Trade and Investment Law Clinic Papers 2014

Illicit Trade and International Economic Law

To: Black Market Watch

10 June 2014, Geneva

Submitted by Elva (Jing) Zhang and Darshika Bandaranayake

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EXECUTIVE SUMMARY

This memorandum was prepared by LLM in International Law students at the Graduate Institute of International and Development Studies at the request of Black Market Watch ('BMW'). Specifically, BMW's request was twofold:

I. Examine illicit trade with a view to introduce the issue into the purview of International Economic Law ('IEL'); and
II. Analyse what actions can be pursued to combat or stem the flow of illicit trade under IEL.

Illicit trade is an umbrella term that is used to describe a range of illegal activities from human trafficking, the trade in endangered species, illegal logging, fake medicines, illegal trade in arms and the production and sale of counterfeited and pirated goods. While the exact magnitude is difficult to assess, it is considered that billions of dollars are generated through this shadow economy.

Despite the significant economic consequences, the response of IEL to illicit trade is minimal. This state of affairs is not altogether surprising when considering that the very objective of IEL is to increase the flow of trade and investment. Therefore the natural conclusion is that measures designed to combat illicit trade can potentially be trade distortive or impede foreign investment.

The objective of this memorandum is to evaluate the current state of affairs in respect of the relationship between IEL and illicit trade, uncover any synergies between them and finally, identify opportunities where IEL can be used to combat illicit trade.

In conducting the analysis, the authors employed the commonly cited definition of illicit trade found in the WHO *Framework Convention on Tobacco Control.* The utility in using this definition primarily lies in its ability to capture the broad range of activities that are considered to fall under purview of illicit trade. In addition, it takes into consideration that the 'illegality' of the trade may arise at any stage of the supply chain. For example, fake medicines are illegal at the stage of production, whereas cigarettes may be legitimately produced, but smuggled into another country. Finally, the definition hints at one key obstacle in the fight against illicit trade – the inconsistent determination on what activity is 'illegal'.

The rule-based World Trade Organisation ('WTO') system presents a few entry points for addressing illicit trade. Firstly, the *Agreement on Trade Related Aspects of Intellectual Property Rights* ('TRIPS')[1] includes some substantive obligations on member states in respect of minimum standards of protection of intellectual property rights ('IPRs'). These standards have been widely adopted by most WTO Members through their national legislations. China too has undertaken a complete overhaul of its copyright, patent, and trademark regimes since its accession to the WTO in 2001. However, the enforcement obligations under the TRIPS Agreement weakens the effectiveness of the regime as it only attempts to establish general standards to be implemented according to the framework determined by each Member. Moreover, it recognises the existence of different standards of enforcement of IPRs among member states.

The memorandum also looked at the possibility of addressing illicit trade through a cause of action under the WTO dispute settlement system based on a situation complaint. In essence, the analysis indicates that such an action would be useful in achieving a political outcome and raising awareness of illicit trade issues, rather than a legal solution.

As measures aimed at addressing illicit trade may have the effect of distorting trade and conflicting with WTO rules, the authors also looked at whether the WTO rules provided sufficient latitude to allow WTO Members to introduce such measures. Essentially, under the rules of the *General Agreement on Tariffs and Trade* 1994 ('GATT 1994')[2], so long as such measures are not of a quantitative nature, do not discriminate imports/exports as against domestic products, nor between imports/exports of different origins, these measures are generally accepted under WTO disciplines. Where measures do not meet these requirements, they may still be 'saved' by relying on general exceptions provided under GATT Article XX. However, in order to increase the chance of a measure being justified, policy makers should align the primary objective of the measure to the justifications provided under Article XX(b), (d) and (g), rather than developing a measure solely on the basis of fighting illicit-trade related issues.

[1] Marrakesh Agreement Establishing the World Trade Organization, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A ('TRIPS').
[2] Marrakesh Agreement Establishing the World Trade Organization, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A ('GATT 1994').

Potential recourse under international investment law was also examined where a foreign investor suffers damage as a result of illicit trade activities in a host country. The analysis was undertaken by attempting to formulate a claim on the violation of common substantive obligations found in investment treaties. In making such a claim, the investor will have to demonstrate that it was the failure of the host state to address the illicit activity that has led to the alleged damage. While in theory an investor may have such a cause of action under IIL, their prospects of success would be limited given the difficulty in attributing, or establishing a causal link to the damage suffered by it, to the acts or omissions of the host state.

Finally, the last section of this memorandum suggests recommendations on how IEL can be developed to better address illicit trade.

1. INTRODUCTION

1.1 AN INTRODUCTION TO ILLICIT TRADE

1. Illicit trade is not confined to a particular activity or industry, but generally regarded to encompass a broad range of activities across different fields. It includes, but is not limited to:
   - human trafficking;
   - illicit trade of human organs;
   - environmental crime (eg. trade of ivory, endangered species);
   - illegal trade in natural resources;
   - intellectual property infringements (counterfeit and pirated products);
   - illegal arms trading;
   - fraudulent medicine;
   - smuggling of excisable goods (eg. tobacco products, alcohol);
   - trade in narcotics
   - illicit financial flows.[3]

2. Given the very nature of illicit trade – it is done covertly - and the wide-ranging activities it is said to cover, charting the exact magnitude and scope of the issue is inherently difficult. Nonetheless the estimates paint a bleak picture: Global Financial Integrity recently estimated that the global retail value of illicit trade was approximately $650 billion.[4]

3. Statistics on specific illicit trade activities provide a glimpse as to how pervasive and significant the issue is:
   - The International Chamber of Commerce projects that the illicit trade of pirated and counterfeited goods could reach up to 1.77 trillion dollars by 2015.[5]

[3] World Economic Forum, *Global Agenda on Illicit Trade* (2012), <http://www3.weforum.org/docs/AM12/WEF_AM12_GAC_IllicitTrade.pdf>.
[4] Global Financial Integrity (2011)] Transnational Crime in the Developing World, <http://www.gfintegrity.org/storage/gfip/documents/reports/transcrime/gfi_transnational_crime_web.pdf>.
[5] International Chamber of Commerce, *Global Impacts Study* (2011), < http://www.iccwbo.org/Advocacy-Codes-and-Rules/BASCAP/BASCAP-Research/Economic-impact/Global-Impacts-Study/>.

