Why Fragmentation of International Law Matters: The Case of Indonesia's Bilateral Investment Treaty Policy and Its Impact on Its Effective Use of the WTO's Dispute Settlement System

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An unexplored are in the discussions of fragmentation of international law is the relationship between the WTO Agreements and Bilateral Investment Treaties (BITs). Indonesia has recently challenged the United States before the Dispute Settlement Body of the World Trade Organization in a case regarding US measures affecting the importation and sale of cigarettes from Indonesia. If a WTO Panel or the Appellate Body were to find the United States' measures inconsistent with the WTO Agreements and the United States were not to comply with the Panel or Appellate Body report, the WTO could authorize Indonesia to suspend concessions to the United States under the GATT, the GATS or the TRIPS agreement. This paper addresses the possible conflicts that might arise between the authorisation to suspend concessions under the WTO Agreements on the one hand and BITs on the other. This paper argues that a BIT between Indonesia and the Unites States could severely undermine Indonesia's position to persuade the United States to comply with an adverse ruling by the WTO in the cigarettes case.

Keywords: fragmentation of international law, WTO Agreements, Bilateral Investment Treaties, Dispute Settlement Body

I. Introduction

This paper addresses the possible conflicts between Bilateral Investment Treaties (BITs) and the suspension of concessions under the World Trade Organization Agreements (WTO).

Indonesia and the United States are members to the WTO, and have signed a Trade and Investment Framework Agreement (TIFA) with the United States.[2] One of the objectives of the TIFA is to foster an open and predictable environ-

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ment for international trade and investment. Even though Indonesia and the United States have not signed a bilateral investment treaty, for the purposes of this I will assume that they have (a hypothetical BIT).

On June 2009, the United States enacted the 'Family Smoking Prevention Tobacco Control Act of 2009 Public Law 111-31 (the Act).[3] The Act prohibits the production or sale in the United States of all cigarettes with a "characterizing flavour" (clove cigarettes) other than menthol or tobacco.[4] Indonesia is the world's largest producer of clove cigarettes and exports $500 million worth annually, a fifth of that to the United States.[5] The Indonesian delegation to the World Trade Organization (WTO) stated that "well over 6 million Indonesians depended directly or indirectly on clove cigarette production to put food on the table, clothe on their children's backs and a day's wages in their pocket."[6] Thus, the United States' ban on the importation and sale of clove cigarettes is of major importance to the Indonesian population.

The severe impact of the ban on Indonesia's economy let it to resort to informal diplomatic channels, such as writing to and meeting with Members of the United States' Congress and holding informal, bilateral consultations with the United States in Geneva in August 2009.[7] Failure to resolve the issue led Indonesia to request consultations[8] with the United States under the auspices of the WTO's Dispute Settlement Understanding (DSU). Subsequently Indonesia requested the WTO to establish a panel of experts to examine the legality of the measure under the WTO Agreements.[9] The WTO established a panel to hear

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[2] See: Trade & Investment Framework Agreement program of the United States. TIFAs provide strategic frameworks and principles for dialogue on trade and investment issues between the United States and the other parties to the TIFA. Available at <http://www.ustr.gov/trade-agreements/trade-investment-framework-agreements> accessed 1 September 2010.

[3] Request for Establishment of a Panel by Indonesia, 'United States – Measures Affecting the Production and Sale of Clove Cigarettes' WTO Document WT/DS406/2, 9 June 2010, p. 1. Available at www.wto.org

[4] Ibid.

[5] F Maliki, ' Ruling Sought from WTO on US Clove Cigarette Ban ' Jakarta Globe (Jakarta 13 June 13 2010) http://www.thejakartaglobe.com/business/ruling-sought-from-wto-on-us-clove-cigarette-ban/380328 accessed 1 September 2010.

[6] Dispute Settlement Body, 'Minutes of the Meeting' WTO Document WT/DSB/M/284, 22 June 2010, para. 65. Available at ww.wto.org.

[7] Ibid, para. 66.

[8] Request for Consultations by Indonesia, 'United States – Measures Affecting the Production and Sale of Clove Cigarettes' WTO Document WT/DS406/2, 7 April 2010, p. 1. Available at www.wto.org

[9] Ibid.

the dispute on 20 July 2010. Indonesia challenged the United States' Act under the General Agreement on Tariffs and Trade (GATT) and the Agreement on Technical Barriers to Trade (TBT).

Successfully challenging the ban and assuring compliance by the United States with a WTO ruling is of major importance to Indonesia. Accordingly, it is important that Indonesia – if it were to prevail in the dispute – be able to use all of the countermeasures that the WTO provides in case the United States failed to comply with the WTO's ruling.

The core proposition of this paper is the following: The Indonesia-United States BIT could severely limit Indonesia's options to effectively use the countermeasures provided by the WTO in order to induce the United States to comply with an adverse ruling in case it refrained from voluntarily doing so.

The structure of the paper is as follows: Part II will briefly describe the WTO's dispute settlement system and analyse the countermeasures that are available to Indonesia in case the United States failed to comply with an adverse ruling. Part III will examine possible countermeasures that Indonesia could take against the United States. Part IV will provide a brief overview of the protection of intellectual property rights (IPRs) under BITs. Part V will examine present possible conflicts between the BIT and Indonesia's countermeasures authorized by the WTO. Part VI shows the uncertainty the legal analysis provides to resolve possible conflicts. Finally, Part VII concludes and explains the preferred solution.

II. WTO Dispute Settlement System in a Nutshell

WTO Members may challenge other Members' measures – laws, decrees, regulations or executive orders for example – under the WTO Agreements pursuant to the Dispute Settlement Understanding (DSU).

