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**“CONSUMER PRODUCT SAFETY REGULATION  
AND INVESTOR-STATE ARBITRATION POLICY  
AND PRACTICE AFTER *PHILIP MORRIS ASIA V  
AUSTRALIA*”**  
**LUKE NOTTAGE**

## Consumer Product Safety Regulation and Investor-State Arbitration Policy and Practice after *Philip Morris Asia v Australia*\*

Luke Nottage<sup>#</sup>

Justice Oliver Wendell Holmes famously remarked in *Northern Securities Co v United States* 193 US 197 (1904) that:

“Great cases like hard cases make bad law. For great cases are called great, not by reason of their importance... but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment”.

We might take this reasoning a step further: big cases make or entrench bad policy. A contemporary example is the request for arbitration (reportedly in Singapore) initiated on 27 June against Australia by Philip Morris Asia (PMA), a Hong Kong subsidiary of the tobacco giant,<sup>1</sup> pursuant to the 1993 “Agreement between the Government of Australia and the Government of Hong Kong for the Promotion and Protection of Investments”.<sup>2</sup> PMA is mainly alleging that the Tobacco Plain Packaging Bill 2011 will amount to “expropriation” of its trademarks (Art 6) and a violation of “fair and equitable treatment” (FET) obligations (Art 2(2)).<sup>3</sup>

### *Treaty-based Investor-State Arbitration*

Australia has concluded 21 Bilateral Investment Treaties (BITs) since 1988, and 4 out of 6 Free Trade Agreements (FTAs) with Investment Chapters since 2003, which include investor-state arbitration (ISA) provisions.<sup>4</sup> ISA protections allow a home state’s investor to bring claims directly against the host state for illegally interfering with its investment,

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<sup>#</sup> Associate Professor, Sydney Law School; Program Convenor (Comparative and Global Law), Sydney Centre for International Law.

<sup>1</sup> Kenny C, “Big tobacco ignites legal war”, *The Australian* (online), 27 June 2011 <http://www.theaustralian.com.au/national-affairs/big-tobacco-ignites-legal-war/story-fn59niix-1226082403380> (accessed 31 July 2011).

<sup>2</sup> Available at <http://www.austlii.edu.au/au/other/dfat/treaties/1993/30.html>.

<sup>3</sup> Voon S and Mitchell A, “Time to Quit? Assessing International Investment Claims Against Plain Tobacco Packaging in Australia” 14(3) *Journal of International Economic Law*, forthcoming, available at <<http://ssrn.com/abstract=1906560>> (citing at n19 and throughout the PMA’s Written Notification of Claim, dated 27 June 2011). PMA also apparently relies on provisions (in Art 2(2)) dealing with “full protection and security” and “unreasonable impairment”, and containing an umbrella clause, which are unlikely to prove decisive (ibid, pp 25-26).

<sup>4</sup> Mangan M, “Australia’s Investment Treaty Programme and Investor-State Arbitration” in Nottage L and Garnett R (eds), *International Arbitration in Australia* (Federation Press, 2010) Ch 9. The FTA with the USA (signed in 2005) omits ISA provisions, as does the Investment Protocol (signed 16 February 2011) of the (CER) FTA with New Zealand.

rather than imploring its home state to bring a “diplomatic protection” inter-state claim on its behalf. The home state’s other interests may make it reluctant to espouse their investors’ claims, when the investment dispute happens to arise, so foreign investors have increasingly pressed for direct ISA protections to be added to treaties that host states conclude with home states. This phenomenon, combined with the proliferation of investment treaties and the explosion of cross-border foreign investment world-wide especially since the early 1990s, and has resulted in hundreds of disputes being submitted to formal arbitration proceedings. The Asian region is no longer an exception, although so far relatively few arbitrations have involved Asian investors or host states.<sup>5</sup>

Foreign investors have sometimes succeeded in claiming compensation, especially under earlier treaties that have broadly-worded definitions of expropriation or FET. The Hong Kong BIT (1993) differs from Australia’s FTA with Chile (signed in 2009), for example, which follows recent US treaty practice in adding an Annex (10-B) on Expropriation stating that:

“Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations” (Art 3(b)).

