

## Restructuring investments to gain the protection of a BIT

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**Arbitration analysis: Steven Nelson, partner, and Michael Robbins, associate at US firm Dorsey & Whitney discuss the case of Philip Morris Asia Limited (Hong Kong) v The Commonwealth of Australia**

### Original news

*Philip Morris Asia Limited v The Commonwealth of Australia* PCA Case No. 2012-12

### What is the background to the claim?

The claim originated from Australia's decision to introduce legislation that required tobacco companies marketing cigarettes in Australia to sell them only in logo-free, drab dark brown packaging, and prohibited them from using their logos or marketing content (apart from the brand name in standard font) on their products (plain packaging measures).

With knowledge of Australia's proposed plain packaging measures, Philip Morris Asia Limited (Hong Kong) (Philip Morris HK) undertook a corporate restructuring by which it acquired the Australian Philip Morris subsidiaries, giving it prima facie standing to bring a claim against Australia before an arbitral tribunal appointed under the aegis of the Permanent Court of Arbitration (PCA) pursuant to a 1993 bilateral investment treaty (BIT) between Hong Kong and Australia (the HK/Aus BIT). The HK/Aus BIT allows Hong Kong investors to assert claims directly against the Australian government, and vice versa, for breaches of the investment protections incorporated in the HK/Aus BIT.

Philip Morris HK claimed that the plain packaging measures impaired the value of its intellectual property rights in its brands and thus diminished the value of its investment in Australia, for which it sought declaratory relief and compensation. Its commencement of arbitration under the HK/Aus BIT followed on the heels of the 2012 dismissal by the Australian High Court of a challenge to the law by Philip Morris and other major tobacco companies, including British American Tobacco, Imperial Tobacco and Japan Tobacco.

### What laws were applied?

The tribunal applied established principles of customary international law, notably including those embodied in the 1969 Vienna Convention on the Law of Treaties, in dealing with the claims raised under the HK/Aus BIT. Ultimately, the case was decided on jurisdictional grounds and the tribunal thus did not reach Philip Morris HK's substantive claim that the plain packaging measures amounted to an indirect expropriation of its investment in Australia.

### What was at stake?

International law has yet to draw a bright and easily distinguishable line between non-compensable regulations on the one hand and, on the other, measures that have the effect of depriving foreign investors of the benefits of their investment and are thus unlawful unless adequately compensated. Accordingly, at stake was whether Australia's public policy as reflected in the plain packaging measures were permissible exercises of the police power or interfered with the property and interests of a foreign investor in a manner or to an extent giving rise to a right of compensation on the part of the investor. The case has been seen in some quarters as pitting the sovereign authority of a democratically-elected government against the commercial interests of a large multinational enterprise.

### What were the parties' key arguments?

Australia objected to the tribunal's jurisdiction on the basis that the dispute was foreseeable when Philip Morris HK obtained the nominal protection of the HK/Aus BIT through the corporate restructuring, that the restructuring was done primarily to obtain such protection, and that the resort to arbitration under the HK/Aus BIT therefore constituted an 'abuse of right'.

Under the extensive body of jurisprudence resulting from the lengthy history of arbitrations under BITs and similar intergovernmental agreements, the invocation of the protections under such agreements may be abusive if standing to do so is acquired through measures taken when a dispute has already arisen or is clearly foreseeable. That line of authority is grounded on the principle of good faith, and its application depends upon the subjective motivation for the measures in question, particularly whether the purpose was simply to obtain the benefits of the relevant treaty.

According to Philip Morris HK, the ‘overall objectives of the restructuring were to minimize tax liability, align ownership with control, and optimize cash flow’. There were also ‘additional benefits’, such as:

- alignment of the ownership of the Australian subsidiaries with Philip Morris HK’s pre-existing management control of the subsidiaries
- optimisation of the Philip Morris HK’s cash flow, and
- ‘additional BIT protection[s]’

A further key motivation behind the restructuring was, according to Philip Morris HK, that restructuring aligned the ownership and management control of many Philip Morris affiliates. In the submission of Philip Morris HK, the restructuring had entirely legitimate objectives independent of its desire to obtain the protections of the HK/Aus BIT.

### **What did the arbitral tribunal decide?**

In its award, the tribunal held that Philip Morris HK’s attempt to challenge Australia’s plain packaging measures was an abuse of rights. It determined that Philip Morris HK’s claims were inadmissible and that it was thus precluded from exercising jurisdiction over the dispute.

In the view of the tribunal, it would not normally be an abuse of right to bring a BIT claim in the wake of a corporate restructuring, if the restructuring was justified independently of the possibility of bringing such a claim. However, the tribunal found that Philip Morris HK had not proved that tax or other business reasons were determinative of the restructuring. From all the evidence, the tribunal was only able to conclude that ‘the main and determinative, if not sole, reason for the restructuring was the intention to bring a claim under the HK/Aus BIT, using an entity from Hong Kong’ after it had received ample warnings that the Australian government was considering introducing the plain packaging measures.

