Special Report: The Big Tobacco issue

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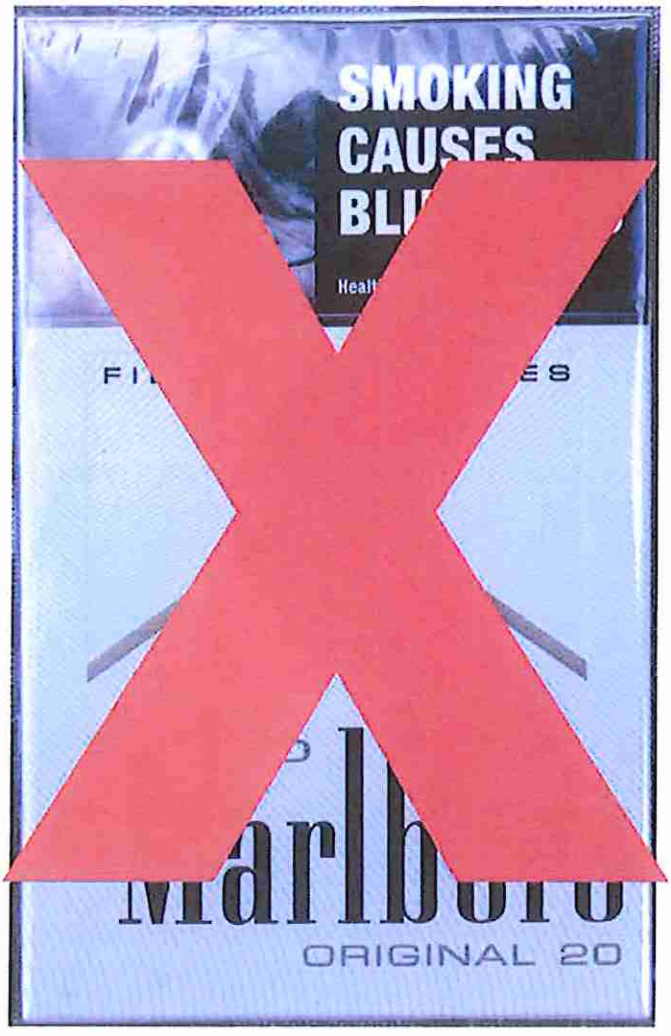
Philip Morris v Australia

Marlboro Man and the government go to arbitration over plain cigarette packaging



Australia and the Backlash against Investment Arbitration

Albert Monichino (left) and **Alex Fawke** discuss the shift in the Australian government's policy against arbitration of investment treaty disputes

One of the major developments in international law in the past century has been the rapid expansion of foreign investment law. Historically, investors had few effective legal mechanisms to protect their property in a foreign state.[1]

This changed in the 20th century with the proliferation of international investment treaties, guaranteeing foreign investors certain levels of protection.

These agreements between states, of which thousands now exist, often contain investor-state dispute settlement (ISDS) provisions. These can empower foreign investors to commence arbitration proceedings against states alleged to be in breach of their obligations.

This direct right of action was hailed as a major advance to encourage foreign investment and, alongside it, economic development.

But something has changed in recent years. Increasingly, states are rejecting ISDS in what has come to be known as the 'backlash' against investment arbitration. This began with certain developing countries, particularly in Latin America. Recently, Australia became the first developed country to announce that it would no longer include investor-state arbitration clauses in its future international investment treaties. This article briefly examines the debate surrounding that policy decision.

Australia's rejection of investor-state arbitration

The Australian Government made its announcement in April 2011 as part of its new trade policy statement.[2] While making clear that it supports the principle of national treatment (i.e. that foreign and local businesses be treated equally under law), it raised two main objections to ISDS.

First, it noted that investment treaties sometimes have the effect of conferring greater legal rights on foreign investors than local businesses, who cannot rely on the treaty protections.

Secondly, it emphasised that ISDS jeopardised Australia's ability to determine its own public policy. In particular, the Government was concerned about action against its plain-packaging legislation. This legislation is now before an arbitral tribunal following a claim by Philip Morris Asia under the Australia-Hong Kong bilateral investment treaty.[3]

The policy change drew on a report by the Productivity Commission in 2009, which concluded that there was no economic justification for Australia to include ISDS provisions in its investment treaties.[4] The Government's decision has sparked debate among business groups, academics and arbitration practitioners.

Arguments in favour of the policy change

Generally speaking, the central criticisms of ISDS are that:

- it erodes state sovereignty in key areas of public policy, such as health and environmental protection;
- it lacks democratic legitimacy in that it is presided over by a narrow and

(Continued on page 29)

Australia and the Backlash against Investment Arbitration

unaccountable group of elites;
- Arbitral Tribunals are said to be biased towards foreign investors; and
- the arbitral decisions are inconsistent, with no system of precedent.[5]

In the Australian context, supporters of the Government's policy decision have emphasised the importance of the *Philip Morris* arbitration, noting the potential threat to Australia's sovereignty over its health policy.[6]

One commentator[7] has even argued that investment arbitration 'is a direct affront to the rule of law', suggesting that the *Philip Morris* tribunal could 'overturn' the High Court's decision which rejected a challenge to the constitutional validity of the plain-packaging legislation on the basis that there was no relevant "acquisition of property" for the purposes of s.51(xxxi) of the Australian Constitution.[8] They also note that, because Australia's legal system is well regarded internationally, a lack of treaty protection will not discourage inbound investment into Australia.[9]

Further, the supporters point out that there are other options available for businesses wishing to protect their overseas investments, such as political risk insurance[10] and entering into specific contracts with the state in which they are investing.

