Assessing the Risk of an International Investment Law Claim Against a Tobacco Control Measure

This paper gives a basic introduction on how an assessment of risk can be undertaken. It should not substitute for a detailed analysis of a country's specific situation nor for formal legal advice from lawyers with expertise in International Investment Law. For more information and technical assistance contact Robert Eckford at reckford@tobaccofreekids.org .

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Introduction and Background

There have been only two international investment law challenges to tobacco control laws. The first against Uruguay and the second against Australia, both of which were dismissed with the claimant, Philip Morris, being ordered to pay the governments' legal costs. Legitimate, non-discriminatory tobacco control measures, especially those based on the WHO Framework Convention on Tobacco Control (FCTC) and its implementing guidelines, should not breach the terms of a country's International Investment Treaties (IITs).

However, the big transnational tobacco companies have been using threats and allegations for decades that certain tobacco control measures breach countries' obligations under IITs. The companies have been shown to have a coordinated strategy of deleratelyre-framing the arguments away from public health and towards flawed international law concerns.

It is helpful for government health officials to be aware of these issues because tobacco companies can seek to delay and prevent proposed tobacco control laws by alleging that they breach international obligations. As this paper shows, these allegations should be resisted. In addition, there are four key actions that governments can take to minimise the risk of a claim:

i. **Be clear as to the objectives for the tobacco control measure and that it is in furtherance of the principles and objectives of the WHO FCTC.** The FCTC is an evidence based international treaty and countries can rely on this to justify their policies. This does not preclude novel measures that go beyond the recommendations of WHO FCTC and its guidelines but any such measure may require further evidence to demonstrate its likely impact on reducing tobacco use, as well as consultation with stakeholders.

ii. **Ensure that no part of government enters into an agreement, gives guarantees or makes representations that encourage or induce investment from tobacco companies by indicating that stricter tobacco control regulations will not be introduced**. Any such representation, could lead to a claim of 'legitimate expectation' that the investment would be protected from an adverse regulatory environment.

iii. **Follow appropriate national constitutional and administrative due processes** carefully when adopting a tobacco control measure (especially those identified below) and keep a good record of the processes. Failure to follow due process can lead to a claim that the government did not provide a tobacco company investor with 'fair and equitable treatment', as guaranteed by many IITs. Ideally, these processes will involve some form of review or consultation with stakeholders.

iv. **Ensure that the measure is applied in a non-discriminatory way.** This means applying the measure to tobacco products irrespective of where they originate from (so that, for instance, domestic production is not favoured). It also means applying a measure to all product types, or where a measure is not applied to a particular product type ensuring there are good regulatory reasons for that decision.

The tobacco companies have so far either *brought or threatened* investment law challenges against measures that severely restrict their use of trademarks such as large health warnings, plain packaging or Uruguay's single presentation requirement. Product bans have at times also led to allegations that they breach international laws (but no claims have been made so far). The companies have generally not pursued investment law arguments against smoke-free laws, general advertising bans and selling retrictions such as point of sale display bans.

For the purposes of this paper, the following measures are considered:

i. Plain packaging of tobacco products;
ii. Picture health warnings of 70% or more on the principle surfaces;
iii. A ban on characterizing flavors of all tobacco products;
iv. A ban on particular tobacco products such as snus, e-cigarettes or heated tobacco products;

In the unlikely event that a claim does arise, there is international technical and legal support available to assist lower- and middle-income countries, including financial support through the Bloomberg/Gates Anti-Tobacco Trade Litigation Fund (see below).

Tobacco Company Legal Challenges Under Investment Treaties

The two international challenges to tobacco control measures brought by Philip Morris under investment treaties were:

> ***Philip Morris v Uruguay***: [1] The first was a claim against Uruguay under its Bilateral Investment Treaty (BIT) with Switzerland, in which Philip Morris challenged Uruguay's 80% Picture Health Warnings and its Single Presentation Requirement (that limited brands to a single variant, so preventing health reassurance brands). This case was commenced in 2010 and the tribunal panel gave its ruling, dismissing the claim on all grounds in July 2016. The tribunal's award emphasised the importance of the WHO FCTC in setting tobacco control objectives and establishing the evidence base for measures. It confirmed that states have a wide discretion in adopting measures for public health.
>
> The ruling set a high bar for any future investment treaty claim against a non-discriminatory tobacco control measure taken in good faith.
>
> ***Philip Morris v Australia***:[2] The second claim was made by Philip Morris against Australia's plain packaging laws. It was commenced in 2011 and was dismissed on jurisdictional grounds in December 2015. The tribunal found that Philip Morris had transferred ownership of the shares in its Australian operation to a subsidiary based in Hong Kong for the sole purpose of taking advantage of the Australia/Hong Kong Bilateral Investment Treaty to bring a claim against the plain packaging laws. The tribunal held that this was 'an abuse of rights', denied the claim and awarded legal costs against Philip Morris.
>
> This case was therefore dealt with on a jurisdictional point of law and the tribunal did not consider whether plain packaging breached the IIT obligations and protections. But this case will prevent the transnational tobacco companies from shifting ownership of their subsidiaries in order to shop around for a treaty to use.

The time and cost of international investment law claims can be beyond the resources of some lower-middle-income countries. These two claims lasted 6 and 4 years respectively and the legal costs alone amounted to many millions of dollars. The two cases led to significant 'regulatory chill' that delayed and prevented other governments from adopting strong tobacco control laws because of concerns that the tobacco industry would bring further claims. Even the threat of a possible claim can be sufficient to deter a government considering tobacco control measures. (In the end, Philip Morris was ordered to pay the legal costs of Uruguay and Australia. For Uruguay this was $7million and for Australia the costs are reported to be considerably more).

The two claims also led to a significant political backlash against the tobacco industry from public health advocates, politicians and parts of the business community that felt the tobacco industry was abusing the international investment regime to oppose genuine public health measures; measures that the system was not intended to adjudicate on.

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[1] The ruling is available here: https://www.italaw.com/cases/460 . A summary of the ruling is available here: https://www.tobaccofreekids.org/assets/content/press_office/2016/2016_07_12_uruguay_factsheet.pdf

[2] The ruling is available here: https://www.italaw.com/cases/851

What are International Investment Treaties?

IITs are treaties where two or more states agree to provide the private companies located in the other state or states to the agreement with legal protections and security if they choose to directly invest into the host nation. The intention behind IITs is to encourage more direct private foreign investment. Most IITs are bilateral (between two states) but in recent years, investment protections often form one part of wider Free Trade Agreements. There are over 3000 IITs worldwide and most countries have committed to these protections with at least some of their trading partners.

There are two key relevant protections given to foreign investors within most IITs:

i. **No expropriation of property** - this provision protects foreign investments from being taken by a government except by the rule of law and with full compensation. It includes *indirect* expropriation where the title to the property is not affected but a new regulation or measure deprives the investor of the use of their investment or effectively removes all its value. Intellectual property is covered by this clause. The tobacco companies claim that strong packaging requirements amount to an indirect expropriation of their trademarks and other intellectual property.

   These argument were rejected by the investment tribunal in *Philip Morris v Uruguay*. The tribunal confirmed that states have a sovereign right to regulate in the public interest which means that non-discriminatory measures in furtherance of a public health objective and adopted in good faith, are not expropriations.

ii. **Fair and equitable treatment (FET)** – this provision guarantees that the state will provide a minimum standard of process when adopting regulations or laws that affect the foreign investments. The tobacco companies have argued that a state breaches this requirement because a tobacco control measure:

   - is 'arbitrary' or without evidence;
   - that it violates their 'legitimate expectations'; or
   - that it was adopted without proper due process.

   These arguments were rejected in the *Philip Morris v Uruguay* case, and the tribunal relied heavily on the fact that the tobacco control measures were based on the WHO FCTC, which is an evidence based treaty. The tribunal found that countries which implement the WHO FCTC in good faith and on a non-discriminatory basis are not acting 'arbitrarily'. The tribunal also confirmed that investors in heavily regulated areas, or who make products known to be harmful, cannot legitimately expect to be free from increased regulation.

   However, investors can still have legitimate expectations if a host state makes specific commitments or representations to them that induce or encourage invesetment by a tobacco company. It is therefore important that all government officials avoid making any representations to tobacco companies that the government will refrain from adopting stricter tobacco control regulations as this could generate an actionable 'legitimate expectation' on the

part of the company that it could operate in the country without further adverse regulations being introduced.
The tobacco industry regularly make unjustified claims that a government has failed to follow a fair or constitutional process in adopting tobacco control laws. Their complaints are usually that the government failed to consider all the relevant evidence and issues, or that the government failed to consult with the tobacco companies that would be affected by the proposed law. These claims are often made as part of legal challenges before national courts but have also formed part of the grounds of challenge in the two investment law claims.