Thus, Australia will need to defend the PMA claim based instead on some (non-binding) awards and (quite divided) commentaries interpreting similar wording in other agreements like the North American Free Trade Agreement (NAFTA). There remains considerable uncertainty over the identification and weighing of legal considerations relevant to claims of “indirect expropriation”, and the cases are necessarily very fact-specific. The Hong Kong BIT also lacks a provision expressly limiting FET obligations to the standards set by customary international law, for example. PMA may argue that its “legitimate expectations” about the regulatory framework (when making its investment) have been frustrated, although this usually requires showing that specific assurances induced the investment.<sup>6</sup>

In addition, even Australia’s earlier treaties (like the Hong Kong BIT in Art 1(e)(iv)) tend to define “investment” liberally to encompass intellectual property rights. The Hong Kong BIT also defines “investor” broadly (Art 1(b)). That helps explain why the Philip Morris group has been able to initiate this treaty claim, while its Swiss-based company has initiated parallel arbitration proceedings challenging different tobacco control measures undertaken by Uruguay pursuant to that bilateral FTA.<sup>7</sup>

### ***Impact of the PMA Claim on Australia’s Policy Debate***

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<sup>5</sup> Bath V and Nottage L, “Foreign Investment and Dispute Resolution Law and Practice in Asia: An Overview” *Sydney Law School Research Paper No. 11/20*, 2011, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1789306](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1789306).

<sup>6</sup> Cf. Voon and Mitchell, above n3, and generally Mitchell A D and Wurzbürger S M, “Boxed in? Australia’s Plain Tobacco Packaging Initiative and International Investment Law” (2011) 27 *Arbitration International*, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1896125](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1896125).

<sup>7</sup> ICSID case no. ARB/10/17 (filed 19 February 2010). See generally also Porterfield MC and Byrnes C R, “Philip Morris v. Uruguay: Will investor-State arbitration send restrictions on tobacco marketing up in smoke?”, *Investment Treaty News* (online), 12 July 2011 <http://www.iisd.org/itn/2011/07/12/philip-morris-v-uruguay-will-investor-state-arbitration-send-restrictions-on-tobacco-marketing-up-in-smoke/> (accessed 31 July 2011).

For many, PMA's treaty-based investor-state arbitration (ISA) claim will seem like a "big bad company" claiming against a government trying to pass a "good law" – aimed at addressing the serious public health problems and expenses still associated with cigarette sales. These persist despite the Australian government already having tried many other measures to curb consumption: graphic warnings on cigarette packaging and in TV or print advertisements, restrictions on displays and promotion, and increasingly high consumption taxes.<sup>8</sup>

PMA's claim will also lead some to acclaim the April 2011 "Gillard Government Trade Policy Statement",<sup>9</sup> which blew cold on ISA provisions in future treaties. On a literal interpretation, which seems particularly likely to prevail especially in the wake of the PMA claim, it means simply that Australia will no longer agree to ISA in any future treaty even with developing countries. This effectively means no more ISA in treaties with anyone. After all, Australian investors anyway are less concerned about ISA protections where the host state has a more developed legal system – offering a reliable court system applying domestic substantive law supportive of the rights of all investors.

However, read in the context of Productivity Commission recommendations into an Inquiry into FTA policy for Australia that was finalized last December,<sup>10</sup> an alternative interpretation is that the Statement still allows scope for the Gillard Government to include ISA in future treaties on certain conditions. In particular, this can happen provided foreign investors are not accorded better rights than local investors. Thus, if the partner country's domestic law protections are lower than Australia's, then future treaties can therefore at least include substantive protections (aimed at Australian investors abroad) capped at the Australian domestic standard of protection. Yet even this policy stance generates complex implications, and the theory and evidence contained in the Productivity Commission analysis have significant weaknesses, as I outline in a recent paper.<sup>11</sup>

By contrast, ISA claims are often brought by smaller and/or "good" investors complaining about "bad laws" enacted by the host state. The larger investors often have political clout even in the host state, and/or their home state, to facilitate a negotiated settlement (including via an inter-state process typically also offered by treaties) without filing formal arbitration claims. Indeed, PMA perhaps approached their home state to encourage it to launch a World Trade Organization (WTO) claim alleging breaches of the TRIPS (Trade-Related Aspects of Intellectual Property Rights) Agreement. But that legal avenue seems weak,<sup>12</sup> which could explain why we now see a direct ISA claim brought by PMA against Australia. (Presumably PMA also decided that the substantive rights under the treaty with Hong Kong provided greater protection than public law rights offered by

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<sup>8</sup> See generally Chapman S and Freeman B, "The cancer emperor's new clothes: Australia's historic legislation for plain tobacco packaging" (2010) *British Medical Journal* 340:c2436.

