COMMENT ON THE PHILIP MORRIS ASIA LIMITED V. THE COMMONWEALTH OF AUSTRALIA

Sourav Roy[*]

ABSTRACT

Sovereign states, which regulate or legislate or make policies based on grounds of public health, environment, and general welfare of the public, have to tread a very careful line nowadays, because of the possibility of disputes filed by foreign investors under the investor-state dispute settlement regime. One such example of this is the recent dispute between Philip Morris Asia Limited v. the Commonwealth of Australia[1] *This dispute took shape after the latter introduced laws that imposed restrictions on the tobacco industry. The investor- state dispute settlement mechanism, is by no means perfect, and is plagued by criticisms concerning legitimacy but it provides an avenue to foreign investors to directly sue a sovereign nation by invoking treaty standards and international law, more generally. How the tussle between states and foreign investors will play out in various sectors, remains to be seen, but this piece is an attempt to provide answers to the issues that will arise in the context of disputes that emanate from the sovereign nations' regulation of the tobacco industry (and foreign investors thereof).*

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* The author completed his B.A. LL.B. (Hons.) from NALSAR University of Law, Hyderabad in 2012 and is currently pursuing his Masters in Commercial Law at the University of Cambridge.

1 PCA Case No. 2012-12.

I. INTRODUCTION

Last December, an arbitral tribunal[2] ("Arbitral Tribunal") ruled on the dispute between Philip Morris Asia Limited (a Hong Kong entity) as claimant and the Commonwealth of Australia ("Australia"), a sovereign state, as respondent. The dispute emanated from the enactment and enforcement of the Tobacco Plain Packaging Act 2011 (the "TPP Act") and related regulations by Australia after which Philip Morris Asia Limited (the "Claimant"/ "PM Asia") commenced arbitration[3] pursuant to the Hong Kong-Australia Bilateral Investment treaty[4] ("BIT").

Pertinent issues relevant to both (i) jurisdictional questions and (ii) alleged violation of substantive treaty standards were raised in this dispute. In the end, however, the tribunal declined to exercise jurisdiction at the preliminary stage itself as it found that the Claimant had committed an "abuse of rights". As a result, the decision didn't rule on the point of alleged violation of treaty standards at all. What was supposed to be a watershed moment in terms of a tribunal authoritatively ruling on whether a state indeed had a right

2 The tribunal was presided over by Professor Karl-Heinz Böckstiegel (President), Professor Gabrielle Kaufmann-Kohler and Professor Donald M. McRae. UNCITRAL Rules (2010) were applicable and the arbitration was under the aegis of the Permanent Court of Justice. On 18 December 2015, the tribunal issued a unanimous decision. On 17 May 2016, the tribunal published the decision after redacting the confidential information.

3 On 22 June 2011, the Claimant served upon the Respondent a Notification of Claim in accordance with Article 10 of the Treaty. Thereafter, the Claimant served a Notice of Arbitration dated 21 November 2011 as the parties couldn't settle the dispute.

4 Agreement between the Government of Hong Kong and the Government of Australia for the Promotion and Protection of Investments dated 15 September 1993.

to regulate the tobacco industry (and foreign investors thereof), and if yes, to what degree, left much to be desired.

This Comment will critically evaluate the decision of the Arbitral Tribunal ("**Award**") on the point of "abuse of rights". Further, this piece will look at the claims about the violation of substantive treaty standards as alleged by the Claimant and will estimate what the answer to those questions would have been, if there was no finding of "abuse of rights".

II. BRIEF BACKGROUND TO AUSTRALIA'S TOBACCO RELATED LAWS AND POLICIES

In 2008, the Australian Government established an independent taskforce of leading Australian and international public health experts to develop strategies to tackle the health challenges caused by tobacco, alcohol and obesity. After considering the recommendations of this taskforce, the government of Australia decided to take a series of tobacco control measures as part of a comprehensive strategy to promote public health and awareness of the risks of smoking which culminated in the TPP Act[5]. The measures included, *inter alia*:

1. Restrictions on tobacco advertising;
2. Introduction of plain packaging;
3. Updated and expanded graphic health warnings.

[5] The TPP Act received Royal Assent on 1 December 2011 and the related regulations came to force on 7 December 2011.

It is pertinent to mention here that Australia is a signatory of the WHO Framework Convention on Tobacco Control ("FCTC")[6].