However, investment law is clear that the tribunals are not a means of appeal from national courts. It is recognised that each country has its own constitutional and administrative procedures. Previous tribunal rulings indicate that a state has to show "*a wilful disregard of due process of law*" or that there must be "*the absence of legitimate purpose, capriciousness, bad faith, or a serious lack of due process*", for there to be a breach of the FET clause.

In *Philip Morris v Uruguay*, one of the panel of three arbitrators gave a dissenting opinion stating that in his view there was no record that Uruguay had properly considered the relevant evidence and issues before adopting the Single Presentation Requirement, and this contributed to his finding that Uruguay had acted 'arbitrarily' and breached the fair and equitable treatment obligation. The majority of the panel did not agree with this view, however, it is a reminder that public health measures are more robust if a government makes a record of the justifying evidence and rationale for the measure.

Investor-State Dispute Settlement

Most IITs contain a dispute settlement clause which allows a foreign investor from one state to bring a claim against a host state where the investor believes that state has violated the investment protections under the IIT. These are called Investor-State Dispute Settlement clauses or ISDS. The case is heard by an ad-hoc tribunal of arbitrators who will issue a binding judgement. There is no centralised set of procedures or court system for these disputes and the arbitrators are appointed by the state and the investor involved in the dispute. If the arbitrators find there has been a breach of the IIT obligations then the usual remedy is to award compensation which can amount to many millions of dollars.

The Bloomberg/Gates Anti-Tobacco Trade Litigation Fund

The political condemnation of the Philip Morris claims, and the 'regulatory chill' they created led to the Bloomberg Philanthropies and the Gates Foundation setting up the Anti-Tobacco Trade Litigation Fund in March 2015. This is a $US 4 million fund to provide technical and financial assistance to lower- and middle-income countries that face international trade and investment claims, or threats of suit from the tobacco industry. The Campaign for Tobacco-Free Kids is responsible for managing the fund. More information is available here:

https://www.tobaccofreekids.org/what-we-do/global/legal/trade-litigation-fund

Assessing the Risk of an Investment Law Claim

There have been no further claims under IITs against tobacco control measures initiated since 2012. There are likely to be several reasons for this. Firstly, the ruling in the Uruguay case sets a very high legal bar for claims against legitimate public health measures. Secondly, the significant backlash experienced by the tobacco industry as a result of Philip Morris' two claims is likely to deter future investment challenges to tobacco control measures. Thirdly, Uruguay received significant international support (both technical and financial), now formalised under the Anti-Tobacco Trade Litigation Fund, meaning the tobacco companies will find it harder to intimidate lower- or middle-income countries with threats of this type of legal claim.

While the risk of a future claim is therefore limited, it cannot be ruled out and should be taken into consideration. The tobacco companies also regularly allege breaches of international obligations that a government may need to respond to. This paper considers the international investment law risk in relation to tobacco control measures in the following way:

1. Identify the tobacco companies that are foreign investors in a country;
2. Identify the country's investment treaties and assess whether these provide the relevant tobacco companies with foreign investment protections; and
3. Apply the investment law principles to the proposed tobacco control measures.

The first two steps are possible ways to understand whether a risk of an investment claim can be excluded entirely.

An investment treaty claim can *only* be made by a tobacco company against a government if the company is a foreign investor into that country, *and* there is an investment treaty between the country that has adopted the tobacco control measure and the country where the parent tobacco company or 'foregn investor' is located.

Step 1. Identify Tobacco Companies That Act As Foreign Investors

The first step of the assessment is understanding whether a tobacco company acts as a foreign investor into a country or host nation.

The big four tobacco companies - Japan Tobacco International, Philip Morris International, British American Tobacco and Imperial Tobacco - are transnational corporations with subsidiaries and affiliated companies throughout the world.

For instance[3]:

- **Japan Tobacco Group** has companies incorporated in 70 different countries throughout Africa, the Americas, Asia, Europe and the Middle East. Ownership of those subsidiaries may be held by one of its main operating companies for instance 'JT International Group Holding B.V.' - which is incorporated in the Netherlands; or 'JT International S.A.' - which is incorporated in Switzerland.

