THE EMERGING ROLE OF INVESTOR-STATE DISPUTE SETTLEMENT ARBITRATION IN RESOLVING PATENT DISPUTES UNDER THE TRANS-PACIFIC PARTNERSHIP

INTRODUCTION

Investor-state dispute settlement ("ISDS") is an element of public international law that enables investors—those who own property in foreign countries—to initiate dispute settlement proceedings against foreign governments. These dispute settlement proceedings can result in millions of dollars in damages being assessed against an implicated government. An exception to the general public international law norm of state-to-state enforcement, ISDS emerged in its modern form in the 1960s and has since been incorporated into numerous bilateral and multilateral agreements.¹ Intellectual property disputes have not typically been the subject of ISDS proceedings, but that began to change with the North American Free Trade Agreement ("NAFTA").²

The recently signed (but yet to be ratified) Trans-Pacific Partnership ("TPP") further raises the prospect of allowing companies to pursue ISDS arbitration against foreign nations to resolve intellectual property disputes.³ Part I of this Paper reviews the history and evolution of ISDS. Next, Part II discusses how intellectual property disputes can give rise to a claim under the ISDS provisions contained in the TPP. Finally, Part III outlines why ISDS is not a desirable feature in the international intellectual property system.

³ Trans-Pacific Partnership (Feb. 4, 2016), available at https://ustr.gov/sites/default/files/TPP-Final-Text-Investment.pdf [hereinafter TPP]. Twelve member nations (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Vietnam) signed the TPP in Auckland, New Zealand on Thursday, February 4, 2016. The TPP will now undergo a two-year ratification period in which at least six of these countries, accounting for at least 85 percent of the combined gross domestic production of the twelve TPP nations, must approve the final text for the deal to be implemented.
I. INVESTOR-STATE DISPUTE SETTLEMENT: AN OVERVIEW

To understand the potential impacts ISDS may have on the international intellectual property system, we must first understand the origin, expansion, and impact of ISDS. Part A herein describes the origin and expansion of ISDS. Part B provides an overview of three ISDS case which illustrate the broad powers of ISDS in its modern form.

A. A Brief History of ISDS

ISDS is a more peaceful and streamlined alternative to the historical remedy for investors whose property was seized by foreign nations: gunboat diplomacy. Before the emergence of ISDS, nations often initiated military actions to defend private commercial interests. Apart from such an extreme remedy, investors only had two other alternatives: (a) seeking relief in the domestic courts of the offending foreign government or (b) hoping that their own government would take up the claim and engage in state-to-state diplomatic dispute settlement. Neither of these alternatives represented a high likelihood of action or success.

After years of failing to have their property rights upheld in foreign forums, investors eagerly sought a new solution. In the words of the Office of the United States Trade Representative ("USTR"), "ISDS represented a better way." Countries began to include ISDS provisions in their investment treaties beginning in the 1960s, and ISDS provisions have become commonplace since that time. The United States entered into its first bilateral investment treaty with ISDS provisions in 1982 (with Panama) and is currently party to fifty in-force agreements

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5 Id.
6 Supra note 1.
7 Id.
with ISDS provisions. By 2008, more than 2,700 bilateral investment treaties incorporating ISDS had exploded into existence worldwide. This trend shows no sign of stopping.

Just as the availability of ISDS has increased over time, Investors are also using ISDS procedures at an ever-increasing rate. Between 1972 and 1996 (24 years), investors registered 38 ISDS cases with the International Centre for Settlement of Investment Disputes (ICSID). Between 1997 and 2015 (18 years), investors registered 511 cases, including a record high of 52 cases in 2015 alone. The United States is now a leading proponent of the ISDS process, perhaps in part because foreign investors rarely pursue arbitration against the United States. Of all ISDS cases registered with the ICSID, only four percent have targeted a North American State (i.e. Canada, Mexico, or the U.S.). In the few times attempted, foreign investors have never succeeded in obtaining an ISDS award against the U.S.

