The Philip Morris Cigarette Packaging Investment Disputes:  
International Investment Arbitral Tribunals as  
Unexpected Defenders of National Regulatory Powers

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Investor-state arbitration is a dispute settlement procedure found in the North American Free Trade Agreement (NAFTA), the Trans-Pacific Partnership (TPP) from which President Trump has withdrawn the United States, and other international trade and international investment agreements. The procedure allows an aggrieved foreign company to sue a government in a three-member international arbitral tribunal for specified violations of international trade and investment agreements. Critics or skeptics of investor-state arbitration sometimes express the view that it represents a corporate giveaway threatening to undermine important areas of national government regulation such as protection of public health and the environment. ¹

This paper examines the recent decisions in two controversial international investment arbitrations: the tobacco company Philip Morris’s challenges against laws in Australia and Uruguay that regulate and restrict cigarette packaging. ² Major newspapers such as the New York Times discussed the cases before they were decided, but have not reported on the outcomes. The decisions are nevertheless of great general interest because, contrary to the stereotype, the international arbitral tribunals categorically rejected Philip Morris’s claims. They shielded the national governments from liability and affirmed government power to enact laws that governments consider necessary to protect public health.

¹ See, e.g., Editorial, This Time Get Trade Right, New York Times, Apr. 20, 2014, at SR10 (citing Philip Morris’s investor-state case against Australia’s cigarette packaging law as an example of “giv[ing] investors unnecessary powers to sue foreign governments over policies they dislike, including health and environmental regulations”); Joseph Stiglitz, On the Wrong Side of Globalization, New York Times, Mar. 16, 2014, at SR12 (citing Philip Morris’s investor-state case against Uruguay’s cigarette packaging law as an example of the undesirability of international investment tribunals and stating that “trade agreements are being used … to undermine environmental and other regulations”); Letter from Jim Shultz (NGO Spokesperson), New York Times, May 22, 2015, at A26 (criticizing Philip Morris’s case against Uruguay as an example of “hand[ing] foreign corporations … new power to [challenge] political action taken to protect public health and safety”); Elizabeth Warren, A trade deal’s corporate giveaway, MetroWest Daily News, March 1, 2015 [previously published in the Washington Post] (criticizing Philip Morris’s case against Uruguay and urging that “progressives should oppose [investor-state dispute settlement] because it would allow big multinationals to weaken labor and environmental rules”).

² Philip Morris Brands v. Uruguay, ICSID Case No. ARB/10/7 (Int’l Center for Settlement of Investment Disputes July 8, 2016); Philip Morris Asia Ltd. v. Australia, PCA Case 2012-12 (Permanent Court of Arbitration Dec. 17, 2015).

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General Observations on Investor-State Arbitration

This paper is not intended to provide a comprehensive examination of the policy issues in investor-state arbitration. Instead, it offers two observations as background. First, some critics say that investor-state arbitration "enable[s] foreign companies to sue governments for alleged losses of potential profits." This is an oversimplification that omits a crucial element. Foreign companies can only sue a government if the company’s economic loss is the result of the government's breach of specified legal obligations under international trade and investment agreements. The most important legal obligations in investment disputes are a prohibition on government expropriation or nationalization of property without just compensation, a prohibition on denial of basic procedural fairness in government decisions, and a prohibition on government discrimination against foreign companies.

Second, contemporary investor-state arbitration is built on a long history of international adjudication in the international law of government responsibility for injuries to foreign nationals and companies. In the early 1920s, the predecessor of the UN's International Court of Justice confirmed that an investment dispute between a foreign business and a host government over an alleged breach of international legal obligations presents a question of international law that is appropriate for an international tribunal to adjudicate. A significant difference between the historical practice and the contemporary procedure and is that, historically, the aggrieved company's home government had to bring a suit on behalf of the company in a state-to-state proceeding against the host government. The contemporary procedure lets the aggrieved company sue in its own name. In the United States, the contemporary procedure originates in the U.S.-Iran Claims Tribunal that heard economic injury claims between the two countries arising from the 1979 Iranian Revolution. Under the rules of the Tribunal, the U.S. State Department represented small claimants seeking less than $250,000, but large claimants presented their own claims to the Tribunal. This approach reflected the idea that big companies with lots of money at stake could afford to hire their own lawyers and should not be represented by State Department lawyers at taxpayers' expense.