There are four major phases of WTO dispute settlement. The first phase is bilateral consultations.[10] Consultations give the parties an opportunity to discuss the matter and to find a satisfactory solution without resorting to litigation. If consultations fail, the parties proceed to the second phase, panel proceedings. In this phase a panel of experts is established in order to solve the dis-

[10] See Article 4 of the DSU.

pute.[11] If a party to the panel proceedings is unhappy with the result, it may appeal the case before the Appellate Body.[12] Rulings by the Appellate Body are final. Once the Appellate Body has issued its report, the Dispute Settlement Body (DSB)[13] is charged with monitoring the implementation of the recommendations.[14]

If DSB recommendations are not implemented, the prevailing party is entitled to seek compensation from the non-complying member.[15] If no compensation is agreed, the prevailing member may request DSB authority to suspend WTO concessions to that member (sometimes referred to as "retaliation"). Accordingly, Members may suspend either tariff concessions or other obligations.[16]

The suspension of concessions is regulated by the DSU.[17] Article 22.3 of the DSU sets out the principles and procedures that a complaining party – Indonesia in this case – has to follow in order to suspend concessions under the WTO Agreements:

1. The general principle is that the suspension of concessions or other obligations should be sought in the same sector(s) were the breach has been found.[18] In the *US – Clove Cigarettes* dispute, Indonesia would first have to seek suspension of concessions in goods because that is what is regulated by the GATT and the TBT, the agreements under which the Act was challenged.
2. If that Member considers that it is not practicable or effective, it may seek the authorisation under a different sector in the same agreement;
3. If suspending concessions under a different sector in the same agreement is

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[11] See Articles 6-16 of the DSU

[12] See Article 17 of the DSU.

[13] The Dispute Settlement Body is composed of all members of the WTO and is established to administer the rules and procedures of the Dispute Settlement Understanding. For a description of its functions see Article 2 of the DSU.

[14] Article 21 of the DSU.

[15] See Article 22 of the DSU.

[16] Petros C. Mavroidis, George A. Berman, Mark Wu, The Law of the World Trade Organization (WTO): Documents, Cases, Materials (West, 2010), p. 1074.

[17] See the Annex for the complete text of Article 22 of the DSU.

[18] See the Annex for a definition of sectors.

[19] Decision by the Arbitrators, European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, WT/DS27/ARB/ECU, 24 March 2000, DSR 2000:V, 2237, para. 6.3 (EC – Bananas III (Ecuador) (Article 22.6 – EC)).

not practicable or effective and the circumstances are serious enough, the Member may seek the suspension of obligations under a different agreement. This is commonly referred to as cross-retaliation. Accordingly, Indonesia could suspend concessions under the General Agreement on Trade in Services (GATS) or the Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) for United States violations under the GATT.

The suspension of concessions is to be authorized automatically unless the DSB decides by consensus to reject the request. If the member concerned objects to the level of suspension proposed or claims that the principles and procedures explained above have not been followed by the complaining party, the matter shall be referred to arbitration.

The purpose of suspension of concessions is to induce compliance. This was stated by the arbitrator in the *US – Offset Act (Byrd Amendment) (Brazil) (Article 22.6 – US)* case:

> "The general obligation to comply with DSB recommendations and rulings seems to imply that suspension of concessions or other obligations is intended to induce compliance, as has been acknowledged by previous arbitrators.[19] However, exactly what may induce compliance is likely to vary in each case, in the light of a number of factors including, but not limited to, the level of suspension of obligations authorized."[20]

How does the suspension of concessions induce WTO Members to comply? Abbot explains it in the following manner:

> "The theory behind authorising a suspension of concessions is that, at least in the short term, political constituencies (i.e. private operators) in the country against which trade barriers are imposed will exercise their influence on the government to bring trade measures into conformity in order to avoid bringing harm to them."[21]

Abbot's explanation is corroborated by Members' experience, which has shown that the best way to use the suspension of concessions is to skilfully

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[20] Decision by the Arbitrator, United States – Continued Dumping and Subsidy Offset Act of 2000, Original Complaint by Brazil – Recourse to Arbitration by the United States under Article 22.6 of the DSU, WT/DS217/ARB/BRA, 31 August 2004, DSR 2004:IX, 4341, para. 6.2. (US – Offset Act (Byrd Amendment) (Brazil) (Article 22.6 – US))

[21] Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, ICTSD Programme on Dispute Settlement and Legal Aspects of International Trade, Issue paper No. 8, International Centre for Trade and Sustainable Development, Geneva, Switzerland., p. 10.

target economic sectors in the losing party in order to create domestic political pressure that may lead the losing Member to comply with the adverse ruling. The experience of the European Union, the United States and Canada is telling in this respect.

Commenting on the European Union's experience, Nordstrom explains that the best strategy is to target goods and sectors produced by politically influential sectors.[22] For example, he notes that in the *US – Steel Safeguards*[23] dispute, the European Union threatened to raise tariffs to goods from 'swing states' in the 2004 presidential elections, such as steel from Pennsylvania and orange juice from Florida.[24] According to Ehring, this strategy played a role in President's Bush decision to abrogate the safeguards. He notes that the products subject to suspension of concessions were politically targeted which meant selecting United States' industries with domestic political leverage as well as industries located in politically critical states for the 2004 United States' presidential election.[25]

Canada's strategy is similar. In the *US – Final Countervailing Duty Determination regarding Softwood Lumber*[26] dispute, Canada chose to raise the tariffs on live swine, ornamental fish, oyster and cigarettes, among others. Canada targeted these products because the supporters of the offending legislation were from Virginia and Maine, and the chosen products were from their districts.[27]

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[22] H Nordstrom, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p. 267. He notes that this strategy is also used by the United States, Canada and Mexico.