B. **The Evolution of ISDS Into a Tool to Protect Investors’ “Expected Profits”**

Aside from becoming more commonly available and more commonly used, the nature of ISDS arbitration has evolved over time. Early on, investors used ISDS arbitration sparingly, typically to protect substantial property assets in a foreign country from expropriation of tangible property without compensation. In recent years, however, the scope of ISDS has expanded beyond the traditional concept of property expropriation. Arbitrators have issued multi-million

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11 Id.
12 Id. at 11.
13 Supra note 1.
14 Supra note 9
dollar awards against countries because legislation related to health, labor rights, and the environment interfered with foreign companies' expected profits. This emerging trend has sparked criticism by some commentators that ISDS is impinging on territoriality principle and the right of nations to self-govern.

The following three cases illustrate ISDS's broad influence over how nations address social and environmental issues within their borders. First, Piero Foresti et al. v. The Republic of South Africa demonstrates that the mere risk of an ISDS award can be enough to compel a government to change course on a piece of well-intentioned social legislation. Second, Metalclad Corp. v. The United Mexican States illustrates how protective environmental legislation can trigger a multi-million dollar ISDS award. Finally, Ethyl Corp. v. Canada, which ultimately led the Canadian Government to change a law, pay out millions of dollars, and produce corrective advertising, serves as a high water mark for the power of ISDS arbitration.

1. The South Africa Case

The South Africa Case arose when the South African legislature passed the Mining and Petroleum Resources Development Act ("MPRDA") in 2002, intending to boost the black population's participation in the mining industry. Without paying any compensation, the MPRDA replaced privately-owned mineral rights with licenses granted by the government. These licenses included a variety of conditions, such as requiring mining companies to hire

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15 Id.
16 Award, Case No. ARB(AF)07/1 (Aug. 4, 2010), available at https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1651_EN&caseId=C90 [hereinafter The South Africa Case].
19 See Mineral and Petroleum Resources Development Act 28 of 2002 (S. Afr.). The MPRDA was part of a broader effort by the South African Government to mitigate the lingering effects of apartheid.
historically disadvantaged South Africans (HDSAs) and requiring investors in the companies to sell a portion of their shares to HDSAs. A group of European mining companies initiated ISDS arbitration proceedings, complaining that the restrictions encumbering the new license rights diminished the value of their property. The companies argued that the MPRDA constituted an impermissible expropriation because the new license rights had less value than the private mineral rights held previously. The mining companies eventually agreed to abandon their ISDS action in exchange for the South African Government amending the MPRDA and eliminating the requirement to sell shares to HDSAs. Thus, although the ICSID never decided the case on its merits, the companies ultimately got their way, and the South African Government incurred over €5 million in unrecovered fees and costs. The South Africa Case received a very negative response from the South African public, and in response the South African Government terminated two of its bilateral investment treaties because the treaties “pose[d] risks and limitations on the ability of the government to pursue its constitutional-based transformation agenda.”

2. Metalclad Corp. v. The United Mexican States

In Metalclad, a U.S. waste disposal company sought to construct a landfill in Mexico. Metalclad applied for a municipal construction permit but started (and finished) construction before receiving the permit, apparently relying on assertions from various government officials

20 See id.
21 Supra note 16, ¶ 54-57.
23 Supra note 16, ¶ 79.
that the permit would be approved. Members of the surrounding community led vocal protests against the opening of the landfill due to environmental concerns. The landfill operated for several months before the government denied the original municipal construction permit and shut the site down. In addition, the Governor issued an Ecological Decree declaring a Natural Area—encompassing the area of the landfill—for the protection of rare cactus. The landfill sat dormant, and Metalclad filed an ISDS claim under Chapter 11 of NAFTA. Reasoning that allowing Metalclad to complete construction of its landfill before denying the construction permit amounted to an indirect expropriation, the ISDS panel ordered Mexico to pay more than $16 million to Metalclad as compensation.

