The Trans-Pacific Partnership Agreement and the ISDS Carve-out for Tobacco Control Measures

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This section highlights the interface between international trade and investment law and municipal and international risk regulation. It is meant to cover cases and other legal developments in WTO law (SPS, TBT and TRIPS Agreements and the general exceptions in both GATT 1994 and GATS), bilateral investment treaty arbitration and other free trade agreements such as NAFTA. Pertinent developments in international standardization bodies recognized by the SPS and TBT Agreement are also covered.

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This report analyzes the tobacco carve-out clause (as well as the negotiations that led to its adoption) included in the final text of the Trans-Pacific Partnership Agreement, which permits the TPP Parties to deny investors that challenge their tobacco control measures access to the investor-state dispute settlement mechanism. The report also discusses the potential advantages and disadvantages of such a solution.

I. Introduction

The negotiations on the Trans-Pacific Partnership Agreement (TPP) were launched in 2010 with eight participating countries (i.e. Australia, Brunei, Chile, New Zealand, Peru, Singapore, the United States and Vietnam). Later Malaysia, Canada, Mexico and Japan joined them, making the TPP the largest liberalization project since the creation of the World Trade Organization. Despite the many technical difficulties encountered by negotiators and opposition from different interest groups, the negotiations were eventually concluded at the beginning of October 2015. Of course, in order to enter into force the TPP still needs to be formally signed by the heads of the participating states and successfully passed through domestic ratification processes. It is optimistically estimated that all those steps may be completed in a year or so.

While the final text has been released only recently1 and still requires detailed analysis, some parts have already proven controversial. One issue that has caught the particular attention of commentators is a carve-out clause for tobacco control measures.

II. Tobacco Products in the Negotiation Process

As the negotiations progressed, scholars and health activists identified a number of different areas where the regulatory freedom enjoyed by the TPP countries in the field of tobacco control could be restricted by the obligations contained in the agreement. First of all, it was argued that the TPP would improve market access for tobacco products by eliminating all existing custom duties. This in turn could translate into a decrease in the prices of such products and a corresponding increase in their consumption.2 Some feared the strengthened protection of

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1 For the full text of the agreement see the official webpage of the New Zealand Ministry of Foreign Affairs & Trade: http://www.mfat.govt.nz/Treaties-and-International-Law/01-Treaties-for-which-NZ-is-Depositary/03-Trans-Pacific-Partnership-Text.php (last accessed 24 November 2015).

2 R. Stumberg, Safeguards for Tobacco Control: Options for the TPPA, 39 American Journal of Law & Medicine 382 (2013), p. 394 (but note that most of applied rates on tobacco products (but not tobacco leaf) are already quite low).
intellectual property rights (which could, for example, make the introduction of tobacco plain packaging laws more difficult) and improved market access for services (which could affect existing and planned licensing schemes or open up specific modes of distribution for tobacco products – e.g. through Internet). There was also criticism of the proposed requirements concerning regulatory coherence and transparency (e.g. those which encouraged the use of regulatory impact assessments, placed disclosure obligations and various notification requirements on public bodies, as well as guarantees securing the involvement of business stakeholders in regulatory processes). In this context, it was submitted that all these obligations would facilitate tobacco companies in collecting materials for future litigations and slow down (or even influence) the regulatory processes. Others expressed their concerns with respect to the Investment Chapter. For example, they pointed out the potential problems that might result from the broad interpretation of the concept of “an investment” and the generous understanding of indirect expropriation or fair and equitable treatment. Another issue which gave rise to controversy concerned the access of tobacco companies to the investor-state dispute settlement (ISDS) mechanism, which would allow them to directly challenge domestic regulatory measures in front of an international tribunal. This problem was particularly relevant for those TPP countries that did not have investment treaties with the United States. Some commentators also argued that granting such an access would produce the so-called “regulatory chilling effect”, whereby countries fearing potential legal responsibility under international investment rules may simply choose not to enact tobacco control measures, particularly those which are of an experimental nature.

At the same time, many commentators were skeptical about usefulness of various general exceptions clauses which were supposed to be included in the TPP. They argued that the complex conditions for applying such clauses, the lack of clarity in the defined standards, and the great uncertainty as to the possible outcomes of disputes (which in turn could also contribute to the regulatory chilling effect) made them de facto inoperable.

