever investor/State arbitration is not available, any dispute between Philip Morris or like-minded investors and host States as a result of tobacco control legislation will have to be settled by domestic courts and under domestic law. There are two additional setbacks: an award for Philip Morris on jurisdiction would have allowed it to deploy similar strategies to the one it put in place to get access to the investor/State arbitration system of the Australia-Hong Kong BIT, on which more below. The second setback and closely connected is that an award on the merits for Philip Morris could have eventually had some persuasive character for other investor/States tribunals dealing with similar legislation adopted by other States that had decided to follow Australia's footsteps. This was one of the purposes of Philip Morris's global litigation strategy. However, domestic judgments for Philip Morris, if any, would lack this character, since each of them would be based on the particularities of the respective domestic legal framework. For the purpose of the said global litigation strategy, the award is a significant setback for Philip Morris and a very welcome development for host States. More recently, Philip Morris received a second blow in the award in *Philip Morris v Uruguay*, a decision the present author will comment on in this journal in a future issue.

I. General Description of the Facts

The Philip Morris Group (PMI), which owns dozens of subsidiaries and affiliates worldwide, has had a presence in Australia since 1954 through Philip Morris Australia (PM Australia), first, and then through PML, a wholly owned subsidiary of PM Australia. Both were owned until 2011 by

Philip Morris Brands Sarl, a Swiss company that is part of the PMI Group. PMI has also had a presence in Asia through Philip Morris Asia, which was incorporated in Hong Kong in 1994 and where it has been operating since. (*PMA v Australia*, paras. 96 – 97).

Philip Morris and Australia started the collision course that led to the controversy when the World Health Organization Framework Convention on Tobacco Control (FCTT) entered into force for Australia on February 2005. There, it is provided that States Parties have the obligation to implement “tobacco control measures, including measures to eliminate the propensity of tobacco packaging to mislead consumers about the health effects of smoking and comprehensive bans on tobacco advertising, promotion and sponsorship.” As a result, in October 2008, the Australian Ministry for Health and Ageing’s National Preventive Health Taskforce (NPHT) made public a discussion paper in which it made a suggestion to “further regulate the tobacco industry with measures such as ending all forms of promotion including point-of-sale display and mandating plain packaging of tobacco products.” The NPHT continued its work in this direction, and in June 2009 identified as one of the key actions to “legislate to eliminate all remaining forms of protection including ... promotion through packaging.” (*PMA v Australia*, paras. 103 – 106). In August 2009, an Australian Senator introduced the Plain Tobacco Packaging Bill 2009, removing branding from cigarette packs. The process of enacting the legislation was affected by some lack of unity within Australian politics. In March 2010, the Australian Department of Foreign Affairs stated that the bill did not represent government policy, and a month later IP Australia, the organ in charge of intellectual property, voiced concerns about plain packaging legislation. However, and almost at the same time, the Health

Minister endorsed the NPHT's recommendation. The process of enacting the legislation was also affected by the complexity of Australian politics, since the Opposition leader criticized the plain packaging proposal in April 2010. In July 2010, the Australian government published a time framework for the process leading to the implementation of plain package legislation. The fate of the legislation was not certain, since after the August 2010 elections, the Labor Party and the Opposition Coalition that had criticized the legislation had the same number of seats in the House of Representatives. Even in May 2011, the Australian government was not sure about the fate of tobacco plain packaging, and its health Minister admitted that the government had a "very big fight on [its] hands in Parliament ...". The TPP bill was introduced in the House of Representatives on July 6, 2011, and the bill was enacted on November 21, 2011.

Philip Morris saw the prospect of the legislation as a serious risk to its investment. In addition to opposing it before the competent Australian authorities, it started a restructuring process in Asia in order to gain access to the protection afforded by a bilateral investment treaty and its investor/State dispute settlement mechanism. It was decided that PM Asia would be the vehicle and the Australia-Hong Kong BIT the applicable legal instrument. To this end, PMI decided to transfer PML and PM Australia to PM Asia on September 3, 2010. On January 21, 2011, PMI Group requested the Australian Treasury's approval of the restructuring in accordance with the Foreign Acquisitions and Takeovers Act 1975. The transaction was not objected to by the Treasury on February 17, 2011, and on February 23, 2011, PM Asia formally acquired PM Australia and PML. On November 21, 2011, the day on which the tobacco plain

packaging legislation was adopted, PMA served Australia with the Notice of Arbitration under the BIT.

II. The Tribunal's Decision

The tribunal's main findings are related to admission of investment for the purpose of the tribunal's jurisdiction, PMA's abuse of right (or abuse of process) to seek the protection of the BIT, and the conditions under which a corporate restructuring can avoid to be deemed as an abuse of right.