3. Ethyl Corp. v. Canada

In Ethyl, a U.S. fuel additive company brought an ISDS action when Canada banned MMT—an additive in the investor’s gasoline—because of its alleged health and environmental dangers. On April 25, 1997, the Parliament of Canada passed the Manganese-based Fuel Additives Act (MFAA), which prohibited the importation and trade of MMT. The MFAA responded to the negative effects MMT was believed to have on vehicle emission systems along with the potential toxic effects of airborne manganese from automobile exhaust. Canada challenged the investor’s claims on the basis of both jurisdiction and standing (the MFAA had

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22 Supra note 17, ¶¶ 37-45.
23 Id. ¶ 50.
24 The Metalclad decision was the first time that an investor had successfully sued a state under the ISDS procedures contained in Chapter 11 of NAFTA. Chris Tollefson, Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA’s Chapter Eleven Investor-State Claim Process, 11 MINN. J. GLOBAL TRADE 183, 184 (2002).
25 See id. ¶¶ 107, 131.
26 Supra note 18, ¶ 5-7.
not actually gone into effect at the time the investor filed the complaint). Ethyl won the preliminary ISDS decision. Canada then opted to settle the case by paying out $13 million, lifting the ban, and commissioning corrective advertising stating that MMT is safe.

The South Africa Case, Metalclad, and Ethyl all evince the power of ISDS to get results for foreign investors, regardless of whether the case proceeds to a final resolution. By using ISDS, investors gain leverage and the corresponding ability to bargain for favorable changes in a nation’s laws while entirely bypassing domestic court systems. Perhaps most troubling, ISDS cases generally lack transparency. In Ethyl for example, “[a]lthough there was undoubtedly significant and intensive private communication during the run-up to and throughout the confrontation, little information was made public. Both panels met in private.” Thus, ISDS allows for laws touching on important matters of public concern, such as social equality and the environment, to be negotiated away behind closed doors in the favor of foreign investors.

II. ISDS AND INTELLECTUAL PROPERTY UNDER THE TPP

Like social equality and the environment, intellectual property rights are another important matter of public concern due to their significant influence on the dissemination and monetization of ideas, expressions, inventions, and information. During the roughly the same time ISDS began emerging, multilateral intellectual property treaty negotiations established minimum standards of protection for intellectual property, culminating in 1994 with the TRIPS Agreement. Although most early investment treaties paid little attention to intellectual property, IP chapters are now standard equipment in most investment treaties and free trade

32 Id.
33 Supra note 18, ¶ 96.
35 Id. at 56.
agreements (including the TPP), leaving an area of uncertainty in the international intellectual property system.\textsuperscript{37} This Section explores the interconnection between ISDS and intellectual property under the TPP. Part A analyzes whether intellectual property disputes can be properly arbitrated under the TPP's ISDS provisions and concludes that many intellectual property disputes could be arbitrated through ISDS. Part B supports the conclusion of Part A with a case study illustrating an analogous interpretation of ISDS provisions under NAFTA.

A. \textit{IP Rights Meet the Definition of a Covered Investment, and the TPP Allows Claims for Expropriation of IP Investments Because of a Broad Exception.}

The TPP's ISDS provisions only apply to investments; therefore, determining whether intellectual property disputes are within the scope of ISDS first requires analyzing the definition of an investment. TPP Chapter 9 defines the term “investment” to mean “every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.”\textsuperscript{38} The definition then goes on to list several particular forms of covered investments and explicitly identifies intellectual property rights.\textsuperscript{39} Accordingly, intellectual property rights are a type of investment within the scope of ISDS under the TPP.

An investor with a covered investment may bring three basic types of ISDS claims against signatory nations under the TPP. An investor may pursue an ISDS claim if: (1) a signatory nation either directly or indirectly expropriates its investment;\textsuperscript{40} (2) a signatory nation discriminates against the investor;\textsuperscript{41} or (3) a signatory nation fails to provide the investor with an

\textsuperscript{38} \textit{Id.} note 3, art. 9.1.
\textsuperscript{39} \textit{Id.}
\textsuperscript{40} \textit{Id.}, art. 9.8.
\textsuperscript{41} \textit{Id.}, art. 9.4-9.5 (which define the Most Favored Nation principle and the National Treatment principle).
internationally recognized minimum standard of treatment.\textsuperscript{42} This Paper focuses on only the first type of claim: direct or indirect expropriation.