Some of the supporters advocate that the Australian government policy should go further and terminate existing BITs containing ISDS clauses.[11]

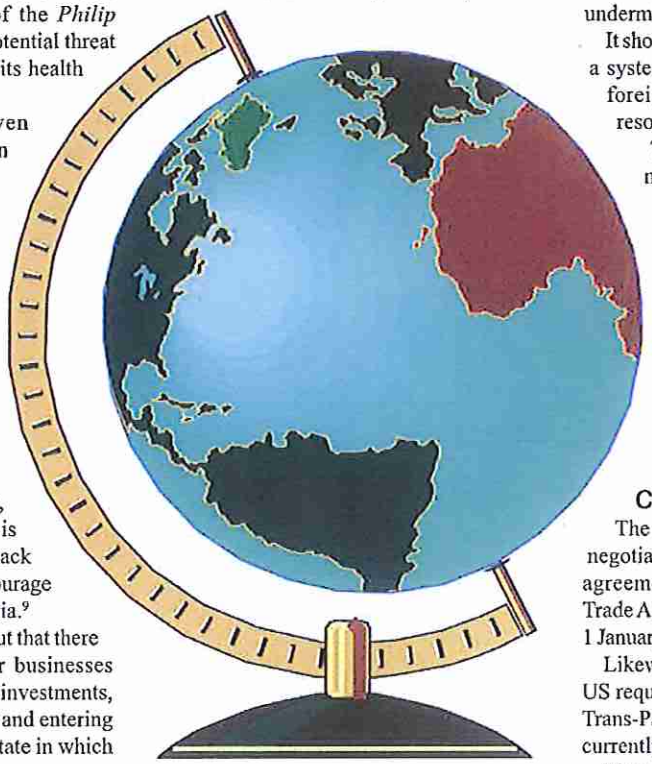
Arguments against the policy change

Opponents of the policy change include the Australian Chamber of Commerce and Industry (ACCI) and several leading arbitration practitioners and academics.[12]

This group wrote to the Prime Minister in July 2012 to express their concerns.[13] They argued that the policy change could leave Australian investors exposed without any effective legal mechanism to protect their overseas investments.

A particular worry is that Australian investors could face discrimination in less developed countries, where governments may favour domestic firms for political reasons and where the judiciary is not free from political influence. The group characterised the policy as a 'one size fits all' approach, asserting that a case by case approach would be preferable.

Without recourse to an ISDS mechanism, the usual protections contained in BITs are often illusory. The investor instead must resort to enlisting diplomatic pressure or alternatively find equivalent



remedies in the domestic law of the host state (assuming they are available).[14] The other protection options are insufficient substitutes: political risk insurance can be expensive or even impossible to obtain, and specific contractual terms are only available to those investors with strong bargaining power.

Small to medium sized Australian companies investing abroad in emerging markets in less developed legal systems will be hardest hit by the policy shift. Larger Australian companies, with greater capacity, may be able to avoid the adverse impact of Australia's new trade policy by establishing offshore vehicles to take advantage of other countries' trade treaties.[15]

In terms of attacks like that in the *Philip Morris* arbitration, Australia could protect itself by creating broad public health exceptions in future BITs.[16] It could, for example, expressly include a right to suspend particular categories of claims, such as those regarding health policy.

It is submitted that the understandable concern about the legal strategy of tobacco companies should not be misdirected at investment arbitration as a whole. In particular, the assertion that investment arbitration undermines the rule of law is misguided.

It should be recalled that, before establishing a system of international legal instruments, foreign investment disputes were often resolved by 'gunboat diplomacy'.[17]

There are valid criticisms to be made about investor-state arbitration, including issues of consistency, environmental protection and human rights.[18]

These issues should be addressed. But it should not be forgotten that investment arbitration as a whole is a peaceful way to resolve international disputes by reference to legal treaties to which states have agreed.

Conclusion

The issue remains a live one as Australia negotiates and concludes further free trade agreements. The Australia-Malaysia Free Trade Agreement, which entered into force on 1 January 2013, contains no ISDS provisions.[19]

Likewise, Australia is apparently resisting US requests to include such provisions in the Trans-Pacific Partnership Agreement (TPPA), currently being negotiated.

There is also the question whether other developed countries will follow Australia's lead and join the backlash.[20]

The immense significance of investment arbitration should not be underestimated. It forms part of the growing body of so-called 'global administrative law'.[21] It is, in a sense, the emergence of global governance. Because of its importance, the debate, both in Australia and overseas, merits further consideration and research.