[3] Information is available from the tobacco companies' annual reports.

- **Philip Morris International** is incorporated in Virginia, U.S., headquartered in New York, U.S., and has its operations center in Lausanne, Switzerland. PMI has subsidiary companies registered in 33 countries and distributes its products to over 180 countries.
- **British American Tobacco Plc.** is incorporated in the United Kingdom and is headquartered in London. BAT and has subsidiary companies in over 115 countries worldwide.
- **Imperial Brands, Plc.** is the fourth largest publicly traded international tobacco company globally. Imperial Brands is incorporated in the United Kingdom and headquartered in London. It has wholly or partly owned subsidiaries in over 64 countries.

Ownership of these subsidiaries and affiliated companies will likely rest with the parent company or their main operating companies and it is therefore likely that these corporations act as foreign investors in most countries in which they operate or have subsidiaries.

While the detailed structures of the these transnational corporations are not public, it is reasonable to assume that their foreign investments are largely held by companies located in either Switzerland, the Netherlands, the United States or the United Kingdom.

Step 2. Identify Relevant International Investment Treaties

The next step in assessing whether there is the potential for a claim is to see what investment treaties a country has. This is straight forward as there is a database of all treaties. The United Nations Conference on Trade and Development (UNCTAD) hosts an Investment Policy Hub website:

http://investmentpolicyhub.unctad.org/IIT.

The UNCTAD site allows any user to select any country from the map to display information on that country's BITs and other multilateral IITs, whether they are in force and what countries they are with; and it provides copies of the text where available.

The countries with the highest number of investment agreements, especially bilateral investment agreements are:

- Switzerland (99 Bilateral Investment Treaties in force)
- The United Kingdom (95 Bilateral Investment Treaties in force)
- The Netherlands (90 Bilateral Investment Treaties in force)

Steps 1 and 2 demonstrate that for many countries, one or more of the tobacco companies will be a foreign investor and there is a reasonable possibility that there will be a relevant IIT between the host country and the country where the tobacco company holds the investment. But this will not always be the case so it is possible to exclude the risk of any claim being made in some instances. Box 1 gives examples:

BOX 1*

The Philipines: Japan Tobacco has subsidiary companies in the Philipines. Ownership of those companies is likely to be held by one of JTG's operating companies that are located in Netherlands, Switzerland and the United Kingdom.

The Philipines has 31 Bilateral Investment Treaties in force including ones with the Netherlands, Switzerland and the United Kingdom.

Those tobacco companies *may* therefore have **sufficient standing to bring a claim** (which does not mean there would be good prospects for such a claim – see STEP 3)

South Africa: Japan Tobacco, Imperial Tobacco and Brisith American Tobacco have subsidiary companies in South Africa. Ownership of those companies is likely to be held by the operating companies that are located in Netherlands, Switzerland and the United Kingdom.

South Africa has 14 Bilateral Investment Treaties in force, however, it does not have one with the United States and its investment treaties with Netherlands, Swizerland and the UK have been terminated. Therefore the risk of a claim being possible from one of the big four tobacco companies is **limited**.

Ireland: Japan Tobacco and British American Tobacco have subsidatry companies in Ireland.

However, Ireland has no Bilateral Investment Treaties. Therefore the risk of any investment treaty claim can be **eliminated**.

*This box is only intended to demonstrate the principles of steps 1 and 2 and should not be relied upon as a full assessment of risk for these countries.

Step 3. Apply Investment Law Principles to Tobacco Control Measures.

The following factors can be taken into account when applying investment law principles to a tobacco control measure, when assessing the risk of an investment treaty claim being made:

1 Is the measure consistent with the government's publicly stated progressive approach to tobacco control? Have the public health objectives of the measure been clearly stated?

2 Is the country a party to the WHO FCTC and is the measures in furtherance of its obligations under that treaty;

3 Is the measure applied to all tobacco products irrespective of where they originate from? Could it be claimed that the measure is really intended to favour domestically produced tobacco products? In other words is the measure discriminatory.

4 Is the measure one that a number of other countries have already adopted without any IIT challenges or is it completely novel measure? Or…

5 Has the measure been successfully defended in a previous IIT claim. The *Philip Morris v Uruguay* case dismissed a challenge to Uruguay's 80% picture health warnings and single presentation requirement.