Article 9.8 of the TPP establishes the ISDS claim for expropriation: "[n]o Party shall expropriate or nationalise a covered investment...except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate and effective compensation...; and (d) in accordance with due process of law."\textsuperscript{43} Proceeding further through Article 9.8, however, paragraph five includes an exclusion that appears to remove IP-related disputes from the scope of expropriation claims:

\begin{quote}
[t]his Article shall not apply to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS agreement, or to the revocation, limitation, or creation of intellectual property rights, to the extent that the issuance, revocation, limitation or creation is consistent with Chapter 18 (Intellectual Property) and the TRIPS Agreement.\textsuperscript{44}
\end{quote}

The paragraph five exclusion, however, has a critical exception that makes it possible for foreign investors to bring IP disputes back within the scope of an expropriation claim (i.e. to render the exclusion moot). The paragraph five exclusion is only operable "to the extent that the issuance, revocation, limitation or creation [of IP rights] is consistent with Chapter 18 (Intellectual Property) and the TRIPS Agreement."\textsuperscript{45} The negative implication of the exception means that IP disputes can be the subject of ISDS expropriation claims if the revocation, limitation or creation of IP rights is not consistent with either the TPP's intellectual property chapter or with TRIPS.

Because of this 'exception to the exclusion', whether or not an IP dispute may proceed under an expropriation claim rests entirely on the meaning of the term "consistent." Put

\begin{footnotes}
\item[42] \textit{Id.}, art. 9.6.
\item[43] \textit{Id.}, art. 9.8.
\item[44] \textit{Id.}, art. 9.8(5).
\item[45] \textit{Id.} (emphasis added).
\end{footnotes}
practically, a well plead ISDS complaint need only allege that a signatory nation revoked, limited, or created IP rights in a manner that is not “consistent” with either the intellectual property chapter or with TRIPS. The Oxford English Dictionary includes no fewer than seven definitions for the term “consistent,” leaving plenty of room for creative lawyering.

B. Eli Lily v. The Government of Canada

U.S. pharmaceutical giant Eli Lilly decided to test the meaning of the word “consistent” appearing in a similar context within NAFTA. NAFTA’s investment chapter includes an apparent exclusion from ISDS arbitration for typical IP disputes; but, just like in the TPP, the exclusion includes a gaping exception: “[t]his Article does not apply to...the revocation, limitation or creation of intellectual property rights, to the extent that such issuance, revocation, limitation or creation is consistent with Chapter Seventeen (Intellectual Property).”

Eli Lilly initiated an ISDS claim against Canada after Canadian courts invalidated two of its pharmaceutical patents for lacking utility. Canadian patent law includes a so-called “promise of the patent doctrine” that requires patent applications to support the claimed inventive promise in order to satisfy the utility requirement. The Canadian courts reasoned that Eli Lilly’s patents failed to show or predict that the medicines would provide the promised benefits.

In its Notice of Intent to Submit a Claim to Arbitration, Eli Lilly argues that this judicial interpretation of the utility requirement is not consistent with NAFTA Chapter 17 (Intellectual Property) and as such, the Court’s invalidation of its patents amounted to an indirect

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46 Consistent, OXFORD ENGLISH DICTIONARY (2nd Ed. 1989).
47 NAFTA, supra note 2.
48 Id., art. 1110(7), emphasis added.
50 Supra note 37 at 1121.
expropriation of Eli Lilly's intellectual property investment.\footnote{Supra note 49 ¶ 93.} NAFTA's discussion of utility in Chapter 17 is brief. Article 1709 provides:

> each Party shall make patents available for any inventions, whether products or processes, in all fields of technology, provided that such inventions are new, result from an inventive step and are capable of industrial application. For purposes of this Article, a Party may deem the terms "inventive step" and "capable of industrial application" to be synonymous with the terms "non-obvious" and "useful", respectively.\footnote{NAFTA, supra note 2, art. 1709(1).}

The language in NAFTA lacks specifics, presumably leaving it up to each signatory country to develop the precise nature of the utility requirement. Nevertheless, Eli Lilly contends that "the effect of [Canada's] judicial 'promise doctrine' is to impose an additional condition precedent and a more onerous standard of utility than mandated by [TRIPS and NAFTA]."\footnote{Supra note 49 ¶ 93(3).}

