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Timely Structuring of Investments Becomes a Moving Target

Nikos Lavranos (NL-Investmentconsulting) · Monday, June 13th, 2016

The recently published Philipp Morris v Australia award concerning Australia's plain packaging of cigarettes legislation contains important indications regarding the conditions for the timely structuring of investments in order to be able to initiate investment arbitration proceedings.

Background of the case

Philip Morris International (PMI), a company incorporated in New York, produces cigarettes and owns several subsidiaries and affiliates globally ("PMI Group"), including Philip Morris Asia Limited (the Claimant in this case) which has its Asia regional headquarters in Hong Kong. The Claimant is the sole shareholder of the holding company Philip Morris (Australia) Limited (PM Australia), which in turn is the sole shareholder of Philip Morris Limited (PML), a trading company incorporated in Australia which operates PMI Group's tobacco product sales in Australia under license from Philip Morris companies in Switzerland and the United States. Until February 2011, PM Australia and PML were owned by a Swiss company which is part of the PMI group of companies.

In December 2007, then Prime Minister Kevin Rudd launched a National Preventative Health Taskforce, which conducted various consultations and investigations on preventative health programs and strategies, including further regulation of the tobacco industry by way of mandating plain packaging of tobacco products. PMI Group and PML participated in the consultation process and expressed their opposition to the planned plain packaging measures.

In April 2010, then Prime Minister Rudd announced the Government's intention to introduce mandated plain packaging of tobacco products by 1 July 2012.

From late 2010 to early 2011, PMI Group undertook a restructuring process which took into account the political risk it was facing in various countries in respect of a number of new regulations relating to plain packaging of tobacco products. More specifically, on 23 February 2011, the Claimant formally acquired PM Australia and PML, which meant that Philip Morris Asia Limited became the owner of its Australian subsidiary.

On 21 November 2011, that is 8 months after the restructuring of the PMI Group, the Tobacco Plain Packaging Bill was enacted.

On the same day, the Claimant served its Notice of Arbitration to Australia (the Respondent), submitting the dispute to international arbitration pursuant to the bilateral investment treaty (BIT)

between Hong Kong and Australia.

On 17 December 2015, the Arbitral Tribunal issued its Award on Jurisdiction and Admissibility, which was only recently made publicly available.

The decision of the Arbitral Tribunal

At this stage of the proceedings the Arbitral Tribunal (consisting of Prof. Karl-Heinz Böckstiegel (President), Prof. Gabrielle Kaufmann-Kohler and Prof. Donald M. McRae) had to decide whether or not the dispute is at all admissible, before being allowed to proceed further. In particular, the question had to be addressed whether or not the claim was brought "after" the dispute "arose". In other words, whether or not the restructuring took place after the dispute arose and thus constituted an abuse of the BIT and should be dismissed entirely.

Normally, one would argue that the cutoff date would be the date on which the disputed law entered into force, i.e., 21 November 2011. Since the Claimant obtained full ownership some 8 months prior to that, it would appear that the restructuring clearly took place months before the dispute "arose" and therefore should be admitted.

However, as will be discussed below in more detail, the Arbitral Tribunal decided otherwise.

The Arbitral Tribunal started by distinguishing between the *ratione temporis* argument and the abuse of rights argument. The Arbitral Tribunal relied heavily on the Levy and Gremcitel v. Peru tribunal's analysis in this regard, which found that even if a tribunal has jurisdiction *ratione temporis*, it may be precluded from exercising its jurisdiction, if the acquisition is abusive. Endorsing the approach in *Gremcitel*, the Arbitral Tribunal found "whenever the cause of action is based on a treaty breach, the test for a *ratione temporis* objection is whether a claimant made a protected investment before the moment when the alleged breach occurred," and "the critical date is when the State adopts the disputed measure."

In the present case, it was the date of enactment of the Tobacco Plain Packaging Act 2011, as before that moment Claimant's rights could not be affected. The Arbitral Tribunal observed that the dispute normally follows the alleged breach and arises when an aggrieved investor "positively opposes" the measures adopted or any claim of the other party that derives from them. Accordingly, the Arbitral Tribunal concluded that the requirements for its jurisdiction *ratione temporis* were met.

The Arbitral Tribunal then moved on to the abuse of rights argument. It found that it is clear, and recognized by earlier decisions that the threshold for finding an abusive initiation of an investment claim is high. It is equally accepted that the notion of abuse does not imply a showing of bad faith. Referring to several other arbitral awards, the Arbitral Tribunal agreed that the mere fact of restructuring an investment to obtain BIT benefits is not per se illegitimate. However, at the same time, the Arbitral Tribunal recognized that it may amount to an abuse of process to restructure an investment to obtain BIT benefits in respect of a foreseeable dispute.

More specifically, the Arbitral Tribunal considered that the legal tests on abuse of right revolve around the concept of foreseeability, with a standard resting between the two extremes of "a very high probability and not merely a possible controversy".

The Arbitral Tribunal was of the opinion that a dispute is foreseeable when there is a reasonable

prospect, as stated by the Tidewater tribunal, that a measure which may give rise to a treaty claim will materialize.

The Arbitral Tribunal went on to juxtapose the developments occurring at the corporate level within the PMI Group of companies and events arising at the political level within the Australian Government.

By 29 April 2010, when Prime Minister Rudd and Health Minister Roxon unequivocally announced the Government's intention to introduce the plain packaging measures, there was no uncertainty about the Government's intentions at that point. Accordingly, the Arbitral Tribunal concluded that there was at least a reasonable prospect that legislation equivalent to the Plain Packaging Measures would eventually be enacted, which would trigger a dispute.