[23] Panel Reports, United States – Definitive Safeguard Measures on Imports of Certain Steel Products, Wt/Ds248/R / Wt/Ds249/R / Wt/Ds251/R / Wt/Ds252/R / Wt/Ds253/R / Wt/Ds254/R / Wt/Ds258/R / Wt/Ds259/R, And Corr.1, Adopted 10 December 2003, As Modified By Appellate Body Report Wt/Ds248/Ab/R, Wt/Ds249/Ab/R, Wt/Ds251/Ab/R, Wt/Ds252/Ab/R, Wt/Ds253/Ab/R, Wt/Ds254/Ab/R, Wt/Ds258/Ab/R, Wt/Ds259/Ab/R, Dsr 2003:VIII, 3273.

[24] Ibid, p. 268.

[25] L Ehring, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p. 248.

[26] Panel Report, United States – Final Dumping Determination on Softwood Lumber from Canada, WT/DS264/R, adopted 31 August 2004, as modified by Appellate Body Report WT/DS264/AB/R, DSR 2004:V, 1937

[27] V Khabayan, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p. 278.

The United States also targets goods from political constituencies which might exert some pressure. In the *EC – Hormones (US)*[28] dispute, the United States imposed 100 per cent *ad valour* duty rates on thirty-four different products. These were primarily beef and pork-related products from France, Germany, Italy and Denmark, products which media reports suggested were selected because they came from countries that were perceived to be the biggest supporters of the hormone ban.[29] Further, Pauwelyn and Bown state that on 14 January 2009, the United States – in what many saw as a 'parting shot' against France from outgoing President Bush – changed the retaliatory duty from 100 to 300 per cent on single product, Roquefort Cheese.[30] The duty was politically targeted. Within a week of the imposition of the duty, Roquefort producers led by media star and former presidential candidate José Bové protested heavily in the streets of Paris.[31] This shows that targeting specific constituencies can create domestic lobbies that push to withdraw the measure that is affecting their products.

Note that these examples refer to retaliation between large developed economies – the United States, the European Union and Canada. The volume of trade between these economies makes the suspension of concessions a viable option because it can cause enough harm to domestic constituencies who can then exert enough political pressure on the government to remove the WTO-inconsistent measure. However, things are different for developing countries. A common criticism of the WTO's retaliation rules is that developing countries with small domestic markets are not able to impose sufficient economic or political losses within the larger WTO Members by suspending concessions – raising tariffs for example – in order to induce compliance, and further, that suspending trade concessions may be more detrimental to the developing country than the non-complying Member.[32]

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[28] Panel Report, EC Measures Concerning Meat and Meat Products (Hormones), Complaint by the United States, WT/DS26/R/USA, adopted 13 February 1998, as modified by Appellate Body Report WT/DS26/AB/R, WT/DS48/AB/R, DSR 1998:III, 699

[29] S Andersen and J Blanchet, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p.240.

[30] C Bown and J Pauwelyn, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p. 14.

[31] Ibid.

Two developing countries that sought to retaliate against developed countries were faced with these difficulties. In the *US – Gambling*[33] case, Antigua and Barbuda successfully challenged a cross-border internet gambling ban imposed by the United States. The United States failed to comply with the ruling, which led Antigua to request authorization to retaliate. In its request for retaliation, Antigua stated that ceasing all trade whatsoever with the United States[34] would have virtually no impact on the economy on the United States' economy, which could easily shift such a relative small volume of trade elsewhere.[35] Ecuador faced the same difficulty with the European Union in the *EC – Bananas III (Ecuador)*[36] case. Ecuador had successfully challenged the European Union's regime for the importation of bananas, and the European Union had failed to comply with the WTO's ruling. Ecuador requested authorization to retaliate and the European Union objected to the retaliation proposed by Ecuador so the issue was resolved in arbitration *EC – Bananas III (Ecuador) (Article 22.6 – EC)*.[37] The arbitrator stated that because Ecuador accounted for a negligible proportion of the EU's exports, the suspension of concessions was unlikely to have any significant effect on demand of those EU exports.[38]

The criticism that developing countries may harm themselves by suspending concessions was also present in these cases. The arbitrator in the *EC – Bananas III (Ecuador) (Article 22.6 – EC)* dispute stated that "in situations were the complaining party is highly dependent on imports from the other party,

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[32] H Nottage, H Nordstrom, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p. 319.

[33] Panel Report, United States – Measures Affecting the Cross Border Supply of Gambling and Betting Services, WT/DS285/R, adopted 20 April 2005, as modified by Appellate Body Report WT/DS285/AB/R, DSR 2005:XII, 5797. (US – Gambling).

[34] Antigua accounted for less than 0.02 percent of US exports.

[35] Decision by the Arbitrator, United States – Measures Affecting the Cross Border Supply of Gambling and Betting Services – Recourse to Arbitration by the United States under Article 22.6 of the DSU, WT/DS285/ARB, 21 December 2007, DSR 2007:X, 4163 (US – Gambling (Article 22.6 – US)), para. 3.

[36] Panel Report, European Communities – Regime for the Importation, Sale and Distribution of Bananas, Complaint by Ecuador, WT/DS27/R/ECU, adopted 25 September 1997, as modified by Appellate Body Report WT/DS27/AB/R, DSR 1997:III, 1085.

