

**Investor-state dispute settlement (ISDS): the threat to health, environment
and other social regulation**

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Summary: This paper provides a brief overview of the experience of investor state disputes settlement (ISDS) and the debate about ISDS in Australia, which resulted in its exclusion from the Australia-US Free Trade Agreement (AUSFTA) negotiated in 2004. The evidence on ISDS was re-examined by the Australian Productivity Commission in its 2010 Report, which found no evidence to justify ISDS but found evidence of considerable policy and financial risk to legitimate social regulation. ISDS action by the Philip Morris Company against Australian tobacco plain packaging legislation under a 1993 Hong Kong-Australia bilateral investment treaty has further influenced Australian government policy against ISDS, and has probably strengthened government and public opposition.

Summary of the experience of ISDS

The growth in ISDS through trade and investment agreements has provoked a corresponding growth in critical examination of the evidence of its outcomes. Many of the disputes have involved public policy measures ranging from restrictions on the use of dangerous chemicals, mining development in environmentally sensitive areas or on indigenous land and health warnings on cigarette packages. The critical discussion revolves around the issue of whether ISDS places unreasonable restrictions on the right of governments to regulate for legitimate health, environmental or other social policy objectives (Tienhaara, 2009, Schneider 2008, Capling and Nossal, 2006).

Historically the direct expropriation of foreign investment was the biggest risk for foreign investors, but this is now relatively rare. Many ISDS disputes are concerned with “indirect” expropriation. This does not involve the physical taking of property but results in “the effective loss of management, use or control or a significant depreciation of the value of the assets of a foreign investor” (UNCTAD, 2000:11).

UNCTAD defines indirect expropriation or regulatory takings as “those takings of property that fall within the police powers of the state, or otherwise arise from state measures like those pertaining to the regulation of the environment, health, morals, culture or economy of a host country”(UNCTAD, 2000:12).

Tienhaara distinguishes two approaches by tribunals in establishing whether or not a regulatory taking has occurred. One approach has tended to focus on the effect of the regulation on the investor, in terms of its economic impact and duration. Tribunals have also take into account the legitimate expectations of the investor. Another approach examines both the effect on the investor and the purpose of the regulation, including whether the stated purpose is proportional to the negative effect felt by the investor. In both approaches, it is arguable that there is insufficient attention to the public purpose of the regulation and the right of governments to regulate (Tienhaara, 2010: 12)

Once a regulatory measure has been defined as a regulatory taking, it can be assessed for legality in the same way as a direct expropriation. In order to be lawful, it must be for a public purpose, it must be non-discriminatory and compensation must be paid to the affected investor (Tienhaara, 2010: 13).

The definition in scope of police powers and the difficulty of distinguishing between genuine regulation not entitled to compensation and a regulatory taking which could be compensable is problematic. There is a growing body of opinion which argues that ISDS gives unreasonable powers to corporations to sue governments for damages over legitimate health, environment or other social regulation.

In North American Free Trade Agreement (NAFTA) countries, where over 60 cases have been filed against government parties, there have been a series of cases involving health and environmental regulation, including Ethyl versus Canada, SD Myers versus Canada, Dow Agro Sciences versus Canada, and Chemtura Corporation versus Canada (Tienhaara, 2010). Although many NAFTA cases have been unsuccessful, they have involved governments in expensive and protracted litigation. A 2009 survey of ISDS more generally found 33 cases involving claims of more than \$1 billion, the highest being a claim for \$50 billion and more than 100 additional cases where claims were between \$100 and \$900 billion (Productivity Commission, 2010:272).

The impact of these cases in NAFTA and through other investment treaties in which even larger damages have been paid has led to an effect described as “regulatory chill”. This is a situation in which governments are made aware of the threat and the costs of both protracted litigation and damages, and are discouraged from legitimate regulation because of these threats. There are a number of case studies that suggest that investors’ threats to use ISDS have discouraged specific types of regulation including the documented withdrawal by Canada of a proposal for tobacco plain packaging regulations following the threat of ISDS arbitration (Productivity Commission, 2010:271).

Legal Process issues

There is no single international investment institution which deals with ISDS disputes. Instead, they refer to one or more sets of procedural rules, used for the creation of specific panels for particular disputes.

The most commonly used rules are those of the UN commission on International trade Law (UNCITRAL) And the International Centre for the Settlement of Investment Disputes (ICSID), part of the World Bank group. There are a series of problems with these processes compared with most national legal processes.