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3 Letter from Toby Sanger (Labor Union Spokesperson), The Economist, Oct. 29, 2016, at 16; see Judith Resnick et al., Letter to Congressional Leaders (April 30, 2015), published on line by Reader Supported News [readersupportednews.org] (stating that it allows companies’ claims where “certain government actions diminish the value of their investments.”); Joseph Stiglitz, On the Wrong Side of Globalization, supra note 1, (“it allows corporations to seek restitution … for alleged diminution of their potential profits as a result of regulation”); Letter from Jim Shultz (NGO Spokesperson), supra note 1 (they “give foreign companies the right to sue … countries in international … tribunals any time the wheels of policy turn in ways they do not like”).

4 E.g., NAFTA, art. 1116 (allowing an investor to sue before an international arbitration tribunal if a host state “has breached an obligation under [specified provisions of NAFTA] … and … the investor has incurred loss or damage by reason of, or arising out of, that breach.”); cf. Restatement (Third) of U.S. Foreign Relations Law § 711 (stating the customary international law that a “state is responsible under international law for injury to a foreign national caused by an official act or omission that violates … a right to property or another economic interest that under international law, a state is obligated to respect for persons, natural or [juridical], of foreign nationality …”).

5 E.g., NAFTA, arts. 1102, 1105 & 1110 (setting out obligations of “national treatment” or non-discrimination, “fair and equitable treatment” or procedural fairness and related principles, and compensation for a direct or indirect expropriation or nationalization or a measure tantamount to expropriation or nationalization); cf. Restatement (Third) of U.S. Foreign Relations Law § 712 (stating the customary international law that a “state is responsible under international law for injury resulting from … a taking by the state of the property of a national of another state that … is not accompanied by provision for just compensation” or “other arbitrary or discriminatory acts or omissions by the state that impair property or other economic interests of a national of another state.”). In NAFTA article 1110, the reference to “indirect” expropriation and a measure “tantamount to” expropriation corresponds approximately to what U.S. constitutional law calls “regulatory takings.” E.g., Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1019 [1992] (holding that a regulatory taking occurs when government regulation forces “the owner of real property … to sacrifice all economically beneficial uses [of the property] …, that is, to leave the property economically idle ….”); cf. Metalclad Corp. v. Mexico, 40 I.L.M. 36 [NAFTA 2001] (finding in an international investment dispute that a company’s damages “involve the complete frustration of the operation of the [enterprise] and negate the possibility of any meaningful return on [the company’s] investment,” and that “[i]n other words, [the company] completely lost its investment.”).

6 See generally ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 467-591 (2d ed. 2008) [surveying the evolution of international investment law and investment disputes since the early twentieth century]; RESTATEMENT (THIRD) OF U.S. FOREIGN RELATIONS LAW §§ 711-713 & Comments (1987) [discussing state responsibility for injuries to nationals of other states].

7 Case of the Marrommati Palestine Concessions [Greece v. Great Britain], Series A – No. 2 (Permanent Court of Int’l Justice 1924).