[37] Decision by the Arbitrators, European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU, WT/DS27/ARB/ECU, 24 March 2000, DSR 2000:V, 2237.

[38] EC – Bananas III (Ecuador) (Article 22.6 – EC), para. 95.

it may happen that the suspension of certain concessions or certain obligations entails more harmful effects for the party seeking suspension of concessions than for the other party."[39] In the *US – Gambling (Article 22.6 – US)* case, the arbitrator noted that the suspension of concessions in the services sector would impose additional costs on Antigua's consumers, as well as adversely affect its travel, tourism and other services industries.[40]

Given the difficulty that developing countries may face by suspending concessions under the GATT or GATS, a more viable option is cross-retaliating under the TRIPS Agreement.

The possibility to cross-retaliate has its origins in a coalition of developed countries led by the United States under the Uruguay Round. The original objective of allowing cross-retaliation was to ensure that countries such as the United States could use their leverage as an importer of goods and raise tariffs in order to induce compliance by developing countries if they were found to breach the GATS or the TRIPS Agreement.[41]

I explained above why the best way to induce compliance is by targeting sectors that affect political constituencies – private actors – that will exert pressure on the non-complying Member to comply with the WTO's ruling. According to Abbot, the pharmaceutical and the copyright/entertainment industry – the principal proponents of the TRIPS – remain the most powerful political constituencies demanding strong IPR protection.[42] Accordingly, retaliatory measures addressing those sectors hold the potential of creating lobbies in the non-compliant Member that will push the government to fulfil its WTO obligations.[43] Further, "The greater the cost of retaliation in the IP area, the greater the possibility of lobbying pressure in favour of the retaliating country."[44]

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[39] Ibid, para. 95.

[40] Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, supra note 30, p. 7, quoting US – Gambling (Article 22.6 – US), para. 4.90-4.100.

[41] James McCall Smith, 'Compliance Bargaining in the WTO: Ecuador and the Bananas Dispute', Conference on Developing Countries and the Trade Negotiation Process, 6-7 November 2003. p. 14-15.

[42] Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, supra note 30, p. 37.

[43] M. Basso and E. Beas, "Cross-Retaliation Through TRIPS in the Cotton Dispute?", Bridges, 5 (May 2005), p. 19.

[44] Ibid.

The political economy of the threat of retaliatory action would be as follows.[45] Indonesia could threaten non-acceptance of patent applications or issue a compulsory license without remuneration of Pfizer and others, and could also suspend the distribution of royalties of licensees of copyrighted works in retaliation of the United States failing to comply with the adverse ruling in the *US – Clove Cigarettes* case. Pfizer and other pharmaceuticals or copyright industries would then have a very strong incentive to lobby the politicians in the United States supporting the cigarettes ban to force lifting the ban.

Ecuador adopted this strategy in the Bananas dispute. After the failure of the European Union to bring its banana regime in conformity with the WTO Agreements, Ecuador requested authorization to cross-retaliate under the TRIPS. Ecuador targeted three general types of intellectual property: music, copyrights, geographical indications and industrial designs.[46] Ecuador's objective was to focus sanctions on EU Members such as France, Spain and the United Kingdom that were the most hostile to the liberalization, while exempting the Netherlands and Denmark in 1998 which had voted against the banana regime.[47] According to McCall Smith, Ecuador's threat to cross-retaliate enhanced its negotiation position with the EU and further moved the EU to support Ecuador's reduction of its external debt in the Club of Paris in exchange for not implementing cross-retaliation.[48] Mendel, who was counsel for Antigua in the *US – Gambling* dispute, notes that the intended effect of Antigua's cross-retaliation request – even though it has chosen not to apply sanctions - was to exert sufficient domestic political pressure to induce the United States to comply with its obligations, or at least engage in negotiations effecting a reasonable compromise.[49]

Brazil also threatened to cross-retaliate against the United States in the *US – Upland Cotton*[50] dispute. Brazil challenged US subsidies to its cotton indus-

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[45] Adjusted example from Arvind Subramanian and Jayashree Watal, 'Can TRIPS Serve as an Enforcement Device for Developing Countries in the WTO?' Journal of International Economic Law 3 (3) 2000, p. 408.

[46] James McCall Smith, 'Compliance Bargaining in the WTO: Ecuador and the Bananas Dispute', supra note 44.

[47] Ibid, p. 15.

[48] Ibid, p. 18.

[49] M. E. Mendel, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p. 313.

try and prevailed at both Panel and Appellate Body stages. The US did not comply and in response Brazil requested authorisation from the WTO to suspend concessions. The WTO's DSB authorized Brazil to impose trade sanctions worth US$ 294.7 million including the possibility to cross-retaliate under the GATS and the TRIPS agreements due to the United States' failure to comply with previous WTO rulings on US cotton subsidies.

Brazil requested that the WTO authorise it to cross-retaliate under the GATS and the TRIPS on the assumption that retaliation in goods alone would harm the Brazilian economy and thus would not be an effective countermeasure.[51] The panel granted such request on the condition that a threshold of US$ 410 million worth of sanctions had been reached.[52] Brazil threatened to suspend concessions by raising tariffs and also by cross-retaliating under the TRIPS Agreement. Brazil issued such threats in March 2010, and in 6 April the United States and Brazil agreed to negotiate an end to the cotton dispute. The "buzz" in the WTO was that the threat to cross-retaliate under the TRIPS had played an important role in getting the United States to enter into negotiations.