Transparency

No organisation keeps track of UNCITRAL disputes, so there is little public information about them. ICSID as part of The World Bank group has a website which lists disputes, and on which tribunal awards can be published, but only if the parties agree that they can be made public. This contrasts with most national legal proceedings, where proceedings themselves are public and records of proceedings and outcomes are publicly available (Productivity Commission: 273).

Composition of tribunals

The tribunals generally have three members: one chosen by the investor, one chosen by the government and the third that is mutually agreed. Unlike judges in most national courts, arbitrators can be practicing advocates. This means an individual can act as an advocate in one case, and an arbitrator in another. The composition of the tribunals which allow advocates to be arbitrators means that arbitrators lack the independence normally expected of members of national judicial systems, who are not permitted to be advocates (Productivity Commission: 273).

At the very least, both the legal framework and the composition of tribunals lead to a lack of proper consideration of public interest issues.

No binding precedents and inconsistency of decisions

Decisions are only binding on the parties involved in the dispute, the tribunal does not have to consider decisions of previous tribunals, and there is no appeal system to ensure consistency. There have been cases where panels have reached very different conclusions based on the same facts (Productivity Commission: 273).

In short, ISDS exposes governments to the risk of expensive litigation and huge potential damages which threaten legitimate public interest legislation in a secretive process without the legal safeguards of an independent judiciary, precedent setting, appeals processes and consistency of decision-making.

The Australia US free trade agreement (AUSFTA) Debate

The Australian Liberal-National (conservative) Coalition Government led by John Howard negotiated a free trade agreement with the US in 2003-4.

The US agenda was a much broader than trade in goods and agriculture, and sought to change a range of Australian health and social policies. This was based on the agenda pursued in the NAFTA and in other US bilateral agreements. Targets included wholesale price controls on medicines through the Pharmaceutical Benefits Scheme, Australian content laws for audio-visual services, quarantine laws, labelling of genetically engineered food and the Foreign Investment Review Board. These were all seen by the US as barriers to trade (Zoellick 2002). The US also wanted an ISDS which would give individual corporations the right to sue governments for damages if government law or policy harmed their investments.

AUSFTA prompted the biggest critical public debate ever held in Australia about a trade agreement. There were hundreds of community meetings, public rallies in many cities, many articles in community, union, local and specialised media, over 700 submissions to parliamentary inquiries in 2004 and thousands of letters, postcards and emails sent to politicians (Ranald, 2010). Two books critical of the agreement were subsequently published (Capling 2004; Wiess et al. 2004).

ISDS was a major topic of community debate, on the grounds that it would be a dangerous weakening of governments' ability to regulate for social and environmental goals. The debate canvassed most of the issues raised in the above summary of ISDS experience (Australian Broadcasting Commission, 2003, Henry 2003).

The debate about AUSFTA in general and the ISDS influenced public opinion. Polls conducted by Hawker Britton showed a steady decline in support for the AUSFTA, from 65 per cent before negotiations started early in 2003 to 35 per cent in February 2004 when the deal was concluded. This lack of support was confirmed by a Lowy Institute poll in February 2005 showing only 34 per cent supported the agreement (Cook 2005, Hawker Britton 2004).

The public debate and decline in support for the agreement prompted the Opposition Australian Labor Party (ALP), and the Democrats and Greens to adopt policies critical of the AUSFTA. These parties together had a majority in the Senate, so their agreement was required to pass the AUSFTA implementing legislation. After a fierce internal debate, the ALP parliamentary caucus finally decided to endorse the AUSFTA implementing legislation with some amendments, on pharmaceuticals and Australian media content (Latham 2004). This was the first time the Australian Parliament had amended the implementing legislation for trade agreement.

The ISDS was a particular focus of the critics of AUSFTA, and was not included by the Howard government in the final agreement, which became public before the Parliamentary debate on the implementing legislation. The exclusion of the ISDS before the Parliamentary debate is an indication of the sensitivity of the issue, and possible government fears that its inclusion would make the agreement unacceptable. The AUSFTA is the only US bilateral free trade agreement which does not include ISDS.

Productivity Commission report recommends against ISDS

The Australian Productivity Commission is an arms-length advisory body set up in 1998 to conduct independent research on a range of economic, social and environmental issues. In 2009, the then ALP Government requested that the Productivity Commission undertake a study into the impact of bilateral and regional trade agreements on Australia's economic performance. The Commission received submissions from business, government and non-government organisations and produced a final report in December 2010.

The study received a large number of submissions on the topic of ISDS, and reviewed these submissions in its report, some of which is quoted above.