A. Nature of the claims-

The Claimant raised the following claims:

1. By introducing plain packaging, the TPP Act and regulations had eliminated intellectual property and goodwill of the Claimant. As a result, the value of Claimant's investment had substantially diminished. This deprivation was tantamount to Expropriation;

2. Where effective alternative measures were available, the TPP Act and regulations were disproportionate. Further, that the measures frustrated the legitimate expectation of the investor that Australia will respect Article 20 of the TRIPS Agreement. This amounted to breach of the Fair and Equitable Treatment ("FET") standard.

3. Additionally the claimant also raised the following claims:

    a. That the measures constituted an unreasonable impairment;

    b. That the measures constituted a denial of full protection and security to a foreign investor.

[6] The FCTC was adopted by the 56th World Health Assembly in May 2003, was opened for signature on 16 June 2003, and entered into force on 27 February 2005. There are 174 States Parties to this treaty.

B. The Claimant as a foreign investor

The Claimant, incorporated in Hong Kong, asserted that the plain packaging measures had an adverse impact on investments that it owned or controlled in Australia. These investments were the shares that the Claimant held in Philip Morris Australia Limited ("PM Australia"), as well as the shares that were held by PM Australia in Philip Morris Limited ("PML"), and the intellectual property and goodwill of PML. The Claimant had acquired its shareholding in PM Australia (and hence a purported indirect interest in the shares and assets of PML) only on 23 February 2011. Only on 23 February 2011 did it qualify as an investor under the BIT in question, to bring a dispute as a foreign investor against Australia.[7]

C. Jurisdiction and the question of "abuse of rights"

A conduct amounts to an "abuse of rights" if a tribunal reaches a finding that an investment has been restructured only in order to gain jurisdiction under a BIT. There must have evidently been no other reason for the restructuring. Such disputes amount to "*an abusive manipulation of the system of international investment protection under the ICSID convention and the BITs*"[8].

The question of abuse of rights arose because of peculiar facts of the present case- At the time the plain packaging measures was announced by the

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7 Supra, note 1, at ¶533.

8 Mobil Corporation, Venezuela Holdings, B.V., Mobil Cerro Negro Holding, Ltd., Mobil Venezolana de Petróleos Holdings, Inc., Mobil Cerro Negro, Ltd., and Mobil Venezolana de Petróleos, Inc. v. Bolivarian Republic of Venezuela, ICSID Case No. ARB/07/27, Decision on Jurisdiction, 10 June 2010, at para 204.

Australian government (on 29 April 2010), PM Asia did not hold any shares or interest in PM Australia or PML. The Claimant had acquired its shareholding in PM Australia (and hence a purported indirect interest in the shares and assets of PML) only on 23 February 2011. Prior to 23 February 2011, Philip Morris Brands Sari, a Swiss company, owned the shares in PM Australia, and PM Australia in turn owned the shares in PML. There was therefore no 'investment' as defined under the BIT prior to 23 February 2011 as PM Asia only acquired its interest in PM Australia on 23 February 2011.

These facts were relied upon by Australia in alleging that there was an "abuse of rights": namely, that the Claimant had restructured its investment only to qualify as a foreign investor so as to take benefit of the dispute resolution mechanism under the BIT.[9]

The following questions were before the tribunal- (i) does restructuring itself amount to an abuse of rights? (ii) Can an entity restructure its shareholding/ control to take benefit of a BIT dispute resolution mechanism? (iii) If it is permissible to restructure so as to take benefit of a BIT dispute resolution mechanism, to what extent is such a practice allowed? (iv) Is there a fine line between restructuring that amounts to an abuse of rights and one which doesn't amount to an abuse of rights?

[9] Australia's response to the Notice of Arbitration, at ¶7: "*Article 10 of the BIT does not confer jurisdiction on an arbitral tribunal to determine pre-existing disputes that have been re-packaged as BIT claims many months after the relevant governmental measure has been announced*".

But before discussing the merits of the Award rendered in this particular case, it is worth referring to some of the earlier tribunals' decisions which shed light on the following points concerning the "abuse of rights".

1. Restructuring is per se not Illegitimate

The *Tidewater v. Venezuela* tribunal held[10]:

> "*It is a perfectly legitimate goal and no abuse of an investment protection treaty regime, for an investor to seek to protect itself from the general risk of future disputes with a host State in this way*."