Initially the above-expressed concerns were met with indifference (or even hostility) from the trade negotiators, who strongly disfavored any special treatment of tobacco products. This changed as the negotiations advanced – partly in response to the growing pressure from health advocacy groups, and partly because of certain legal developments, in particular ongoing challenges that some of the negotiating countries were experiencing with respect to their tobacco control measures – e.g. the investment arbitration proceeding initiated against Australia by Philip Morris Asia Limited under the bilateral investment treaty with Hong Kong. In 2012 the United States eventually put forward a proposal on the relationship between TPP rules and domestic tobacco control policies. It was composed of three elements: (a) making tobacco products subject to some tariff phase-outs; (b) an explicit recognition of the “unique status of tobacco products from a health and regulatory perspective”; and (c) a general exception provision that would “allow […] health authorities in TPP governments to adopt regulations that impose origin-neutral, science-based restrictions on specific tobacco products/classes in order to safeguard public health […] while retaining important trade disciplines (national treatment, compensation for expro
priptions, and transparency) on tobacco measures.\textsuperscript{11}

The language of the US proposal was, however, subsequently softened. The new revised version that appeared in 2013 maintained the temporary market access limitation (i.e. tariff phase-outs) for tobacco products, but dropped the reference to the unique status of tobacco products and the previous language of general exception. Instead, it proposed a statement which indicated that the TPP Parties understood that the TPP general exception applied to tobacco health measures, and provisions requiring consultation with health authorities of the concerned Parties before bringing a state-to-state claim regarding a tobacco control measure under the TPP.\textsuperscript{12}

Although the initial US proposal was welcomed by many pro-health NGOs and commentators\textsuperscript{13} (while at the same time being heavily criticized by business circles as a solution which would weaken the predictability of the international trade regime and the rationality of domestic regulatory processes\textsuperscript{14}), these same actors were more sceptical about revised version. In this context, it was particularly noted that the procedural requirements (i.e. the obligation to consult with public health authorities imposed on the TPP Parties) constituted a very limited barrier to litigation over tobacco control measures. It would also not bar private investors from using the ISDS mechanism against one of the TPP Parties.\textsuperscript{15}

In light of the above developments, it is not surprising that the counterproposal which was put forward by Malaysia in August 2013 was applauded by many.\textsuperscript{16} Malaysia suggested to fully carve out tobacco control measures from the TPP regime (from all its provisions rather than some individual chapters).\textsuperscript{17} Of course the tobacco companies were against this proposal and some other business groups also expressed their concerns with such an approach.

None of the above proposals were eventually incorporated in the final text of the TPP. Instead the TPP Parties decided to introduce a new, narrowly drafted, carve-out clause proposed by the United States. This clause relates only to the access of private investors to the TPP ISDS mechanism (discussed in more detail in the subsequent section of this report). Moreover, the TPP Parties also accepted a phase-out elimination of tariffs on tobacco. For example, Vietnam will have 16 years for elimination of tariffs on manufactured tobacco products, and 21 years for unmanufactured tobacco.\textsuperscript{18}

\section*{III. The Tobacco Carve-out Clause}

The carve-out clause was included in Chapter 29 entitled “Exceptions and general provisions”. The rule (Art. 29.5) gives the TPP State-Parties the right to deny access to the ISDS system to an investor from another TPP country that seeks to challenge a national tobacco control measure. It also stipulates that such a denial can be made at any time, even after the initiation of a proceeding. In particular, the relevant article provides that:

“A Party may elect to deny the benefits of Section B of Chapter 9 (Investment) with respect to claims challenging a tobacco control measure of the Party. Such a claim shall not be submitted to arbitration under Section B of Chapter 9 (Investment) if a Party has made such an election. If a Party has not elected to deny benefits with respect to such claims by the time of the submission of such a claim to arbitration under Section B of Chapter 9 (Investment), a Party may elect to deny benefits during the proceedings. For greater certainty, if a

\begin{itemize}
\item Mitchell et al., supra note 5.
\item The text of the Malaysia proposal is not publicly available.
\end{itemize}
Party elects to deny benefits with respect to such claims, any such claim shall be dismissed.”

The denial-of-benefits concept is not new in the field of international investment arbitration (for example, such a clause is included in the 2012 US Model Bilateral Investment Treaty19). It has been traditionally used to prevent investors from making use of the benefits of an investment treaty if such an investor (e.g., a company) does not have sufficient (i.e., substantial) economic ties to a state on whose nationality it relies.20 Under the denial-of-benefits concept, while an ISDS mechanism still exists, litigation can only be undertaken if the government of a host state allows it. From a procedural point of view, the application of such a clause should be qualified as an objection to the jurisdiction of an investment tribunal in a particular instance. The rationale behind this concept is simple. As explained by Sinclair: “The right-to-denye

benefits provisions ... appear designed to limit Host States’ exposure to claims from ‘mailbox’ companies, which are understood not to contribute to the development goals underpinning an investment treaty.”21 The denial-of-benefits clause included in the TPP is different from traditional clauses because, firstly, it concentrates on the type of measure that is the subject of a claim rather than on the existence of an economic connection between a host state and an investor using the ISDS mechanism. Secondly, the TPP, unlike some bilateral investment treaties (i.e., either directly or through reference to external applicable arbitration rules),22 does not establish any time limits for a host state to raise a jurisdictional objection based on the denial-of-benefits clause.