After reviewing the evidence on ISDS, the report found no evidence that ISDS resulted in greater inflows of foreign direct investment. It also found no evidence for some of the other key arguments used to justify ISDS. For example, it found no evidence of market failure resulting from political risk to foreign investors, and no evidence that regulation is systematically biased against foreign investors (Productivity Commission 2010: 269-70).

On the contrary, the report concluded that that "experience in other countries demonstrates that there are considerable policy and financial risks arising from ISDS provisions" (Productivity Commission 2010: 274).

The report recommended that “the Australian government should seek to avoid the inclusion of investor state dispute settlement provisions in bilateral and regional trade agreements that grant foreign investors substantive or procedural rights greater than those enjoyed by Australian investors” (Productivity Commission 2010: xxxviii).

Australian Labor Party policy on ISDS

Labor’s policy differences with the Howard government on the AUSFTA in 2004 were described above. The Australian Labor Party (ALP) came to office in 2007 with explicit trade policies to protect the right of governments to regulate on health, environment and other public policy issues. The policy also committed to improved consultation and parliamentary debate about trade negotiations (ALP 2009).

Before the TPPA negotiations began in March 2010 the Australian Trade Minister responded in answer to questions that ‘everything was on the table’. However, in response to concerns from unions and community organisations about ISDS, the Minister reported as saying:

“We continue to have serious reservations about the inclusion of investor-state dispute settlement provisions ... and Australian negotiators will be making this clear” (Saulwick 2010).

New Australian Trade Policy on ISDS April 2011

A review of Australia's trade policy was conducted by the new Trade Minister Craig Emerson following the 2010 election. The outcome of this review, announced in April 2011, included the adoption of many of the recommendations of the Productivity Commission *Report on Bilateral and Regional Trade Agreements*.

The policy rejects the inclusion in trade agreements of investor state dispute procedures. It states:

“The Government does not support provisions that would confer greater legal rights on foreign businesses than those available to domestic businesses. Nor will the Government support provisions that would constrain the ability of Australian governments to make laws on social, environmental and economic matters in circumstances where those laws do not discriminate between domestic and foreign businesses...In the past, Australian Governments have sought the inclusion of investor-state dispute resolution procedures in trade agreements with developing countries at the behest of Australian businesses. The Gillard Government will discontinue this practice. If Australian businesses are concerned about sovereign risk in Australian trading partner countries, they will need to make their own assessments about whether they want to commit to investing in those countries” (Emerson, 2011: 20).

The policy was also influenced by actions taken by the Philip Morris International tobacco company in February 2010 against the government of Uruguay, challenging tobacco advertising restrictions which were based on a World Health Organisation Convention. The company claimed that the measures violated the terms of the Switzerland Uruguay bilateral investment treaty by preventing it from displaying its trademark, which received media publicity in Australia (O’Malley, 2010, Davison 2010).

Shortly after the Uruguay legal action, Philip Morris International made a submission to the US trade representative, advocating strongly for ISDS to be included in the Trans-Pacific Partnership agreement (Philip Morris International, 2010).

The Australian government had already announced its intention to introduce tobacco plain packaging legislation. In January 2011 the trade Minister responded to media reports of the Philip Morris Uruguay legal action and its submission for an ISDS in the TPP by saying that "Philip Morris would be 'whistling in the wind' if it tried to undermine national anti-tobacco laws" (Rowbotham, 2011).

The Australian government also responded to these actions specifically in its policy announcement which mentions the ability of governments to regulate tobacco advertising:

"The government has not and will not accept provisions that limit its capacity to put health warnings or plain packaging requirements on tobacco products" (Emerson 2011:20).

Australian Tobacco plain packaging legislation

The plain tobacco packaging policy of the Australian Labor Party announced in 2010 was strongly supported by public health groups, all medical professional groups and consumer health organisations (Australian Health Care and Hospitals Association, 2011, Cancer Council, 2011a).

In April 2011 the Australian government announced that it would introduce legislation for the mandatory plain packaging of all tobacco products. The scheme, which will enter into force from July 2012, will apply to all tobacco products prescribing that the packaging must be a plain dark colour and that no trademarks except the business or company name may appear on the packaging. The legislation implements certain of Australia's international obligations as a party to the World Health Organisation Framework Convention on Tobacco Control (World Health Organisation, 2011).

The legislation was also based on Australian research that showed that tobacco control measures, including restrictions on advertising, developed in Australia over the last 30 years had been successful in reducing numbers of smokers to less than 20% of the population. However, tobacco smoking continued to kill more than 15,000 Australians per year, at the social cost of \$31.5 billion per year. Research showed that most new smokers are young people, many under the age of 18, and that particular tobacco brands shown through packaging were major form of advertising which attracted this group. (World Health Organisation, 2011, Parliament of the Commonwealth of Australia, 2011).