2. Restructuring may be Illegitimate in Certain Cases

The *Tidewater v. Venezuela* tribunal went on to hold that though restructuring in general is not illegitimate, it may amount to an abuse of process if it has been carried out only to obtain BIT benefits in respect of a foreseeable dispute[11].

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[10] Tidewater Inc., Tidewater Investment SRL, Tidewater Caribe, C.A., Twenty Grand Offshore, L.L.C., Point Marine, L.L.C., Twenty Grand Marine Service, L.L.C., Jackson Marine, L.L.C. and Zapata Gulf Marine Operators, L.L.C. v. The Bolivarian Republic of Venezuela, ICSID Case No. ARB/10/5, Decision on Jurisdiction, 8 February 2013, at ¶184.

[11] Tidewater, supra note 10: "*At the heart, therefore, of this issue is a question of fact as to the nature of the dispute between the parties, and a question of timing as to when the dispute that is the subject of the present proceedings arose or could reasonably have been foreseen… If the Claimants' contentions are found to be correct as a matter of fact, then, in the view of the Tribunal, no question of abuse of treaty can arise. On the other hand, if the Respondent's submissions on the course of events are correct, then there may be a real question of abuse of treaty. […] But the same is not the case in relation to pre-existing disputes between the specific investor and the [S]tate. Thus, the critical issue remains one of fact: was there such a pre-existing dispute?*"

This has been reiterated by the *Mobil Corporation v. Venezuela* tribunal as well[12]:

> *"205. With respect to pre-existing disputes, the situation is different and the Tribunal considers that to restructure investments only in order to gain jurisdiction under a BIT for such disputes would constitute, to take the words of the Phoenix Tribunal, "an abusive manipulation of the system of international investment protection under the ICSID convention and the BITs".*

3. Dividing Line

According to the *Pac Rim v. El Salvador,* there is a dividing line between a legitimate restructuring and one that amounts to an "abuse of rights"[13]:

> *"2.99. […] In the Tribunal's view, the dividing-line [between legitimate restructure and an abuse of process] occurs when the relevant party can see an actual dispute or can foresee a specific future dispute as a very high probability and not merely as a possible controversy."*

4. Manipulative Conduct

The principle that a restructuring undertaken to gain treaty protection in light of a specific dispute can constitute an abuse was reiterated in *Lao Holdings v. Laos*[14]*:*

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12 Mobil, supra note 8, at ¶204.

13 Pac Rim Cayman LLC v. Republic of El Salvador, ICSID Case No. ARB/09/12, Decision on Jurisdictional Objections, 1 June 2012 ("Pac Rim decision on the Respondent's Jurisdictional Objections"), at ¶2.13.

14 Lao Holdings N.V. v. Lao People's Democratic Republic, ICSID Case No. ARB(AF)/12/6, Decision on Jurisdiction, 21 February 2014, at ¶70.

> *"70. The Tribunal considers that it is clearly an abuse for an investor to manipulate the nationality of a company subsidiary to gain jurisdiction under an international treaty at a time when the investor is aware that events have occurred that negatively affect its investment and may lead to arbitration. In particular, abuse of process must preclude unacceptable manipulations by a claimant acting in bad faith who is fully aware prior to the change in nationality of the "legal dispute," as submitted by the Respondent."*

The Arbitral Tribunal in PM Asia v. Australia contributes to the above jurisprudence by distilling the law further on the question of abuse of rights and by providing clarity on the following issues - *Firstly,* the Award elucidates that though under certain circumstances, a restructuring may constitute an abuse, a high threshold needs to be discharged before reaching a finding on abuse of process. However, the high threshold is calibrated. The foreseeability of a dispute need not be a very highly probable dispute. As long as there is a reasonable prospect of a dispute, a dispute is foreseeable. In such a case, a restructuring done with the intention of bringing an investment within the scope of a BIT would amount to an "abuse of rights".

Secondly, there is no 'one size fits all' approach in discerning whether restructuring amounts to an "abuse of rights". Therefore, each case will require proof of the foreseeability of the claim, which will in turn depend on the particular circumstances of each case. *Thirdly,* the abuse is subject to an objective test and not a subjective one.