<sup>9</sup> Available at <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html>.

<sup>10</sup> Available at <http://www.pc.gov.au/projects/study/trade-agreements>.

<sup>11</sup> Nottage L, "The Rise and Possible Fall of Investor-State Arbitration in Asia: A Skeptic's View of Australia's 'Gillard Government Trade Policy Statement'" *Transnational Dispute Management: Sydney Law School Research Paper No. 11/32*, 2011, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1860505](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1860505). See also Kurtz J, *The Australian Trade Policy Statement on Investor-State Dispute Settlement* (2011), available at <http://www.asil.org/insights110802.cfm>.

<sup>12</sup> Voon T S and Mitchell A D, "Implications of WTO Law for Plain Packaging of Tobacco Products", in Mitchell A D, Voon T S and Liberman J (eds), *Public Health and Plain Packaging of Cigarettes: Legal Issues* (Edward Elgar, 2012), draft available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1874593](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1874593).

Australian courts, including the constitutional prohibition on the government acquiring property without paying compensation.<sup>13</sup>)

The problems with the Gillard Government's recently announced policy stance on ISA would have received a fairer hearing if the first arbitration claim against the Australian government had been brought not by a tobacco company for this sort of legislation. Imagine for example if we'd had a Malaysian solar power panel manufacturer claiming breach of the FET obligation due to NSW legislation retrospectively changing feed-in tariffs that the state government had promised to retain for at least five years, based on ISA protections contained in the 2009 ASEAN-Australia-NZ FTA. As I explain in my recent paper, the government did back down and anyway the chances of success would not necessarily have been high. But if such a claim had been made then we would have had an example of a smaller "good" company complaining about a "bad law".

Instead, Australians (and others) will now tend to remember the PMA claim whenever ISA is mentioned. That will entrench the Gillard Government's policy stance rather than creating opportunities to properly reconsider more targeted ISA reform options, such as those outlined in Appendix A of my paper. After all, social psychologists and now behavioural economists have long warned about "availability bias" (we usually give too much weight to high-profile or memorable events) and "confirmation bias" (we discount counter-examples and instead are disproportionately influenced by evidence that seems to support our existing preferred theories).<sup>14</sup>

However, all is not lost. Even this arbitration claim by PMA may leave scope for more rational debate about ISA's problems – which are indeed significant – and the best ways to address those. When the notice of claim was filed in 27 June, it was unclear whether the case would even get to full-scale arbitration. PMA initiated a 3-month "cooling off" period prior to being able to commence the arbitral proceedings against Australia (as provided by Art 10 of the Australia-Hong Kong treaty). Although tribunals interpreting other treaties have differed in their interpretations of similar provisions, this arguably meant that no arbitration could commence for at least 3 months. A major objective for PMA was probably to obtain concessions on the timing and scope of Australia's plain packaging legislation will have been enacted, resulting in the claim being withdrawn or settled.<sup>15</sup> Then the broader hubbub over ISA policy might have died down, allowing more rational debate to be resumed.

However, this opportunity was restricted when the House of Representatives passed the Bill on 24 August 2011, sticking to the original implementation schedule.<sup>16</sup> Tobacco

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<sup>13</sup> Berkovic N, "Big tobacco's pre-emptive strike raises stakes", *The Australian* (online), 2 July 2011 <http://www.theaustralian.com.au/national-affairs/big-tobaccos-pre-emptive-strike-raises-stakes/story-fn59niix-1226085121167> (accessed 31 July 2011).

<sup>14</sup> Cf generally Nottage L and Kozuka S, "Lessons from Product Safety Regulation for Reforming Consumer Credit Markets in Japan and Beyond: Empirically-Informed Normativism" (2011) *Sydney Law School Research Paper No. 11/39*, 2011, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1895084](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1895084).

<sup>15</sup> In fact, the formal arbitration probably cannot commence until the legislation is enacted, to the detriment of the investor: see eg Rothwell D R, "Big Tobacco v Australia: Philip Morris jumps the gun on legal challenge", *The Conversation* (27 June 2011) <http://theconversation.edu.au/big-tobacco-v-australia-philip-morris-jumps-the-gun-on-legal-challenge-2025> (accessed 31 July 2011).