8 See Restatement (Third) of U.S. Foreign Relations Law § 713.

9 E.g., NAFTA, art. 1116.

10 Declaration of Algeria concerning Settlement of Claims by the United States and the Islamic Republic of Iran, art. III, para. 3, initialed on Jan. 19, 1981, reprinted in 20 Int’l Legal Mat. 230, 231 (“Claims of the nationals of the United States and Iran that are within the scope of this agreement shall be presented to the Tribunal either by the claimants themselves or, in the case of claims of less than $250,000, by the Government of such national.”).
Overview of Philip Morris’s Cigarette Packaging Cases

Philip Morris’s main claim in its cases against Australia and Uruguay was that the two host countries indirectly expropriated the company’s trademarks. This was because the countries prohibited or limited the use of Philip Morris brand names and logos on cigarette packaging. Australia’s plain packaging law completely prohibited the use of brand names and required generic packaging with very explicit depictions of the health risks of smoking. Uruguay’s regulation prohibited the use of variations on the company’s primary trademark. The regulation allowed, for example, one variation on Marlboro; the company chose Marlboro Red and had to give up the variations Marlboro Blue, Marlboro Light, and Marlboro Fresh Mint. In total, the regulation stopped Philip Morris from using seven of its thirteen trademarks in Uruguay. Prohibiting the use of a trademark was, according to the company, an indirect expropriation of the trademark because a trademark’s only value comes from using it. Philip Morris also challenged a second regulation in Uruguay that required the health warning to occupy 80 percent of the cigarette package, leaving 20 percent for the brand name and logo.

A separate Philip Morris claim, at least against Uruguay, was that the cigarette packaging regulations were arbitrary and illegal because they were not supported by evidence showing that restricting brand names on cigarette packaging actually contributed to a reduction in smoking.

Philip Morris’s claims seem to raise significant legal questions, and on their face the claims do not appear to be frivolous or without legal support. The two countries’ measures plainly had the effect of depriving Philip Morris of the use of any trademarks on its packaging in Australia and the use of seven of its thirteen trademarks on its packaging in Uruguay. But when the cases came before international investment arbitral tribunals, the tribunals exercised great deference in favor of the national governments. In both cases, the tribunals went out of their way to recognize implied government defenses that utterly defeated Philip Morris’s claims, even though the defenses were not expressly found in the texts of the applicable investment treaties. In the Uruguay case, the tribunal reinforced its rejection of Philip Morris’s claims with a multi-million-dollar award of costs against the company.

The Australia Case

In the Australia case, the tribunal did not reach the merits and dismissed Philip Morris’s claim for lack of jurisdiction. It ruled that Philip Morris committed an abuse of process by modifying its corporate ownership structure to enable it to bring a suit under the Australia-Hong Kong bilateral investment treaty.

To bring a claim under the treaty, the parent company of Philip Morris Australia needed to be incorporated in Hong Kong. When Philip Morris started the case in June 2011, it appeared to satisfy the ownership requirement because the direct corporate parent of Philip Morris Australia was Philip Morris Asia, incorporated in Hong Kong. But a Philip Morris company in Switzerland had owned Philip Morris Australia before 2011 and the Swiss company transferred ownership of the Australian subsidiary to Philip Morris Asia in February 2011.
The tribunal ruled that, in addition to the formal ownership requirement under the treaty, international investment law imposes an implied prohibition on abuse of process. It said “the initiation of a treaty-based investor-State arbitration constitutes an abuse of rights (or an abuse of process, the rights being procedural in nature) when an investor has changed its corporate structure to gain the protection of an investment treaty at a point in time when a specific dispute was foreseeable.”

In Philip Morris’s case, the tribunal found that the dispute over the plain packaging law was already reasonably foreseeable when the company reorganized its structure in early 2011. The tribunal emphasized that in “April 2010, long before the restructuring, the Australian Government announced that it would introduce Plain Packaging Measures and never withdrew from that position.” The tribunal “thus conclude[d] that, at the time of the restructuring, the dispute that subsequently materialized was foreseeable to the Claimant.” The tribunal also found that Philip Morris did not offer persuasive alternative business or tax reasons for the restructuring.