In addition, Art. 29.5 contains two footnotes. Footnote 12 stipulates that the article does not prejudice either the operation of Art. 9.14 (which provides for a standard denial-of-benefits clause) nor a TPP Party’s rights under Chapter 28 (Dispute Settlement) in relation to a tobacco control measure. In other words, tobacco control measures can still be contested by State-Parties to the TPP in the state-to-state dispute settlement procedure.

Footnote 13 defines a “tobacco control measure”, indicating that the notion encompasses any measure related to the production or consumption of manufactured tobacco products, their distribution, labelling, packaging, advertising, marketing, promotion, sale, purchase, or use, as well as enforcement measures, such as inspection, recordkeeping, and reporting requirements. This definition of “tobacco control measures” is further extended by the inclusion of products which are made from or derived from tobacco. Arguably, this allows the TPP Parties to exclude from the ISDS mechanism measures concerning electronic cigarettes, because nicotine which is added to most of the e-liquids is predominantly extracted from tobacco plants or tobacco dust.23 Once e-liquids are qualified as tobacco products, measures that regulate their delivery devices (e.g., battery powered vaporizers), labelling (e.g., plain packaging) and advertising of electronic cigarettes will be also captured by the definition. This conclusion might be different if the industry were to start using synthetic rather than naturally-occurring nicotine (or would extract nicotine from plants other than tobacco). Note however that although the production of synthetic nicotine is a well known process, this option is currently rarely (if ever) used in the production of e-liquids, mainly because the costs are considerably higher compared to normal extraction.24

On the other hand, footnote 13 excludes from the scope of the definition those measures which relate to tobacco leaves which are not in the possession of a manufacturer of tobacco products, or that are not part of a manufactured tobacco product. This should be seen as a concession made to tobacco growers.

%20ACIEP%20Meeting.pdf (last accessed 24 November 2015).

20 For a historical review of the denial-of-benefits clause, see e.g., L.A. Mistelis & C.M. Baltag, Denial of Benefits and Article 17 of the Energy Charter Treaty, 113 Penn State Law Review 1301 (2009).


22 E.g., Art. 41 of the ICSID Arbitration Rules provides that jurisdictional objections shall be made as early as possible, but not later than the expiration of the time limit fixed for the filing of the counter-memorial (available at: https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Pages/ICSID-Convention-Arbitration-Rules.aspx last accessed 24 November 2015).


theres-no-evidence-e-cigarettes-are-as-harmful-as-smoking (last visited 24 November 2015). Overall, synthetic nicotine is currently used in industrial production (e.g. as an ingredient of certain pesticides).
(mainly from the United States), which was introduced in order to reduce their opposition to the ISDS carve-out clause and increase the chances for successful ratification in the US Congress.25

IV. The ISDS Carve-out for Tobacco Control Measures: A Move in the Right Direction?

The inclusion of the ISDS carve-out for tobacco control measures in the TPP has been praised by many.26 In particular various health advocacy groups as well as tobacco control specialists have quickly pronounced it as a major victory for public health.27 According to them, a carve-out not only removes an important weapon from the legal arsenal available to transnational tobacco companies, but it will also reduce the regulatory chilling effect which can result from the threat of potential international litigation over a domestic tobacco control measure.28 As a consequence, countries will be more willing to experiment in this regulatory field and therefore will be able to provide a higher level of health protection. I share this view – the ISDS carve-out may indeed strengthen, at least to some extent, the position of countries in this specific regulatory field.

There are, however, those who remain skeptical. Besides tobacco companies, which are obviously unhappy about the outcome of the negotiations,29 some analysts as well as representatives of other industries are also concerned.

First, it is argued by a number of commentators, that the inclusion of the tobacco carve-out (here from the ISDS mechanism) indirectly indicates that various safeguards which are conventionally included in trade and investment agreements (and the TPP is no exception in this regard) are simply not sufficient to guarantee the necessary regulatory autonomy of states in the field of health and environmental protection. Why otherwise would one single out a specific commodity/policy, leaving other products/policies untouched?30 In a similar vein, Mitchel, Voon and Whittle also ask: “Might a TPP tobacco carve-out also suggest within the TPP that other health areas are less significant and undermine any general health exception?”31 It therefore seems that what is needed is some general change in the current approach taken in international trade and investment treaties (e.g. in the form of a well-drafted and elaborated general exception or some overall regulatory carve-out) rather than an ad hoc solution that only addresses one specific harmful product.