The examples of Brazil's and Ecuador's show why several commentators have argued that suspending TRIPS obligations may be more practicable and effective in inducing compliance when implemented by a developing Member against a developed one.[53] Accordingly, if Indonesia was to prevail in the *US-Clove Cigarettes* dispute and the US failed to comply, the best option for it would be to cross-retaliate under the TRIPS Agreement.

III. Indonesia's Options for Cross-Retaliation

It is my understanding that Indonesia does not have a law allowing it to

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[50] Panel Report, United States – Subsidies on Upland Cotton, WT/DS267/R, Corr.1, and Add.1 to Add.3, adopted 21 March 2005, as modified by Appellate Body Report WT/DS267/AB/R, DSR 2005:II, 299.

[51] Bridges Weekly Trade News Digest, Volume 13, Number 30, 9 September 2009, p. 5.

[52] Decision by the Arbitrator, United States – Subsidies on Upland Cotton – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement, WT/DS267/ARB/1, 31 August 2009.

[53] W Zdouc, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010); Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, supra note 30.

suspend IPRs on the basis of authorization by the WTO. This is not suprising. Indeed, "[m]ost countries have not included in general IP legislation a grant of authority to the executive to suspend rights or alter the conditions to be exercise on the basis of retaliation authorised by the WTO DSB."[54] Thus, Indonesia will probably need to enact a law allowing for cross-retaliation. It could learn from Brazil's experience. After the US failed to comply with the ruling in the US – Upland Cotton case and the WTO authorized it to cross-retaliate, Brazil submitted a bill to the Brazilian parliament permitting derogation from domestic intellectual property rights and guarantees in order to be able to cross-retaliate against the US.[55]

A bill proposed by Brazil's Foreign Trade Chamber (CAMEX) in 2007 sought to establish a legislative framework for the suspension of TRIPS obligations in Brazil.[56] The bill – PL 1893/2007 – envisaged the following measures:

1. Temporary rejection of requests for the registration of intellectual property rights;
2. Interruption of the proceedings on pending applications for registration of rights;
3. Blocking of international payments of royalties and technical assistance resulting from the exploitation of intellectual property rights:
4. Granting of compulsory licenses
5. Discriminatory fees for the processing of applications related to the registration of intellectual property rights or to the exploitation of those rights;
6. Refusal of registration to exploit economically the object of protection of the right;
7. Public domain over intellectual property rights; and
8. Extinction of intellectual property rights.

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[54] Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, supra note 30, p. 33.

[55] W Zdoue, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p. 527.

[56] L. E. Salles, 'The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p. 303.

[57] Interview with Carolina Saldanha, International Trade Advisor at UNO Trade Strategy, Brazil.

Resolution 16 by the Brazilian Chamber of Foreign Trade (CAMEX) dated March 15 2010 started public consultations regarding the potential suspension of US companies' rights in the area of intellectual property. Among the measures in the proposals are the following:[57]

1. Temporary withdrawal of the patent rights on certain products or processes affecting:
   a. Pharmaceutical products and processes, including those used for veterinary processes;
   b. Chemical products and processes used in agriculture; and
   c. Biotechnological products and processes used in agriculture.
2. Compulsory and non-remunerated patent licensing of products and process relating to:
   a. Pharmaceuticals, including veterinary ones
   b. Chemicals used for agricultural purposes
   c. Biotechnological used for agricultural purposes.

Abbott suggests other options for cross-retaliation. In the field of copyrights, the suspension of concessions could take the form of a limitation on the distribution of royalties that would otherwise be received from licenses of copyrighted works without affecting the basic right of the copyright holders to exclude others from the use of their work.[58] With respect to patents, he suggests that certain rights such as preventing importation, local sale (and offering) and use could be suspended without granting third parties the right to make a product in the domestic market.[59] With respect to industrial designs, Abbott suggests that authorizing manufacturers to produce textiles and clothing which copy designs from the complained-against Member could be a useful mechanism to induce compliance.[60]

In the event that the United States failed to comply with an adverse ruling in the cigarettes case, Indonesia could use these examples and tailor the cross-retaliation in a manner that it causes the highest political pressure in the US to comply with the ruling.

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[58] Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, supra note 30, p. 23.

[59] Ibid, p. 26.

[60] Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, supra note 30, p. 29.

Here is where the hypothetical BIT between Indonesia and the United States comes in. If Indonesia were to cross-retaliate against the US in the manner described above, the question that arises then is this: Does suspending TRIPS obligations breach the hypothetical US-Indonesian BIT? Before addressing this issue, I will first provide a brief overview of IPR protection in BITs.

IV. Protection of IPRs in BITs

Indonesian international investment agreements tend to include IPRs within their definition of investment.[61] The United States also includes IPRs in the definition of investment in its BITs. Accordingly, it is almost certain that an Indonesia-US BIT would include IPRs as protected investments. Further, the BIT – as almost all BITs – would provide protection against expropriation and guarantees such as fair and equitable treatment, national treatment and full protection and security, among others.

The inclusion of intellectual property rights (IPRs) is common in international investment agreements (IIAs).[62] Having IPRs in the definition of investment means that they are protected by the general guarantees afforded to investors under IIAs. Most BITs provide the possibility to sue a host state directly, and this has been described as an essential feature of most BITs.[63] Both Indonesia[64] and US[65] BITs certainly provide this possibility. Further, Indonesian and US BITs include protection against expropriation, national treatment, fair and equitable treatment and most-favoured nation among others. It follows that a US investor that has valid IPRs in Indonesia will have made a protected investment under the BIT, and it would be entitled to sue Indonesia before an international tribunal for state action which breaches the protections afforded by the BIT.