In the tribunal’s view, there was no uncertainty about the Australian Government’s intention to introduce the plain packaging measures after its announcement on 29 April 2010. The tribunal held that, from that date, there was at least a reasonable prospect that legislation equivalent to the plain packaging measures would eventually be enacted and that a dispute would arise. The tribunal further held that the Australian Government’s adoption of the plain packaging measures was not only foreseeable but actually foreseen by Philip Morris when it chose to change its corporate structure.

The tribunal concluded, accordingly, that the initiation of the arbitration constituted an abuse of rights, as the corporate restructuring by which Philip Morris HK acquired the Australian subsidiaries occurred at a time when there was a reasonable prospect that the dispute would materialise and was carried out for the principal, if not sole, purpose of gaining HK/Aus BIT protection. Accordingly, the tribunal held that the claim was inadmissible and that it was precluded from exercising jurisdiction.

### **What is the impact of the award on BIT claims?**

If the tribunal had decided the merits of the case, then it would have addressed a question of great interest to governments and investors globally. That is, the circumstances under which sovereign states may be obligated to compensate foreign investors for losses resulting from the adoption of regulations that governments have regarded as being in the public interest.

Instead, this award serves essentially to confirm the principles established by earlier tribunals according to which only genuine investors that meet the requirements of the relevant BIT at the time of making an investment will be afforded protections of BITs. The award reinforces the importance of early planning before an investment is made to determine the scope and nature of treaty protections that may be available. If a specific dispute has already arisen or is foreseeable, it will likely be too late for investors to restructure an investment to gain the protection of a BIT.

The effect of the Philip Morris challenge is already being felt. Australia became the first developed country to join the backlash against such dispute resolution clauses. Following the news of Philip Morris' claim, the Australian government made a policy announcement in April 2011 that it would no longer include investor-state dispute settlement clauses in its future BITs. The announcement stated that investor-state dispute settlement provisions jeopardised Australia's ability to determine its own public policy.

### **How might this award affect international arbitration generally?**

This award will not have a large impact on international arbitration generally, but it nonetheless has become a 'poster child' for political objections to investment treaties and trade agreements that allow investors, in practice usually foreign corporations, to bring legal challenges against governments, which would otherwise enjoy sovereign immunity. It has become a cause célèbre for those who see it as an intolerable subjection of the right of sovereign, democratic governments to regulate business conduct in their territories to abusive claims of large, well-financed multinational corporations, forcing states to defend their laws before tribunals composed of private individuals. This has, in fact, become a major issue in the negotiation of the Transatlantic Trade and Investment Partnership (TTIP) Agreement currently under negotiation between the US and the EU, and it significantly influenced the disputes provisions of the recently-concluded but as-yet-unratified Trans-Pacific Partnership Agreement (TPPA).

This political backlash has obscured the fact that governments do occasionally take actions affecting foreign investors in violation of established principles of international law. The lack of remedies for such violations reduces the security of investment, thus potentially depriving countries, particularly in the developing world, of much-needed capital investment, which is the purpose of BITs to encourage. The inability of the tribunal to exercise jurisdiction in the Philip Morris case has deprived us of a possible opportunity for clarification of the line between legitimate regulation, which is recognised in nearly all BITs and in customary international law, and interference with rights protected by treaty and law. This is not a new conundrum in public international law, but it is one the balance of which is constantly shifting as economic and social conditions change. It is unfortunate that this case, having provoked so much angst and political hyperbole, could not have resulted in some much-needed clarification on the merits of that significant issue.

The political reaction has doubtless been intensified by the heightened awareness in recent years of the harm caused by human activities to the environment and human health. For example, several countries, including New Zealand, Ireland, the UK, France, Canada, India and Turkey, have indicated intentions to introduce legislation similar to Australia's plain packaging measures. It will not be surprising if tobacco companies continue their rear-guard efforts to try to forestall such measures for as long as possible. And, although the TPPA itself contains a 'saving' clause emphasising the right of parties to adopt non-arbitrary measures, including environmental measures, necessary to protect human, animal or plant life or health, the states that are signatories to the TPPA will no doubt be wary of possible challenges to such regulatory measures under other international agreements to which they are already parties.

Considering the growing concern that BITs confer, or at least acknowledge, greater legal rights of foreign investors than of domestic businesses and the perceived erosion of a state's ability to determine its own public policies, there may well be a trend for future BITs to include modified investment-protection or arbitration clauses that provide appropriate exemptions for matters such as health and environmental policy, even though it is doubtful that such exemptions add to the substantial regulatory latitude already enjoyed by states under international law. In the meantime, investor-state arbitration clauses will continue in BITs that are already in effect. The protection and comfort that BITs give to foreign investors mean that such treaties have the potential to help drive economic growth, employment and standards of living in the developing world, and we will likely see a continuation of claims brought by investors under those agreements.

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