A fundamental aspect of any tribunal jurisdiction is whether the given investment in question is covered by the given international investment agreement or BIT. Australia claimed that the investment had not been admitted since, among other reasons, PMA had not disclosed that the purpose of the investment had been to obtain BIT protection. (*PMA v Australia*, para. 515). The tribunal was strict in this decision. It held that the Australian government knew of the BIT and of PMA's intention to challenge the legislation, that PMA did not have to disclose the reason for the restructuring to seek BIT protection, and that never did the Australian government revoke the decision not to object the investment, nor did the government start administrative proceedings to declare the decision invalid. (*PMA v Australia*, paras. 518, 521 & 522). The tribunal then concluded that PMA's investment had properly been admitted by Australia.

Then, the tribunal proceeded to assess Australia's objection that the tribunal lacked jurisdiction because by the time the dispute started, PMA did not have any investment in Australia. The tribunal expressed as a matter of general principle and following previous awards under other international investment agreements:

Whenever a treaty action is based in a treaty breach, the test for a *ratione temporis* objection is whether a claimant made a protected investment before the moment when the alleged breach occurred. (*PMA v Australia*, para. 529).

The tribunal then stated that, in this particular case, the dispute started when Australia had enacted the tobacco plain package legislation, on November 21, 2011. By this time, PMA's investment had already been approved by Australia, on February 23, 2011, as was mentioned. The dispute then fell under the jurisdiction of the tribunal.

Next, the tribunal dealt with Australia's objection to the admissibility of the claims on the basis of PMA's abuse of right. According to Australia, "an abuse of right can be found where a corporate restructuring is *motivated* wholly or partly by a desire to gain access to treaty protection in order to bring a claim in respect of a specific dispute that, at the time of the restructuring, *exists* or is *foreseeable*." (*PMA v Australia*, para 536). The tribunal's findings and conclusions in this regard are the most important of the award.

To address this objection, the tribunal began by citing previous awards under various BITs, such as *Tidewater v Venezuela*, *Mobil Corporation v Ecuador*, and *Gremcitel v Peru*, clearly indicating that restructuring of investment for the purpose of obtaining BIT protection in relation to future disputes is not illegitimate per se, nor is it an abuse of right. (*PMA v Australia*, paras. 541 - 544). The tribunal then went on to assess past awards dealing with restructuring of investments to gain BIT protection in the event, not of a future controversy, but of a *foreseeable* dispute in which context an abuse of right would be at issue.

The tribunal identified two different thresholds of foreseeability: the first was “reasonable foreseeability of the dispute”, articulated by the tribunal in *Tidewater v Venezuela*; and the second was “very high probability of the dispute,” adopted by the tribunal in *Pac Rim v El Salvador*. Clearly, the second criterion was much stricter than the first. Although the tribunal in *PMA v Australia* expressed that a high threshold was required to declare the existence of an abuse of right, the tribunal followed the less strict approach of the reasonably foreseeable dispute of the *Tidewater* tribunal. It stated:

[T]he initiation of a treaty-based investor-State arbitration constitutes an abuse of rights (or an abuse of process, the rights abused being procedural in nature) when an investor has changed its corporate structure to gain the protection of an investment treaty at a point in time when a specific dispute was foreseeable. The Tribunal is of the opinion that a dispute is foreseeable when there is a reasonable prospect ... that a measure which may give rise to a treaty claim will materialize. (*PMA v Australia*, para. 554).

The tribunal then proceeded to make its key determination on whether the dispute about tobacco plain packaging was reasonably foreseeable before PMI's corporate restructuring in Asia. To this end, the tribunal had to determine a date on which the controversy became reasonably foreseeable for PMI. The tribunal stated that "a dispute in the legal sense is a disagreement about rights, not merely about policy." (*PMA v Australia*, para. 566), and set forth April 29, 2010, as such a date. Then, the Australian Prime Minister and the Health Minister announced the government's unequivocal decision to introduce tobacco plain packaging measures. (*PMA v Australia*, para. 566). The tribunal noted that never after this date did the government express a different intention.

Moreover, the tribunal made two important qualifications for its choice of date. First, the fact that 19 months passed between the announcement and the enactment of the legislation did not mean that the legislation and the dispute were not foreseeable. The length in this event was due to a high level of transparency in the Australian legislative process and its various stages of consultations with relevant stakeholders (*PMA v Australia*, para. 567). For the tribunal, such consultation process did not affect the foreseeability of the plain packaging legislation. The second qualification was that the fact that announcement of legislation was made by a minority government did not affect the foreseeability of the measure and of the dispute, either. If it were so, in the tribunal's words, "there would be one rule for majority

governments and another for minority governments, which would create difficulties for States whose electoral processes can result in minority governments.” (*PMA v Australia*, para. 568).

Thus, the tribunal concluded that by the time of the PMA’s restructuring, February 23, 2011, the dispute with Australia over tobacco plain packaging was already reasonably foreseeable. (*PMA v Australia*, para. 569).

The tribunal ended the award by dealing with PMA’s argument that there were other reasons for the restructuring prior to the dispute, in particular, that a wide restructuring process had been ongoing since 2005 and that the restructuring had as an objective the reduction of PMA’s tax liabilities. (*PMA v Australia*, paras. 575 – 576). The tribunal concluded that PMA had not proven that the restructuring had had a reason other than to get BIT protection. Indeed, no contemporary document in support of any other reason had been provided by PMA, nor had people familiar with the operation been presented as witnesses. (*PMA v Australia*, paras. 582 – 584).