Commentators have identified instances in which BITs might be breached due to governmental action affecting IPRs. For example, Marie Louise Seeling argues that a patent revocation or invalidation may constitute an expropriation

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[61] *See* for example: Article I (a) (IV) of the Indonesia-UK BIT, Article 1 of the Indonesia-Spain BIT, Article 58(f) (VI) of the Japan-Indonesia EPA (2007), and Article 1(2) of the 2003 Japan-Korea BIT.

[62] *See* the definition of intellectual property as an investment in the United States' 2004 Model BIT. Available at: http://www.ustr.gov/sites/default/files/U.S.%20model%20BIT.pdf.

[63] Eastern Sugar BV v Czech Republic, Partial award and partial dissenting opinion, SCC Case No 088/2004; IIC 310 (2007), para. 180.

in cases where a State changes its laws in a way that aims only at foreign investors.[66] Ruse-Khan suggests that the temporary withdrawal of IPRs might constitute an expropriation under international law.[67] Mendehall argues that the issuance of compulsory licenses without giving the patent owner an opportunity to present his case could amount to a denial of justice in breach of a BIT.[68] Gibson argues that the issuance of a compulsory license without payment of adequate compensation in accordance with Article 31(h) for the TRIPS provides strong evidence for a finding of expropriation.[69] Liberti notes that failures to provide adequate remedies for IPR violations under domestic law could give rise to a denial of justice contrary to BITs.[70]

For a governmental action against IPR to constitute an expropriation it must amount to a "substantial deprivation" of property.[71] That the most significant criterion to establish a finding of indirect expropriation is the severity or significance of the impact the measure had on the owner's ability to use and enjoy the property is usually referred to as the "sole effects doctrine".[72] Accordingly, the economic impact on the IPR must be very significant in order to constitute an expropriation.

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[64] See: Article X of the Indonesia-Spain BIT, Article XI of the Australia-Indonesia BIT, Article IX Indonesia-Chile BIT. All available at www.unctad.org

[65] See Section B of the United States' 2004 Model BIT. Available at: http://www.ustr.gov/sites/default/files/U.S.%20model%20BIT.pdf

[66] Seeling, Marie Louise. "Can Patent Revocation or Invalidation Constitute a Form of Expropriation?" Transnational Dispute Management. Volume 6 – Issue #02 – August 2009, p. 10-12.

[67] Henning Grosse Ruse-Khan. Suspending IP obligations under TRIPS. A viable alternative to enforce prevailing WTO Rulings. P. 6 http://www.ip.mpg.de/shared/data/pdf/ciel_paper_on_trips_suspension_-_final.pdf. See also Arvind Subramanian and Jayashree Watal, 'Can TRIPS Serve as an Enforcement Device for Developing Countries in the WTO?', supra note 45, p. 408.

[68] J Mendelhall, "Fair Treatment of Intellectual Property Rights under Bilateral Investment Treaties" Transnational Dispute Management. Volume 6 – Issue #02 – August 2009, p. 18-19.

[69] Gibson, Christopher S., A Look at the Compulsory License in Investment Arbitration: The Case of Indirect Expropriation. American University International Law Review, Vol. 25; Suffolk University Law School Research Paper No. 09-32.p. 48. Available at SSRN: http://ssrn.com/abstract=1428419

[70] Liberti, L. (2010), "Intellectual Property Rights in International Investment Agreements: An Overview", OECD Working Papers on International Investment, 2010/1 OECD Publishing, p.17.

[71] Pope & Talbott v. The Government of Canada, Arbitration under UNCITRAL Rules, Award, 10 April 2010, para. 296.

[72] A K Hoffmann, 'Indirect Expropriation' in August Reinisch (ed), Standards of Investment Protection, (Oxford University Press, New York), p. 16.

Indeed, the burden of proof to establish a violation of fair and equitable treatment is lighter than to establish expropriation.[73] Because of this, Schreuer argues that "decisions by tribunals over the last couple of years show that tribunals frequently find a violation of the FET standard but simultaneously deny that there has been an expropriation."[74]

V. Does the Suspension of Concessions Violate the BIT?

The main question is however, whether the suspension of TRIPS obligations breaches the US-Indonesia BIT.

Two types of suspension IPR rights stemming from Brazil's proposal – compulsory licenses without remuneration and the temporary withdrawals of patent rights – according to Gibson and Ruse-Khan could constitute expropriations. According to Marie Lousie Seeling, changes to Indonesia's IP legislation to target foreigners and revoke or invalidate their patents constitute an expropriation. Abbott acknowledges that holders of IPRs against which cross-retaliation is proposed may object to "discriminatory" changes to IP rules on constitutional grounds.[75] The "discriminatory" changes to the IP legislation could constitute a breach of fair and equitable treatment under the hypothetical US-Indonesia BIT.

Abbot makes some suggestions in order to tailor the suspension of TRIPS obligations in order to avoid issues of expropriation.[76] He suggests that tailoring the suspension of IPRs for a limited time period, paying royalties at less than 100 per cent – but still paying – may avoid claims of expropriation. Further, Abbott suggests that temporary limiting the enforcement of IPRs may be difficult to characterise as an expropriation because the use of IPR content is not restricted.[77]

However, avoiding the issue of expropriation under the BIT is not – in my view – the hardest problem. Even if Indonesia were to cross-retaliate in a man-

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[73] C Schreuer,' Introduction: Interrelationship of Standards' in August Reinisch (ed), Standards of Investment Protection, (Oxford University Press, New York), p. 2.

[74] Ibid.

[75] Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, supra note 30, p. 33.