III. MATTERS PERTAINING TO THE ISSUANCE, REVOCATION, LIMITATION, OR CREATION OF IP RIGHTS SHOULD BE EXCLUDED FROM THE TPP'S INVESTMENT CHAPTER WITHOUT EXCEPTION

Whether Eli Lilly's argument has merit remains to be decided: the hearing is scheduled to begin on May 30, 2016.\footnote{Eli Lilly and Company v. Government of Canada, GLOBAL AFFAIRS CANADA (Dec. 31, 2015), http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/elh.aspx?lang=eng.} If the NAFTA arbitration panel adopts Eli Lilly's interpretation of the term "consistent," however, the door will be open for corporations to demand compensation stemming from judicial invalidation of their patents (or other forms of IP). Brandishing the stick of a large ISDS award will give these corporations tremendous leverage to negotiate favorable changes in a target country's intellectual property laws.

If this is already occurring under NAFTA, it will get worse under the TPP. Aside from adding eleven more nations to the mix, the TPP's "exception to the exclusion" is broader than NAFTA's. Where NAFTA's exception requires only an inconsistency with its internal IP
chapter, the TPP’s exception is operable where there is an inconsistency with either its IP chapter or the TRIPS agreement. The IP chapter of the TPP alone amounts to roughly 32,000 words, including 265 footnotes. TRIPS adds another 12,000 words. Because operation of the exception requires merely an inconsistency between the state action and these texts, IP disputes can and will be readily captured within the scope of ISDS arbitration.

The principles of territoriality and sovereignty are cornerstones of international law and international relations. Sovereignty includes the right of the State to create and enforce laws within its territory, and the right to self-govern. If the exception in the TPP is maintained, the consequence is that in agreeing to an investment treaty, a government takes on an obligation to constrain the evolution of its national intellectual property standards. The public policy that drives this type of evolution would be limited to whatever exists at the time the treaty is signed.

The international intellectual property system does not embrace such rigidity. Instead, it has a working tradition of deference to differing national approaches. For example, TRIPS reflected multilateral commitment to minimum standards—not harmonization.\textsuperscript{55} TRIPS Art. 1.1 states, “[m]embers shall be free to determine the appropriate method of implementing the provisions of this Agreement within their own legal system and practice.”\textsuperscript{56} In addition, The General Agreement on Tariffs and Trade (GATT), explicitly reserves to member states the right to apply measures “necessary to secure compliance with laws or regulations . . . not inconsistent with the provisions of this Agreement, including . . . the protection of patents, trademarks and copyrights.”\textsuperscript{57}

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\vspace{1em} \textsuperscript{55} Supra note 37 at 1128.
\textsuperscript{56} TRIPS, supra note 36.
In order to preserve the flexibility imbued within the international intellectual property system, Article 9.8, paragraph 5 of the TPP should be revised to eliminate the exception to the exclusion. The revised provision would simply recite “[t]his Article shall not apply to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS agreement, or to the revocation, limitation, or creation of intellectual property rights.” The Article 9.8, paragraph 5 exclusion appears to have been drafted with the intent of excluding intellectual property disputes from ISDS expropriation claims. Eliminating the exception to the exclusion will preserve this intent and shield national intellectual property laws from being manipulated behind the closed doors of ISDS.

CONCLUSION

ISDS is a valuable tool for investors seeking redress in foreign countries. Not all areas of the law, however, should be included within its scope. ISDS allows for laws touching on important matters of public concern, such as social equality, the environment, and now potentially intellectual property, to be negotiated away behind closed doors in the favor of foreign investors. In contrast, the international intellectual property system has a tradition of deference to differing national approaches and gives nations the flexibility to self-govern. NAFTA and the to-be-ratified TPP include strangely-drafted exclusionary language that appears intended to remove IP disputes from the scope of ISDS. A closer examination, however, reveals an exception that could render the exclusion moot. To maintain the integrity of the international intellectual property system, under the TPP this exception should be removed.