On these bases, the tribunal decided that PMA’s claims were inadmissible and, therefore, that it was precluded from exercising jurisdiction over the dispute. (*PMA v Australia*, para. 588).

III. Comments on *Philip Morris Asia v Australia*

The award is a product of its time in many respects. The health risks and costs of tobacco are unquestionable; the Framework Convention on Tobacco Control is getting ample support with 180 State parties to date (http://www.who.int/fctc/signatories_parties/en/); States' regulatory powers are in expansion in treaties and multiple awards after the Great Recession; and multinational corporations are facing significant resistance from civil society in many parts of the world, much more in this case, with the unrealistic relief PMA requested, which was the suspension of the legislation. To expect that an ad hoc tribunal will totally ignore these significant trends is untenable. This is without saying, obviously, that the foregoing patterns fully predetermined the final outcome of the award. The members of the tribunal are among the most prestigious arbitrators in the world, and the decision is the output of a fair and well-conducted legal proceeding.

Although the case was no doubt complex for the parties, the proven fact before the tribunal met to write the award was that there had been no reason for the restructuring of PMA other than to get BIT protection. The application of the abuse of right doctrine loomed large. Had the restructuring had other proven objectives, the task for the tribunal would have been much more challenging. A combination of this fact of the dispute and the external trends already mentioned could have guided the tribunal's interpretation of the facts and the applicable law.

There are traces of this guidance. First of all, and regarding the interpretation of law, the tribunal faced a choice between the two pre-existing thresholds of foreseeability in

international investment law in connection with the abuse of rights doctrine: the *high degree* of probability of the dispute vs. the *reasonable degree* of the controversy. The tribunal chose the latter, which is a lower threshold. Selecting the former would have been difficult when applying it to the facts, since, for instance, in May 2011 the fate of the plain packaging legislation was still uncertain, due to the political climate prevailing in Australia at the time. When assessing this reality under the prism of the high degree of probability of *Pac Rim v El Salvador*, the tribunal would have been in an uncomfortable position to show convincingly that the dispute met this threshold at this particular time, when the investment had already been made by PMA. A conclusion of abuse of right would have been difficult to make. Instead, the facts met the lower bar of *Tidewater v Venezuela* quite well.

Second, the interpretation of facts was also generous to the host State. The choice of the date from which the dispute became foreseeable led to a decision in conformity with global trends. There were many plausible dates, some of them subsequent to that of the investment, February 23, 2011, and hence unsuitable for a conclusion of abuse of right. Paramount among them was April 6, 2011, the day of introduction of the Plain Packaging Bill into the Australian Parliament. It was on this date that PMA knew the precise terms of the proposed legislation, since there is no evidence that PMA had such information before. On this date, PMA did in fact know the true extent of the conflict of the measure with its rights and could have actually concluded that the dispute was reasonable to expect. But the tribunal instead chose as a determining factor the announcement of the legislation as the element to predict foreseeability. General announcements usually come before the full disclosure of the proposed legislation,

thus making a finding of foreseeability of dispute possible at an early stage for the benefit of host States.

But in addition, the finding that announcements by a minority government can make a dispute foreseeable also deserves to be commented upon. The reason for this finding was the need to avoid having two rules: one for majority governments and another for minority governments. Basically, their announcements are enough for both. However, majority and minority governments are different political realities, and for this reason, there would be nothing wrong, in principle, if there were different rules. In addition, it is the political environment surrounding the proposed measure potentially affecting the investor, not necessarily the nature of the government in charge of the process, that is the factor that weighs heavily in the assessment on when it is reasonable for an investor to expect the adoption of the measure and the ensuing controversy with the host State.

Finally, the tribunal was strict with PMA regarding evidence of the restructuring. What mattered for the tribunal was not evidence of a general restructuring process, but of the specific restructuring process leading to the BIT protection. The fact that there could have been some restructuring in PMI since 2005 was of no relevance to the tribunal. In this way, PMA's ability to link its Asian restructuring to the wider process was narrowed, and getting BIT protection became its sole rationale.

In synthesis, States and civil society have much to celebrate and foreign investors have some reasons to worry after *PMA v Australia*. The tribunal expanded the doctrine of abuse of rights and limited the latter's ability to restructuring in order to get BIT protection. The award also revealed that investor/State arbitration tribunals can effectively respond to the pressing needs of the day. In his annual report to the United Nations 25 years ago, the then President of the International Court of Justice, Robert Jennings, stated:

[A] court must indeed apply legal rules and be seen clearly to be doing so
Nevertheless, a good and useful court will not be ignorant of the political issues involved or of the political consequences of the decision it takes. (Sir Robert Yewdall Jennings, "Report of the International Court of Justice" UN Doc. A/46/PV.44. (1991)).

Amen, the tribunal in *PMA v Australia* could have well said.