<sup>16</sup> See "World-first plain packaging for tobacco products a step closer to becoming law", *The Conversation* (25 August 2011) <http://theconversation.edu.au/world-first-plain-packaging-for-tobacco-products-a-step-closer-to-becoming-law-3053>; and my more extensive comments in "Repercussions of Australia's Tobacco Plain Packaging Act" (25 August 2011)

companies had alleged that they will be unable to produce only plain packaged cigarettes by 20 May 2012, which retailers are required to sell from 1 July 2012, according to the proposed legislation. Indeed, British American Tobacco (BAT) asserted to a parliamentary inquiry that this timeframe will lead to a tobacco shortage.<sup>17</sup> This suggested some potential for compromise, namely a longer lead-in time. But the Gillard Government seems to have found it hard to back down from its public statements supporting the original legislation and dismissing PMA's claim.<sup>18</sup> The Government may also consider that even multi-billion compensation payouts to PMA, and even other tobacco companies like BAT which have also reportedly considered filing legal action against the legislation, are economically justified in the long-term anyway. After all, Australia's entire tobacco market was worth \$10.4 billion in 2009, while the health costs from smoking are thought to amount to \$30 billion.<sup>19</sup>

### ***Further Practical Implications***

Should arbitration formally commence after 27 September 2011, if PMA and Australia cannot agree otherwise the procedure shall follow UNCITRAL Arbitration Rules "as then in force". This means the 2010 version of those Rules (see Art 1), recently agreed by the United Nations. This version has been praised for many significant improvements compared to the original 1976 Rules.<sup>20</sup> However, because Hong Kong is still not a member of the World Bank / ICSID family, treaties like this one with Australia do not provide for ICSID Arbitration Rules. The 2006 revisions of the ICSID Rules, in particular, offer greater transparency compared to the UNCITRAL Arbitration Rules, including public notifications about important steps in the proceedings through the ICSID website.<sup>21</sup>

Nonetheless, the Hong Kong treaty (Art 10) allows for PMA and Australia to agree in writing to modify the UNCITRAL Rules. It may be in PMA's short-term interest to agree to greater transparency in the arbitral proceedings, if its strategy is really to seek a negotiated settlement about the scope or timing of the plain packaging legislation.

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[http://blogs.usyd.edu.au/japaneselaw/2011/08/repercussions\\_of\\_australias\\_to.html](http://blogs.usyd.edu.au/japaneselaw/2011/08/repercussions_of_australias_to.html) (both accessed 21 September 2011).

<sup>17</sup> Lester T, "Tobacco Shortage Fear", *The Sydney Morning Herald* (online), 5 August 2011 <http://www.smh.com.au/national/tobacco-shortage-fear-20110804-1idh4.html> (accessed 9 August 2011).

<sup>18</sup> See also eg "Roxon introduces plain packaging bill", *ABC News* (online), 6 July 06 <http://www.abc.net.au/news/2011-07-06/roxon-introduces-plain-packaging-bill/2784492> (accessed 31 July 2011); Atkins D, "Radical Roxon is one to watch", *Courier Mail* (online), 7 July 2011 <http://www.canberratimes.com.au/news/opinion/editorial/general/plain-packaging-is-a-start-more-needs-to-be-done/2230749.aspx> (accessed 31 July 2011).

<sup>19</sup> Bryant N, "Big Tobacco takes on Australia over bland branding", *BBC News* (online), 3 July 2011, <http://www.bbc.co.uk/news/business-13986740> (accessed 31 July 2011); and Kerr C, "Trade minister blasts tobacco companies over claims government plan in breach", *The Australian* (online), 19 May 2011 <http://www.theaustralian.com.au/national-affairs/trade-minister-blasts-tobacco-companies-over-claims-government-plan-in-breach/story-fn59niix-1226058538247> (accessed 31 July 2011). It is unclear whether claims by other companies could be initiated under Australia's investment treaties. It is also unclear whether PMA will seek only compensation, or instead a "suspension" of the legislation in its case – a possibility not expressly excluded by the Hong Kong BIT: see Kurtz J, "Big Tobacco v Australia: taking the battle to the global stage", *The Conversation* (online), 27 June 2011, <http://theconversation.edu.au/big-tobacco-v-australia-taking-the-battle-to-the-global-stage-2027> (accessed 31 July 2011).

<sup>20</sup> Eg Eg Croft C and Kee C "The UNCITRAL Arbitration Rules Revision: Implications for Australia" in Nottage L and Garnett R (eds), *International Arbitration in Australia* (Federation Press, 2010) Ch 7.

<sup>21</sup> Available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=Cases\\_Home](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=Cases_Home).