Having said this, it also should be noted that this concern (i.e. insufficient legal protection of state prerogatives in other regulatory areas) was arguably addressed, at least partially, by the drafters of the TPP Investment Chapter. Various standards that have proved controversial in the past (e.g. minimum standard of treatment or indirect expropriation) were formulated in a way that provides the TPP Parties with ample room for manoeuvre. For example, Annex 9-B explains that “non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations, except in rare circumstances.” While one can still ask why these clauses were considered insufficient to guarantee the TPP State-Parties sufficient regulatory space in the area of tobacco control, their inclusion may be regarded as a more systemic response to the current critical debate on the restraints imposed on countries by international investment obligations. Seen from this perspective, tobacco carve-out appears to be more motivated by political rather than legal reasons.

Second, while it might be true that the exclusion of tobacco control measures from the TPP ISDS sys-

28 Ibidem.
31 Mitchel et al., supra note 5, p. 292. See also, J. Strawbridge, Cigarettes, TPP, and the Wisdom of Product-Specific Rules in Trade Deals, 9(5) Transnational Dispute Management (2012).
tem could reduce the regulatory chilling effect, one should also note that it will not eliminate it entirely as many other mechanisms for contesting such measures still remain available. These include not only the TPP state-to-state dispute settlement system (which as noted above is not affected by the carve-out), but also mechanisms which are provided by the World Trade Organization and various bilateral investment treaties or free trade agreements with investment chapters that are binding on the TPP countries.

Third, some commentators and representatives of industry also point out that a carve-out for a specific commodity (in this case tobacco products) may have some unintended negative systemic consequences. In this context, critics particularly refer to slippery slope concerns. The idea behind this type of argument is that once an exemption for a specific harmful commodity is established, one also creates a precedent for similar exclusions of other products which possess some negative externalities (e.g., alcoholic beverages, soft drinks or certain types of processed food). Indeed, there is some empirical evidence showing that the establishment of certain restrictions on one product may lead to a subsequent regulatory cascade with respect to other goods as well. Since the TPP is expected to operate as point of reference (i.e. a "golden standard") for other future trade deals and a vehicle for norm diffusion, one may rationally assume that its precedential effect will be significant. Of course, it can be argued that tobacco products are unique because of, e.g., their proven negative health effects and/or the past abuses of the international trading system by transnational tobacco companies. But on the other hand, it is not difficult to imagine that other goods could also be labeled as unique in some sense (e.g. alcohol as a important factor in domestic violence and/or a cause of traffic accidents). So are increasing numbers of carve-outs for other products a possible scenario? Due to the very limited amount of empirical data and the existing methodological difficulties in assessing slippery slope concerns, any answer at this time would have to be considered speculative. Nonetheless I believe that, at least in the short term, such answer would be negative. Considering the opposition that was raised against the exclusion of tobacco products from the TPP (which eventually led, with respect to tobacco control measures, only to a carve-out from the ISDS mechanism rather than from the entire agreement), one should not expect that countries will be eager to exclude other additional categories of risky goods. On the other hand, there are greater chances that some form of tobacco carve-out may appear in other trade agreements, including the Transatlantic Trade and Investment Partnership – another important trade deal currently being negotiated between the United States and the European Union.

In the long term perspective, while it still might be difficult to introduce additional carve-outs for other risky products through mega trade deals, it may be easier to do so in the context of bilateral free trade agreements between like-minded countries. This scenario becomes even more probable if one considers the growing attention being paid by international community, including the World Health Organization, to the prevention of non-communicable diseases.


34 Consider, for example, various taxes on sugary drinks, health warnings (including pictorial ones, as are currently contemplated by Thailand) and comprehensive advertising bans on alcohol products. See also e.g., P. Stephens, Food should be regulated like tobacco, say campaigners, 14 May 2014, available at: http://www.bbc.com/news/health-27446958 (last accessed 24 November 2015).

35 Cf. e.g. with the statement made by the President Barack Obama in his State of Union Address (Remarks by the President in State of the Union Address, 20 January 2015, available at https://www.whitehouse.gov/the-press-office/2015/01/20/remarks-president-state-union-address-january-20-2015 (last accessed 24 Novemberr 2015).


37 See e.g., K. Leonard, Domestic Violence and Alcohol: What is Known and What Do We Need to Know to Encourage Environmental Interventions?, 6(4) Journal of Substance Use 233 (2001).

To sum up, while it seems that the tobacco carve-out may be regarded as a victory for anti-tobacco activists, it is definitely not a total victory. Other provisions of the TPP that were identified by the commentators as potentially constraining governments in the area of tobacco control remain applicable. The same is true with respect to various other dispute settlement mechanisms (both within and outside the TPP) which are still available to the industry (either directly or indirectly). On the other hand, the inclusion of the tobacco carve-out may be criticized from the broader health perspective. Singling out one specific product does not appear to be the best answer to the systemic concerns that are raised in the context of international trade and investment obligations. Other industries may also legitimately question such an approach, fearing that it will establish a precedent that allows for the exclusion from trade and investment agreements of other products that produce certain negative externalities.