The tobacco industry immediately commenced a \$20 million public campaign against the legislation, which included paid television advertisements and a public relations campaign involving carefully placed opinion pieces in the media. The main argument was the right to be compensated for loss of intellectual property rights involved in brand names and trademarks on packaging, which would cost taxpayers millions if not billions of dollars. At the same time, they threatened legal action against the legislation, mentioning a possible constitutional case in

Australian courts, exploring an intellectual property dispute in the WTO, and the possibility of pursuing ISDS through other trade agreements. (ABC Radio National, 2011, Institute of Public Affairs, 2011).

Despite the tobacco industry campaign, public opinion polls showed majority support (59%) for the legislation (Cancer Council, 2011a). After some prevarication, the Liberal-National opposition parties, influenced by public opinion, announced that they would support the legislation in principle (Thompson, 2011).

The government proceeded with the legislation. After the release of a consultation paper and an exposure draft, the revised legislation was introduced into the Australian Lower house of Parliament House of Representatives in July 2011.

Philip Morris ISDS case against Australia

Philip Morris International described itself as a U.S.-based company when it made a submission in 2010 to the US trade representative supporting an ISDS process in the TPPA.

However, it claimed to be a Swiss-based company when it used an ISDS process to sue the Uruguayan Government for damages under a Uruguayan-Swiss investment agreement when that government introduced legislation restricting tobacco advertising (International Centre for Trade and Sustainable Development, 2010).

Philip Morris can also claim to be a Hong Kong company because Philip Morris Asia, incorporated in Hong Kong, invested in Australia by becoming the sole shareholder of Philip Morris (Australia) on February 23, 2011. Philip Morris Asia's investment in Australia therefore took place almost a year after the Australian government announcement of its intention to legislate for plain packaging of tobacco products (Voon and Mitchell, 2011:22).

It would therefore be difficult for the company to maintain that at the time of its investment in Australia, it had a legitimate expectation that plain packaging would not be introduced. On the contrary, it appears that the investment of Philip Morris Asia in Australia was part of a forum shopping strategy to enable the company to take action against Australia under the Hong Kong Australia bilateral investment treaty.

Philip Morris Asia Ltd launched an investment claim against Australia on 27 June 2011, under the terms of the Hong Kong Australia bilateral investment treaty. This was one month before the legislation was introduced in Parliament (Philip Morris Ltd, 2011, Kenny, 2011).

The timing of the claim followed the more general public relations and advertising campaign against the legislation by the tobacco industry, and appeared to be intended as an attempt to delay the legislation and/or prevent its passage through the Parliament through its argument that the legal action would cost taxpayers millions, if not billions of dollars.

There was a strong public reaction to the Philip Morris legal action from health and consumer organisations, and academics. (Heart Foundation and ASH Australia, 2011 Cancer Council, 2011b, Faunce and Tienhaara, 2011). There was also critical commentary from trade law experts.

One legal commentator, a supporter of ISDS, lamented the fact that the case could give an ISDS a bad name (Nottage, 2011).

The legal action has not had the results the company hoped for. On the contrary, the Prime Minister and the Health Minister made strong public statements saying that they would proceed with the legislation, were prepared to oppose any legal action and were confident that they could win the case on the grounds that the legislation was legitimate public health legislation based on the World Health Organisation Convention (Australian Associated Press, 2011).

The bill passed the House of Representatives on August 24, 2000, with the support of the Greens and independents on whom the minority Labor government relies to form a majority. The Liberal National Coalition proposed some unsuccessful amendments but did not oppose the legislation. In September, the legislation is expected to pass through the Senate, where the government and Greens have a majority.

Conclusion

In 2004 a strong public debate, based on the experience of ISDS in NAFTA and other trade and investment agreements, influenced the then Liberal-National government to exclude ISDS from the AUSFTA.

Under an ALP government, the evidence was reviewed in 2010 by the Productivity Commission, a body generally supportive of free trade, which concluded that there was no economic justification for ISDS, and that the public policy and economic risks of ISDS were such that Australia should not support its inclusion in trade agreements.

The campaign by the tobacco industry against the tobacco plain packaging legislation and the use of ISDS by Philip Morris under the Hong Kong Australia investment treaty has if anything hardened public opinion and the government's position against ISDS in the TPPA.

This may prove to be a stumbling block in the TPPA negotiations, especially if other governments take a similar position.

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