6 Taking into account government's administrative and parliamentary processes in adopting the law or measure, could it be said that the government has acted arbitrarily or with a "a wilful disregard of due process of law"? In the case of a completely novel measure, this may require more evidence to be considered together with some consultation with stakeholders. It is important for there to be a good record kept of the government processes.

7 Has any part of government given any guarantee or made any representation that could have induced a tobacco company to have make or increase its investment into the countr by stating that no further regulatory restrictions on tobacco or nicotine products would be made? If there is any suggestion that such representations had been made, this could materially increase the risk of a challenge being made.

If the answers to questions 1-5 are YES, and the answers to questions 6 and 7 are NO, then the risks of a claim being made under an IIT are limited, and if one is brought then the prospects of defending the claim should be good.

The tobacco control measures that the tobacco companies generally allege may be in breach of IITs:

i. Plain packaging of tobacco products;
ii. Picture health warnings of 70% or more on the principle surfaces;
iii. A ban on characterizing flavors of all tobacco products;
iv. A ban on particular tobacco products such snus, e-cigarettes or heated tobacco products;

are all in furtherance of obligations or recommendations in the WHO FCTC and its implementing guidelines. There is good evidence to support these measures being effective as part of a comprehensive tobacco control strategy.

Provided that the measures are applied to products irrespective of where they originate from, the measures should be considered as legitimate, non-discriminatory public health measures taken in good faith. As such they would not be seen as an 'indirect expropriation' of the companies' investments under the relevant IITs.

It is also relevant to note that these measures are increasingly common across the globe – and there have only been 2 claims under IITs challenging tobacco control measures. Plain packaging laws have been adopted by eight (8) countries and many more are in the process of considering draft laws. Thirteen (13) countries have already implemented picture health warnings that are 70% or greater in size. Thirty-nine (39) countries have adopted bans on flavored tobacco products. Shisha is banned in 3 countries in Africa alone. E-cigarettes are prohibited in 36 countries and heated tobacco products are prohibited in those countries that automatically prevent new tobacco products entering the market.

- *Products not on the market*

Shisha, electronic cigarettes, heated tobacco products and flavored tobacco products may or may not already be sold in a particular country. If a product is not already on the market, then banning its production or sale in a country will not involve any interference with an exisiting investment by a foreign investor. An investment law claim must rely on the loss of an actual investment or a substantial proportion of its investment. Banning products that are not already an a market is highly unlikely to impact on an existing investment.

- *Novel and 'reduced risk' products*

The big tobacco companies have invested heavily in what they call 'reduced risk products'. These include heated tobacco products such as Philip Morris' IQOS system and BAT's GLO system. The companies claim that these products are significantly less harmful that traditional combustable tobacco products like cigarettes. The companies' marketing and statements to governments also make it clear that they are trying to ensure that the strict regulations imposed on traditional tobacco products do not apply to these new products so that, for instance, they can advertise them or package them without health warnings.

There is very limited evidence on the health impacts of these new products and most of the research that exists has been funded by the tobacco companies. Many countries are considering taking a sensible cautious approach and either regulating them in the same way as cigarettes, or even banning them completely to avoid attracting new, young users to nicotine addiction. Both these approaches are fully justified and consistent with the principles of the WHO FCTC.

However, there is a real risk that the tobacco companies will bring legal challenges to measures that severly restrict or prohibit these novel products to try to protect their investments. A claim under an IIT could be one type of challenge the tobacco companies will consider. But this should not deter governments from taking strong action to protect public health.

Conclusion

An analysis of international investment law principles indicates that in most circumstances, an investment law claim against a tobacco control measure that is in furtherance of WHO FCTC obligations is unlikely to succeed. The *Philip Morris v Uruguay* case provides strong confirmation of this assessment. The widespread condemnation of Philip Morris' previous investment law claims from politicians and the business community also reduces the risk of a tobacco company bringing new claims.

But the tobacco companies continue to allege that strong packaging and labelling laws breach IIT rules and obligations and these allegations can impact on decision makers in governments. The tobacco companies may start to make similar arguments to try to oppose strong regulations proposed for novel tobacco products. A basic understanding of the issues can assist government officials in health ministries in making the case that these allegations should not delay the progress of strong tobacco control laws. If an assessment raises any concerns then detailed legal advice should be obtained from investment law experts.