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Endnotes

1. For a brief overview of the historical development of foreign investment

(Continued on page 30)

Australia and the Backlash against Investment Arbitration

(Continued from page 29)

law, see Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties* (Kluwer Law International, 2009) 1-74

2. Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity (April 2011), Department of Foreign Affairs and Trade <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html>

3. The Australian Government has set up a useful website devoted to the case: <http://www.ag.gov.au/Internationallaw/Pages/Investor-State-Arbitration---Tobacco-Plain-Packaging.aspx>

4. See Productivity Commission, Bilateral and Regional Trade Agreements: Research report (13 December 2010) < http://www.pc.gov.au/projects/study/trade-agreements>.

5. One of the most frequent critics is the International Institute for Sustainable Development. Their useful (if somewhat one-sided) website can be found at: <www.iisd.org>

6, See Kyla Tienhaara, 'ACCI's right to sue campaign not supported by the facts', *The Conversation* (online), 13 August 2012, <http://theconversation.edu.au/accis-right-to-sue-campaign-not-supported-by-the-facts-8800>. See also the comments by Minister for Trade, Dr Craig Emerson MP, in Geoff Kitney, 'Business push for sovereign risk protection', *The Australian Financial Review*, 9 August 2012, 12.

7, See Thomas Faunce, 'An affront to the rule of law: international tribunals to decide on plain packaging', *The Conversation* (online) 29 August 2012, <http://theconversation.edu.au/an-affront-to-the-rule-of-law-international-tribunals-to-decide-on-plain-packaging-8968>.

8. *JT International SA v Commonwealth; British American Tobacco Australasia Ltd v Commonwealth* [2012] HCA 43.

9. The Economist adhered to this view in an article earlier this year. See 'Foreign investment dispute: Come and get me', *The Economist*, 18 February 2012, 38-40.

10. See Raymond Doak Bishop, James Crawford et al., *Foreign Investment Disputes* (Kluwer Law International, 2005), 491-622.

11. See Kyla Tienhaara, 'ACCI's right to sue campaign not supported by the facts', *The Conversation* (online), 13 August 2012, <http://theconversation.edu.au/accis-right-to-sue-campaign-not-supported-by-the-facts-8800>

12. See for example, Jürgen Kurtz, Australia's Rejection of Investor-State Arbitration: Causation, Omission and Implication" (2012) ICSID Review, Vol 27, No 1 pgs 65-86.

13. See Australian Chamber of Commerce and Industry, Letter to The Hon Julia Gillard MP, 13 July 2012, <http://acci.asn.au/getattachment/3061e3f7-017c-49e4-8f67-53353e02e48f/ISDS-Letter-to-PM_COMPLETE_16072012.aspx>. See also Geoff Kitney, 'Business push for sovereign risk protection', The Australian Financial Review, 9 August 2012, 12.

14. In the Phillip Morris context, "acquisition" (under the Australian Constitution) is different to "expropriation" and "fair and equal treatment" (which are among the relevant subject matters of the protection offered in the HK-Australia BIT).

15. Dutch companies, for example, benefit from a wide range of treaty protections when investing overseas. See Chris Merritt, 'Change in treaty policy detrimental to Aussie companies: Clifford Chance', *The Australian*, 7 March 2013, 29.

16, As in the Australia-Chile Free Trade Agreement, signed 30 July 2008, [2009] ATS 6 (entered into force 6 March 2009), art 3(b).

17. For example, when Venezuela defaulted on its sovereign debt in 1902, several European states sent warships to Venezuela, demanding that their citizens be repaid. See Nigel Blackaby, Constantine Partasides et al., *Redfern and Hunter on International Arbitration* (Oxford University Press, 5th edition, 2009) 465.

18. See Sundaresh Menon SC, *'International Arbitration: The Coming of a New Age for Asia (and Elsewhere)'*, ICCA Congress 2012, Singapore, <http://www.arbitration-icca.org/media/0/13398435632250/ags_opening_speech_icca_congress_2012.pdf> at 6-10. Of particular concern is that developing countries may be threatened with arbitration against legitimate regulatory proposals, leading to 'regulatory chill'. See Luke Eric Peterson & Kevin R. Gray, *International Human Rights in Bilateral Investment Treaties and Investment Treaty Arbitration* (April 2003), International Institute for Sustainable Development < http://www.iisd.org/pdf/2003/investment_int_human_rights_bits.pdf>

19. See the Malaysia-Australia Free Trade Agreement, signed 22 May 2012, [2011] ATNIF (entered into force 1 January 2013).

20. Leon E. Trakman, 'Investor State Arbitration or Local Courts: Will Australia Set a New Trend?' (2012) 46 *Journal of World Trade* 83.

21. For a discussion of investor-state arbitration in the context of the emergence of "global administrative law", see Gus Van Harten and Martin Loughlin, "Investment Treaty Arbitration as a Species of Global Administrative Law" (2006) 17(1) European Journal of International Law 121. A useful source providing a range of research on global administrative law can be found at: http://www.iilj.org/GAL/