[76] Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, supra note 30, p. 35-36.

ner that does not "substantially deprive" IPR holders' rights, because Indonesia's cross-retaliation would discriminate on the basis of origin[78] and because the selection of IPRs to suspend is politically motivated – this is how it has to be in order to be effective – could give rise to breaches of fair and equitable treatment. As noted in part IV, according to arbitral tribunals, conduct that is clearly politically motivated and impairs investments constitutes a breach of fair and equitable treatment.[79] Further, limiting the enforcement of IPRs could constitute a denial of justice in breach of fair and equitable treatment.[80]

The conflict is quite clear. Action authorized by WTO — and consequently accepted by the United States[81] - could constitute a breach of the hypothetical Indonesia-US BIT. How should this conflict be resolved? Would action authorized by the WTO prevail by the BIT or would the BIT prevail? I do not want to take a position in this debate; I will just present some possible arguments that could be made to support both positions.

VI. Do Legal Principles Provide a Definitive Solution to the Conflict?

The conflict between suspending TRIPS obligations and other international agreements is not new. Zdouc notes that a potential complication between the suspension of TRIPS obligations is the relationship between the TRIPS Agreement and certain international conventions on the protection of intellectual property rights administered by WIPO.[82] The possibility of conflict was acknowledged by the arbitrator in the *EC – Bananas III (Ecuador) (Article 22.6 – EC)* dispute. The arbitrators refused to make a determination and made the following statement:

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[77] Ibid.

[78] In our example, Indonesia would only suspend TRIPS obligations to United States' IPR holders.

[79] Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, 24 July 2008, pp. 696-698.

[80] For cases linking denial of justice and FET see for example: Metalclad Corporation v. Mexico, ICSID Case No. ARB(AF)/97/1, Award 30 August 200, para. 91, Técnicas Medioambientales Tecmed, S.A. v. United Mexican States, ICSID Case No. ARB.(AF)/00/2, Award, 29 May 2003, para. 162.

[81] By signing the WTO Agreements, the United States accepted the possibility that a WTO Member could retaliate against it under the TRIPS Agreement.

[82] W Zdouc, "The politics of selecting trade retaliation in the European Community: a view from the floor' in Chad P. Bown and Joost Pauwelyn (eds), The Law, Economics and Politics of Retaliation in WTO Dispute Settlement (Cambridge University Press, New York 2010), p. 526.

> "It is not within our jurisdiction as Arbitrators, acting pursuant to Article 22.6 of the DSU, to pass judgment on whether Ecuador, by suspending, once authorized by the DSB, certain TRIPS obligations, would act inconsistently with its international obligations arising from treaties other than the agreements covered by the WTO (e.g. the Paris, Berne and Rome Conventions which Ecuador has ratified). It is, if at all, entirely for Ecuador and the other parties to such treaties to consider whether a specific form chosen by Ecuador for implementing such suspension of certain TRIPS obligations gives rise to difficulties in legal or practical terms under such treaties."[83]

Abbot argues that a complained-against WTO Member would be equitably estopped from attempting to independently enforce an obligation under a WIPO Convention – before the International Court of Justice for example – as a means to prevent effective enforcement of its WTO obligations. The reason being that the complained-against Member would be objecting to the application of a rule of enforcement it had clearly accepted under WTO rules.[84] In our example, the US would be equitably estopped to allege a violation of a WIPO Convention by Indonesia because of the suspension of TRIPS obligations.

Would the same argument be applicable in the context of the US-Indonesia BIT? In my view, the possible legal outcome depends on the nature of the investor's rights under the BIT. The WIPO Conventions do not provide for investor-state dispute settlement and do not provide direct enforceable rights to private individuals. BITs do. Private individuals are allowed to directly enforce the rights under the BITs. Does this mean that BITs provide investors rights independent of those of the state or is the state the owner of those rights and merely allows investors to enforce the states' substantive rights?

Arbitral case-law is split and does not give a definitive answer to this question. The *Loewen v. USA* tribunal for example, stated that rights under a BIT belonged to the state:

> "There is no warrant for transferring rules derived from public international law into the field of international law where claimants are permitted for convenience to enforce what are in origin the rights of Party states."[85]

This position has been advocated by the US, Canada and Mexico before investment tribunals constituted under NAFTA.[86]

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[83] EC – Bananas III (Ecuador) (Article 22.6 – EC), para. 152. (footnotes omitted).

[84] Abbot, Frederick M (200). Cross-Retaliation in TRIPS: Options for Developing Countries, supra note 30, p. 14, citing The Nuclear Tests Case (Australia v. France), ICJ Judgement of Dec. 1974 (I.C.J. Reports 1974, at 253).

[85] Loewen Group Inc. & Raymond L. Loewen v. United States of America, ICSID Case No. ARB/03/4, Award, 26 June 2003, para. 233.

The tribunal in *Corn Prods. Int'l v. Mexico* reached a different conclusion. It stated that "In the Tribunal's view, the NAFTA confers upon investors substantive rights separate and distinct from those of the State of which they are nationals."[87] Further, the tribunal stated that "[it] considers that the reality under Chapter XI is that an investor which brings a claim is seeking to enforce what it asserts are its own rights under the treaty not exercising a power to enforce rights which are actually those of the State"[88]

If the rights under the BIT are those of the state and the investor merely enforces those rights, as stated by the *Loewen v. USA* tribunal, then the position advocated by Abbott – that the US would be equitably estopped – would prevent an investor from enforcing the US rights under the BIT. However, if the rights under the BIT are owned by investors independent from the State – as stated by the *Corn Products* tribunal – then it is likely that an investor could successfully challenge Indonesia's cross-retaliation measures under the hypothetical Indonesia-US BIT.