In the present dispute, the Arbitral Tribunal found that this was indeed a fit case of "abuse of rights". The Claimant/ investor was aware as early as 2010 that the plain packaging measures would be implemented by 2012.[15] There was never a doubt that these measures would eventually be implemented. Thus the restructuring in 2011 was done with the sole aim to take benefit of the BIT dispute resolution mechanism.

It is pertinent to note that the Claimant did plead before the Arbitral Tribunal that the restructuring was done for other reasons, most notably, for tax purposes and that it was a part of a global restructuring dating back at least a decade. However, the Arbitral Tribunal was not satisfied by the evidence tendered on this point. The Claimant couldn't establish, in terms of evidence that this was indeed for tax benefits and not for the sole purpose of accessing a favourable BIT dispute resolution mechanism[16].

III. THE SUBSTANTIVE TREATY STANDARDS IN QUESTION

As the Arbitral Tribunal reached a definitive conclusion on "abuse of rights", it declined jurisdiction. Therefore, it was no longer necessary to consider the questions about the violation of substantive treaty standards. However, this article will briefly discuss the course that would have ensued, should the Arbitral Tribunal have not declined jurisdiction. The following

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15 Supra, note 1, at ¶557- 569.

16 Supra, note 1, at ¶581- 584: "*Therefore, the Tribunal finds that the Claimant has not been able to prove that tax or other business reasons were determinative for the restructuring. From all the evidence on file, the Tribunal can only conclude that the main and determinative, if not sole, reason for the restructuring was the intention to bring a claim under the Treaty, using an entity from Hong Kong.*"

discussion looks primarily at the claims of (a) Expropriation; (b) breach of FET standards.

A. Expropriation

This piece argues that in international law, not all deprivations of property amount to expropriation. The Police Powers doctrine recognizes that a state may take property and property owners may suffer significant economic losses without giving rise to state responsibility in certain cases[17]. Quoting the *Saluka v. Czech Republic* tribunal in this regard[18]:

> *"It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare."*

According to this view, Police Powers is a part of sovereignty itself and therefore, is always available to the state to justify a certain measure[19]. As Schreuer puts it, "*in investment law "the 'all or nothing' principle is applied. This means that investors are entitled to full compensation in case of an expropriation and to nothing if*

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17 CME v. Czech Republic, UNCITRAL, Final Award, 14 March 2003; Saluka v Czech Republic, UNCITRAL, Partial Award, 17 March 2006; Methanex v. USA, UNCITRAL, Final Award, 3 August 2005; Ioannis Kardassopoulos v. Georgia, ICSID Case No. ARB/05/18, Award, 3 March 2010.

18 Saluka v. Czech Republic, UNCITRAL, Partial Award, 17 March 2006.

19 Jorge E. Viñuales, *Customary Law in Investment Regulation,* (2013/2014), 23 ITALIAN YEARBOOK OF INTERNATIONAL LAW 23; JORGE E. VIÑUALES, *Sovereignty in Foreign Investment Law*, in THE FOUNDATIONS OF INTERNATIONAL INVESTMENT LAW, at p. 317-362, (Douglas, J. Pauwelyn and J. E. Viñuales, The Foundations of International Investment Law (Oxford University Press, 2014).

a legitimate regulation is found to have occurred."[20] Police powers rule flows from customary international law and therefore, its application does not depend upon a clause incorporating it into the treaty, unless the treaty otherwise excludes it[21]. This interpretation is consistent with the Vienna Convention on the Law of Treaties[22].

Based on the above, it is submitted that a non-discriminatory measure, taken on grounds of public health, after following due process, would not qualify as expropriation. Whether Australia would eventually have satisfied the tribunal as to the fulfilment of those conditions is not something that can be foretold. What this piece rather argues is that, should it have satisfied these conditions, the measures would not amount to expropriation.

B. *FET Standard*

For lack of a uniform definition of the FET standard, this piece uses one of the various forms in which this standard has been defined by tribunals. A breach of the FET standard was defined in *Waste Management v. Mexico*[23] as: "*involv[ing] a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process*".

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20 C REINER AND CH SCHREUER, *Human Rights and International Investment Arbitration,* in PM DUPUY, EU PETERSMANN AND F FRANCIONI, HUMAN RIGHTS IN INTERNATIONAL INVESTMENT LAW AND ARBITRATION (2009), at p. 95.