The Arbitral Tribunal continued by observing that the length of time it takes to legislate is not a decisive factor, due to the characteristics of a democratic system. This does not make the outcome any less foreseeable. The Arbitral Tribunal also noted that the Australian Government never withdrew from its position, announced in April 2010, despite a change of political leaders and a change to a minority government. What became uncertain, the Arbitral Tribunal found, was not whether the Government intended to introduce plain packaging, but whether the Government could maintain a majority or would be replaced. If this were treated as a basis for saying that there was no reasonable prospect of a dispute, it would create one rule for majority governments and another for minority governments, which would create difficulties for States whose electoral processes can result in minority governments.

Consequently, the Arbitral Tribunal found that at the time of restructuring, the dispute that materialized subsequently was foreseeable to Claimant.

In the Arbitral Tribunal's view, it would not normally be an abuse of right to bring a BIT claim in the wake of a corporate restructuring, if the restructuring was justified independently of the possibility of bringing such a claim. However, the Arbitral Tribunal concluded that the Claimant was not able to prove that tax or other business reasons were determinative for the restructuring and found that the main and determinative, if not the sole, reason for the restructuring was the intention to bring a claim under the BIT.

Consequently, the Arbitral Tribunal concluded that the initiation of the arbitration constituted an abuse of rights, that the claims raised in the arbitration were inadmissible and that it was precluded from exercising its jurisdiction over the dispute.

The main take away from this case

While the conclusions of the Arbitral Tribunal are strictly related to the provisions contained in the Hong Kong-Australia BIT, which may differ from other BIT texts, they nevertheless represent an important indication.

The fact that the Arbitral Tribunal did not simply take the date of entering into force of a legislative act as the cutoff date but rather took the start of the legislative process, which may or may not lead to the eventual adoption a particular act, is a troubling development because it introduces a high level of uncertainty as to when a restructuring may be considered legal and at which point it must be considered abusive. The use of vague terms such as the "intentions of a Government" or the "concept of foreseeability" make it unreasonably difficult for an investor to assess the situation

correctly.

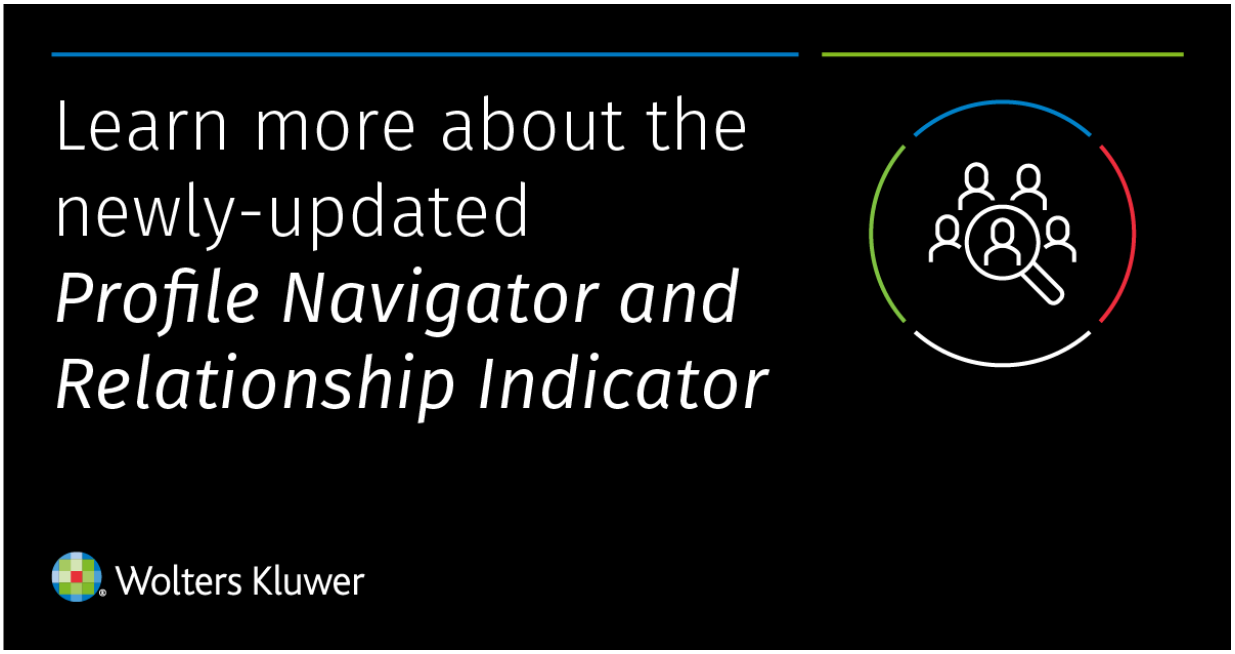
This is especially true since Governments change all the time and so do their intentions and policy objectives. Consequently, by applying these criteria the cutoff date becomes a moving target, which is difficult to hit by the investor.

Clearly, it would be much more preferable and create more legal predictability if the date of enactment of a legislative act or the date of adoption of an administrative measure (such as the issuance of a license) would be used as the cutoff date.

But since that is apparently not the case anymore, it is even more important for the investor to fully and irrefutably document the reasons for the restructuring decision and the exact timing of it.

This is of particular importance in order to prove that the restructuring was made well before any dispute arose and that it was not done for the sole or main purpose of initiating investment arbitration proceedings.

In sum, it becomes increasingly vital for investors to continuously monitor the intentions of Governments when structuring their investments and deciding whether or not to initiate investment arbitration proceedings.



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