In sum, the tribunal held that “the initiation of this arbitration constitutes an abuse of rights, as the corporate restructuring by which the Claimant acquired the Australian subsidiaries occurred at a time when there was a reasonable prospect that the dispute would materialise and as it was carried out for the principal, if not sole, purpose of gaining Treaty protection.” Therefore, “the claims raised in this arbitration are inadmissible and the Tribunal is precluded from exercising jurisdiction over this dispute.”

The Uruguay Case

In the Uruguay case, the tribunal reached the merits of Philip Morris’s claim. The applicable investment treaty defined an indirect expropriation as a “measure having the same nature or the same effect” as an actual government expropriation or nationalization. The tribunal explained that the government’s measures must have “a major adverse impact” on the company and must “amount to a ‘substantial deprivation’ of [the] value, use, or enjoyment [of the property],” taking into account “the intensity and duration of the economic deprivation suffered by the investor.”

Under this standard, the tribunal summarily rejected Philip Morris’s claim that Uruguay’s regulation limiting the brand name and logo to 20 percent of the cigarette package constituted an indirect expropriation of the trademark. This was because the “brand and other distinctive elements continued to appear on cigarette packs” and “the limitation to 20% of space available … consisted only in a limitation … on the modalities of use of the relevant trademarks.”

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11 Philip Morris Asia v. Australia, ¶ 554 (adding that “a dispute is foreseeable when there is a reasonable prospect … that a measure which may give rise to a treaty claim will materialise.”).
12 Id. ¶ 568.
13 Id. ¶ 569.
14 Id. ¶ 588.
15 Id.
16 Philip Morris Brands v. Uruguay, ¶ 192 (quoting Switzerland-Uruguay Bilateral Investment Treaty, art. 5(1)).
17 Philip Morris Brands v. Uruguay, ¶ 192 (internal quotation marks omitted).
18 Id. ¶ 276 (ruling that “there is not even a prima facie case of indirect expropriation by [this] Regulation.”).
19 Id.
As for Uruguay’s regulation prohibiting variations on a cigarette brand name, Philip Morris argued that it “banned seven of the thirteen variants [it] manufactured and sold ..., rendering them and the associated goodwill ‘valueless.’” The tribunal, however, did not accept the premise of looking at the seven trademarks individually. Instead, it evaluated the entire portfolio of Philip Morris’s trademarks in Uruguay, ruling that the “business is to be considered as a whole since the [law] affected its activities as a whole.” Taking this holistic perspective, the tribunal observed that Philip Morris’s operations in Uruguay increased their profits after the challenged regulation took effect, with the company’s own analysis showing positive cash flow in perpetuity. This left Philip Morris with the claim that it would have been even more profitable if its seven trademarks had not been banned. The tribunal held that “as long as sufficient value remains after the Challenged Measures are implemented, there is no [indirect] expropriation” and “a partial loss of the profits that the investment would have yielded absent the measure does not confer an expropriatory character on the measure.”

After rejecting Philip Morris’s claim of indirect expropriation as a factual matter, the tribunal added the most noteworthy part of its decision. In the tribunal’s view, the cigarette packaging regulations represented “a valid exercise of the State’s police powers” and, as such, they were not and could not be an indirect expropriation, as a matter of law. The tribunal recognized police powers as an implied government defense to expropriation even though it was not expressly found in the text of the investment treaty. The tribunal noted that “[p]rotecting public health has ... long been recognized as an essential manifestation of the State’s police power ....” The tribunal synthesized the pertinent international law into the “principle that the State’s reasonable bona fide exercise of police powers in such matters as the maintenance of public order, health or morality, excludes compensation even when it causes economic damage to [a company] and ... should not be considered as expropriatory ....” The tribunal explained that the police powers doctrine requires the government action to be “taken bona fide for the purpose of protecting the public welfare, ... [to be] non-discriminatory and [to be] proportionate.” The tribunal ruled that the challenged Uruguayan regulations satisfied these requirements fully. Accordingly, it held that the claim of indirect expropriation of Philip Morris’s trademarks must be rejected under the police powers doctrine.