21 Jorge E. Viñuales, *Customary Law in Investment Regulation,* (2013/2014), 23 ITALIAN YEARBOOK OF INTERNATIONAL LAW 23.

22 Article 31(3)(c) VCLT: "[i]n interpreting a treaty, account has to be taken of 'any relevant rules of international law applicable in the relations between the parties'".

23 ICSID Case No. ARB(AF)/00/3.

The *Total v. Argentina*[24] tribunal was emphatically clear while stating that it is difficult to give an exact definition of the scope of this provision. Since this standard is inherently flexible, it is difficult, if not impossible, "*to anticipate in the abstract the range of possible types of infringements upon the investor's legal position*"[25]. What constitutes the exact contours of the FET provision is a separate matter of scholarship altogether[26]. What is relevant for us here is to keep in mind the context in which the FET argument was raised by the Claimant in this case.

It was the Claimant's argument that the measures in question were not the least restrictive measures and because there were other measures that the state could have taken, without introducing plain packaging, the FET standard is breached. Such an argument flows from the awards like *Occidental Petroleum Corporation, Occidental Exploration and Production Company v. the Republic of*

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[24] Total v. Argentine Republic, ICSID Case No ARB/04/01, Decision on Liability (27 December 2010).

[25] Supra, note 24, at ¶104; C. Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, 6 J. World Trade,(2005/3), 357, 365.

[26] In a first line of cases, certain tribunals have been willing to extend protection under fair and equitable treatment to the State's duty to maintain a stable framework. Often, this sub-element of the standard has been buttressed by reference to the BIT's preamble, which may refer to stability as one of the goals of the treaty. Examples of references to BIT preamble for FET/ stability- CMS v. Argentina, ICSID Case No ARB/01/08, Award (12 May 2005); LG& E v. Argentina LG&E Energy Corp, LG&E Capital Corp and LG&E International Inc v. Argentine Republic, ICSID Case No ARB/02/1, Decision on Liability (3 October 2006) ¶125; Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, LP v. Argentine Republic, ICSID Case No ARB/01/3, Award (22 May 2007) ¶260. In contradistinction, certain tribunals have stressed that, as a matter of principle, the State's right to regulate cannot be considered frozen or restricted as a result of the existence of investment treaties. These include Parkerings-Compagniet AS v. Lithuania, ICSID Case No ARB/05/8, Award (11 September 2007); Total v. Argentine Republic, ICSID Case No ARB/04/01, Decision on Liability (27 December 2010). As held in Parkerings v. Lithuania: "*It is each State's undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilization clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment*."

Ecuador[27], where the tribunal held that administrative/ legislative measures that are more stringent that the least restrictive measures/ alternative measures, constitute a breach of the FET standard on grounds of proportionality[28].

However, such a concept is neither a general principle nor part of customary law and therefore, a measure that otherwise satisfies public purpose; is non-discriminatory and has been taken after following due process is unlikely to be compensated for[29].

IV. CONCLUDING REMARKS

The Award in question didn't rule on the point of alleged violation of treaty standards at all. We haven't heard the last word yet on a sovereign nation's right to regulate the tobacco industry (and foreign investors thereof), on grounds of public health. Similar actions are underway against other countries like Uruguay and will probably be initiated against other countries that impose plain packaging. The degree to which such anti-tobacco measures constitute a valid regulation thus remains to be seen. What is certain is that in the other cases, the "abuse of rights" issue will be less thorny and eventually we will have a decision on merits that looks at expropriation and FET in the context of anti- tobacco regulations.

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27 ICSID Case No. Arb/06/11.

28 AES Summit Generation v. Hungary, Award, ¶ 10.3.7–9; KINGSBURY AND SCHILL, *Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest-The Concept of Proportionality*, *in* INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW (Schill ed., 2010), at p. 97.

29 JONATHAN BONNITCHA, *Substantive Protection under Investment Treaties: A Legal and Economic Analysis*, chapter 4(Cambridge University Press, 2014).

This article is therefore a pointer to the arguments that the sides will take and develop in those cases and it concludes by saying that it is more likely than not that a legitimate exercise of the state's regulatory powers to protect the health of its citizens by taking measures that are non-discriminatory and abide by due process, will neither constitute expropriation, nor a breach of the FET standard.