Agreeing to greater transparency may also be in PMA long-term interest, namely avoiding problems when seeking to enforce and execute any favourable arbitral award against the Australian government. This possibility arises because, for instance, social psychologists have also shown that a process perceived as fairer is more likely to generate one side's compliance with an outcome, even if substantively adverse to that party.<sup>22</sup>

If the parties can agree on such changes to UNCITRAL Rules, and perhaps others such as requiring arbitrators actively to facilitate settlement throughout proceedings (“Arb-Med”), this may point the way more generally towards alternative policy initiatives by Australia (and indeed other countries) regarding ISA. Rather than throwing the baby out with the bath water and omitting ISA provisions completely, states could encourage arbitral institutions and others to develop more tailored sets of Arbitration Rules for ISA, include them in future treaties, and then require or encourage their investors to invoke those Rules in any future disputes – appealing to those firms’ short- and long-term interests, including commitments to broader Corporate Social Responsibility.

In fact, Dr Kate Miles and I proposed this in detail in a 2009 paper.<sup>23</sup> But we also mentioned that this would not preclude other reforms to the ISA system, including adding to investment treaties broader express exceptions for non-discriminatory regulation bona fide in the public interest (eg for public health purposes). These are already found in WTO Agreements, and indeed in some of Australia’s more recent FTAs and investment treaties. Future treaties may simply exclude certain products, but this is a blunter approach because treaties last often for decades, yet they are infrequently renegotiated. Experts in consumer product safety law also know how difficult and protracted it can be to establish what constitutes a socially acceptable level of safety in consumer goods. Another possibility would be to extend to safety regulation the approach taken to claims of “expropriatory taxation” under some treaties, or to subject such issues to the process now recommended under the OECD Model Tax Treaty – whereby an affected firm can at least trigger an inter-state arbitration.<sup>24</sup>

Some of these approaches to re-balancing private and public interests in the investment treaty regime, and others such as more carefully drafted definitions for “investment” or “investor”, were in fact acknowledged in the Productivity Commission’s final report last year as possible ways forward in minimising excessive “regulatory chill” on government policy-making. But in blowing even colder on ISA provisions in future treaties, this April’s Trade Policy Statement seems particularly concerned about the chill factor – reiterating concerns about possible claims by tobacco companies (and, indeed, foreign pharmaceutical companies related to the government’s PBS regime). Both sectors had been lobbying the US government to press for significant protections in the Investment Chapter being added to the Trans-Pacific Partnership (TPP) agreement, which aims to

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<sup>22</sup> Tyler T R, *Why People Obey the Law* (Princeton University Press, 2006).

<sup>23</sup> Nottage L and Miles K, “Back to the Future’ for Investor-State Arbitrations: Revising Rules in Australia and Japan to Meet Public Interests” *Sydney Law School Research Paper No. 08/62*, 2008, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1151167](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1151167) (updated as chapter 10 of my book with Professor Garnett cited above at n4).

<sup>24</sup> Burch M and Nottage L, “Novel Treaty-Based Approaches to Resolving International Investment and Tax Disputes in the Asia-Pacific Region” 18 *Australian International Law Journal* forthcoming. See also the longer book chapter version of the present paper, mentioned in the opening footnote above.

join the US and Australia with seven other partners in the first Asia-Pacific regional FTA.<sup>25</sup>

It remains to be seen whether Australia's new policy stance will prevail in the ongoing TPP negotiations, and indeed begin to unravel a growing acceptance of the ISA system in our region. PMA's claim may even result in Australia terminating and then renegotiating some of its existing investment treaties,<sup>26</sup> although apparently the Gillard Government has no such plans at present, and anyway this should not affect the protections afforded to past investments from firms based in those treaty partners. The PMA claim certainly highlights the complex practical and policy implications of consumer product safety regulation in an investment treaty and FTA era.

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<sup>25</sup> See generally Nottage L, "Asia-Pacific Regional Architecture and Consumer Product Safety Regulation for a Post-FTA Era" *Sydney Law School Research Paper No. 09/125*, 2009, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1509810](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1509810).

<sup>26</sup> Tienhaara K and Faunce T, "Gillard must repel big tobacco's latest attack", *The Canberra Times* (Online), 28 June 2011 <http://www.canberratimes.com.au/news/opinion/editorial/general/gillard-must-repel-big-tobaccos-latest-attack/2209168.aspx> (accessed 31 July 2011).