In addition to its indirect expropriation claim, Philip Morris asserted a separate claim that the Uruguayan regulations were arbitrary. It argued that the regulations “were adopted without ... scientific evidence of their effectiveness, without due consideration ... and with no reasonable connection between the objectives [of reducing smoking] and the utility of the [cigarette packaging requirements].” The tribunal rejected this claim. First, it ruled as a general matter that “[t]he responsibility for public health measures rests with the government and international tribunals should pay great deference to governmental decisions of national needs.

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20 Id. ¶ 279.
21 Id. ¶ 279.
22 Id. ¶ 286.
23 Id. ¶ 287 (observing that the “analysis might end here, leading to the dismissal of the ... claim for the above reasons,” but going on to set out “an additional reason in support of the same conclusion that should also be addressed in view of the Parties’ extensive debate in that regard.”).
24 Id.
25 Id. ¶ 290 (ruling that the treaty must be interpreted in the light of rules of customary international law as they have evolved).
26 Id. ¶ 291.
27 Id. ¶ 295 (also noting that this principle “did not find immediate recognition in investment treaty decisions.”).
28 Id. ¶ 305.
29 Id. ¶ 389.
in matters such as the protection of public health.”

Second, with respect to the specific regulations in issue, the tribunal ruled that although there had not been detailed research about the actual effects banning trademark variants, nevertheless it was “an attempt to address a real public health concern, ... [it was] not disproportionate to that concern and ... it was adopted in good faith.” The tribunal reached the same conclusion about the regulation limiting the brand name and logo to 20% of the cigarette package.

Having ruled against Philip Morris on all its claims, the tribunal concluded its award with the issue of how to apportion the costs of the proceeding. The tribunal recognized that it had “wide discretion with regard to cost allocation,” and it ruled that “in the circumstances of this particular arbitration, the application of the ‘loser pays’ principle is appropriate.” It ordered Philip Morris to pay Uruguay $7 million in legal fees and to pay entire amount of the arbitrators’ fees and the tribunal’s administrative expenses of approximately $1.5 million.

Conclusions

The decisions in the two Philip Morris cases are all the more significant because they do not appear to have been foregone conclusions. The tribunal in the Australia case recognized an implied defense of abuse of process even though it was not found in the treaty. The tribunal in the Uruguay case evaluated the effect of the cigarette packing regulations on the company’s portfolio of trademarks instead of on the seven individual trademarks. Then it articulated an implied government defense under the police powers doctrine, another defense not expressly found in the treaty. The tribunal’s reasoning on this issue was not even necessary to deciding the case. And then the tribunal recognized a principle of great deference to governmental judgments on protection of public health. Finally, it exercised its discretion to award multi-million-dollar costs against Philip Morris.

It is hoped that this paper contributes to a better understanding of investor-state arbitration that may help inform future policy discussions about international investment disputes. Although President Trump has withdrawn the United States from the TPP and made statements about renegotiating NAFTA, the President and his advisors have not announced a position on investor-state arbitration. Critics and skeptics mentioned in the paper’s opening paragraph appear to assume that the international arbitral tribunals have a pro-business bias. The Philip Morris cases do not support this view. Indeed, international businesses aggrieved by host-government measures may wish to think twice before electing investor-state arbitration as the forum for challenging those measures. It would be ironic if business interests come to see investor-state arbitration as undesirable. In the opinion of this paper’s author, the Philip Morris cases make valuable contributions to international investment law by upholding important government regulatory powers on public health. But an alternative interpretation from a pro-business advocate might be that the decisions are dangerous examples of arbitrators with a pro-government bias who were engaging in judicial legislation to create defenses not recognized under the treaties.

30 Id. ¶ 399.
31 Id. ¶ 409.
32 This Occasional Paper does not discuss other Philip Morris claims that the tribunal rejected.
33 Philip Morris Brands v. Uruguay, ¶ 584.
34 Id. ¶ 586.