Other arguments could be made by virtue of the principles of *lex specialis* and *lex posteriori*. However, it is not my intention to provide a legal solution to this conflict. On the contrary, my intention is to note that there is an important conflict, and that legally there is too much uncertainty regarding how it will be resolved. Such uncertainty is precisely what I advocate that States should avoid by inserting provisions in BITs that deal with this issue. A real and very recent example shows how legal uncertainty might deter States to enact measures.

In 19 February 2010 Philip Morris International filed a Request for Arbitration[89] to institute arbitration proceedings against Uruguay pursuant to the

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[86] See: Reply to the Counter-Memorial of the Loewen Group Inc. on Matters of Jurisdiction and Competence, 26 April 2003, at 33 et seq. (US Position), available at: http://www.state.gov/documents/organization/9947.pdf; Amended Memorial of Fact and Law of the Application, the Attorney General of Canada, The Attorney General of Canada v. S.D. Myers Inc., Court File T-225-01, para. 67 (Canada Position), available at: http://www.dfait-maeci.gc.ca/tna-nac/documents/Myersamend.pdf; and United Mexican States v. Metalclad Corporation, Supreme Court of British Columbia, Judgement, 2 May 2001, 5 ICSID Rep 236, at p. 247, para. 44 (Mexico Position).

[87] Corn Products International Inc v Mexico, ICSID Case No. ARB(AF)/04/1, Decision on Responsibility, 15 January 2008, para. 167.

[88] Corn Products International Inc v Mexico, ICSID Case No. ARB(AF)/04/1, Decision on Responsibility, 15 January 2008, para. 174.

[89] FTR Holdings S.A. (Switzerland), Phillip Morris Products S.A. (Switzerland) and Abel Hermanos S.A. (Uruguay) v. Oriental Republic of Uruguay, ICSID case no. ARB/10/7, registered march 26, 2010.

Switzerland-Uruguay BIT.[90] Philip Morris' claims arise out of a Uruguayan Ordinance by the Ministry of Public Health that requires each cigarette brand to have a "single presentation" prohibiting different packaging or presentations of cigarettes sold under a given brand. Philip Morris argued that its trademarks were a protected investment under the BIT[91], that the legislation had caused economic harm to its investment and that the legislation breached the obligations *inter alia*, to provide fair and equitable treatment[92] and refraining from taking measures of expropriation unless they were taken under due process of law and against effective and adequate compensation.[93]

Todd Weiler, a recognized investment treaty arbitration expert, issued a legal opinion commissioned by the Physicians for a Smoke Free Canada in the case and dismissed Philip Morris claims and possibility of success before a tribunal. He even described the claims as "nothing more than a cynical attempt by a wealthy multinational corporation to make an example of a small country with limited resources to defend against a well-funded international legal action, but with a well-deserved reputation as a worldwide leader in tobacco control."[94] Others have argued that Uruguay had a very good chance to win.[95]

However, in the face of this challenge, Uruguay decided to water down its anti-smoking laws and change its strict tobacco control.[96] It is likely that uncertainty regarding the outcome of the arbitration and the high costs of defending such a claim played a significant role.

In the event that Indonesia was to cross-retaliate against the US, it would undoubtedly be faced with investor-state arbitrations under the hypothetical US-Indonesia BIT, and there will be a very high degree of uncertainty regard-

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[90] Switzerland-Uruguay BIT. Available at www.unctad.org.

[91] Article 1(2)(c) of the Switzerland-Uruguay BIT covers intellectual property in all ifs forms.

[92] Article 3(2) of the Switzerland-Uruguay BIT.

[93] Article 5(1) of the Switzerland-Uruguay BIT.

[94] See Todd Weiler Legal Opinion, para. 36. Available at www.smoke-free.ca/eng_home/2010/.../Opinion-PMI-Uruguay.pdf Last accessed 1 September 2010.

[95] Simon Lester, "The Investor-State Challenge to Uruguay's Anti-Tobacco Law" International Economic Law and Policy Blog, available at http://worldtradelaw.typepad.com/ielpblog/2010/07/uruguays-antitobacco-law-and-investment-treaties.html Accessed 2 September 2010.

[96] Luke Peterson. "Uruguay Hints at Compromise in Arbitration with Philip Morris" 28 July 2010 http://kluwerarbitrationblog.com/blog/2010/07/28/uruguay-hints-at-compromise-in-arbitration-with-philip-morris/ Accessed 28 August 2010.

ing the outcomes of the claims. Just like happened to Uruguay, Indonesia could be deterred to cross-retaliate against US because of investor-state claims. This means that the hypothetical Indonesia-US BIT will very likely deprive Indonesia of that best weapon that the WTO provides to developing countries in order to induce the US to comply with an adverse ruling.

VII. Conclusion and Possible Solution

As this paper shows, there is too much uncertainty regarding the impact of BITs on the ability of WTO Members to suspend concessions under the TRIPS Agreement. This uncertainty is in my view sufficient to deter WTO Members to cross-retaliate under the TRIPS Agreement if they have signed a BIT with their opposing party in the dispute settlement proceedings. The main point that I want to convey is that this issue should not be left to be decided in arbitration, it should be for States – Indonesia and the US in my example – to deal with the relationship between the suspension of concessions under the WTO and a BIT directly in the text of the BIT. Failure to do will – in my view – abolish the possibility that States party to the WTO and BITs at the same time have to suspend concessions under the TRIPS Agreement. This will be a major blow for the possibility that developing countries have to induce developed countries with rulings by the WTO.