- According to the World Customs Organization ('WCO'), 1.9 billion cigarettes were seized in 2011. And in some low-mid income countries, up to 50% of the market in cigarettes is illicit. [6]
- It is estimated that the annual earnings from the sales of counterfeit and substandard medicines are over US$ 32 billion globally. [7]
- The United Nations Office on Drugs and Crime estimates the annual value of elephant ivory from Africa and South-East Asia to Asia at US$62 million; and trafficking of illegal logging from South East Asia to the European Union and Asia at US$3.5 billion. [8]

4. Illicit trade has been linked to significant social, economic, and political consequences including: providing a revenue stream for organised crime and terrorist groups; depriving governments of revenues from excisable goods; the exploitation of labour; health issues; government spending on law enforcement; environmental degradation; and the destabilisation of states.[9]

1.2 The International Response to Illicit Trade

5. The international regulation of illicit trade has been compartmentalised, targeting specific areas or activities of illicit trade. With illicit trade used as an umbrella term to include diverse activities across very different sectors, the international response is unsurprising – to an extent, measures required to tackle illegal logging is different to what is required to address the illegal trade in firearms. However, this is not to say that different types of illicit trade activity are unrelated or occur in isolation from each other. Indeed, organised crime syndicates are known to be involved in multiple illicit trade activities, and often, similar channels or trade routes are used for multiple goods. Thus, a more holistic approach, in addition to more specific approaches, is required in order to comprehensively address illicit trade.

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[6] World Customs Report, *Illicit Trade Report* (2012) < http://www.wcoomd.org/en/media/newsroom/2013/june/~/media/WCO/Public/Global/PDF/Topics/Enforcement%20and%20Compliance/Activities%20and%20Programmes/Illicit%20Trade%20Report%202012/WCO%20REPORT%202013%20-%20BR.ashx>.
[7] World Health Organisation, *Fact Sheet No.275: Substandard and counterfeit medicines* (2003) < http://www.who.int/mediacentre/factsheets/2003/fs275/en/>.
[8] United Nations Office on Drugs and Crime, *The Globalization of Crime: A transnational Organised Crime Threat Assessment* (2010) <http://www.unodc.org/documents/human-trafficking/UNVTF_fs_HT_EN.pdf>
[9] World Economic Forum, above n3.

6. Table 1 (below) provides a brief insight as to how international law has responded to illicit trade.

INTERNATIONAL RESPONSE	SUMMARY OF REQUIREMENTS
UN Convention against Transnational Organised Crime	The Convention requires states to undertake a number of measures against transnational organised crime. They include: the creation of domestic criminal offences; the adoption of frameworks for extradition; mutual legal assistance and law enforcement cooperation; and training and technical assistance for building capacity of national authorities.
UN Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children	Supplementing the UN Convention against Transnational Organised Crime obligations, the Protocol requires state parties to take necessary measures to: criminalise trafficking; prevent trafficking, protect and assist victims; and promote international co-operation to combat trafficking.
UN Convention against Corruption	The Convention covers prevention, criminilisation, international cooperation and asset recovery. It requires, for example, State parties to coordinate policies to prevent corruption and create supervisory bodies to oversee the implementation of those policies.
Convention on International Trade in Endangered Species ('CITES')	CITES subjects the international trade in specimens of selected species to certain controls. For example, under CITES all import, export, re-export and introduction from the sea of covered species are subject to a licensing system. State parties are required to appoint one or more Management Authorities to administer the licensing system and one or more Scientific Authorities to advise them on the effects of trade on the covered species.
UN Convention on Biodiversity	The Convention has three main objectives: the conservation of biological diversity; the sustainable use of the components of biological diversity; and the fair and equitable sharing of the benefits arising out of the utilisation of genetic resources
UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances	The objective of the convention is to promote cooperation among the parties so that they may address the different aspects of illicit traffic in narcotic and psychotropic substances. Under the Convention, the parties shall take necessary measures, including legislative and administrative measures, tracing and seizing drug-related assets and the extradition of money launderers.

WHO Framework Convention on Tobacco Control ('FCTC') & The Protocol to Eliminate Illicit Trade in Tobacco Products	The FCTC requires state parties to introduce tobacco control measures including price and tax policies, bans on tobacco advertising, promotion and sponsorship, packaging and labeling requirements, protection from exposure to second-hand smoke, education and public awareness measures, regulation of tobacco product contents and disclosures, treatment for tobacco dependence, and measures to combat illicit trade. The treaty also promotes international cooperation to support tobacco control.
UN Protocol against the Illicit Manufacturing of and Trafficking in Firearms, their Parts and Components and Ammunition of the Convention on Transnational Crime	Under the Protocol states parties are required to make commitments to introduce crime-control measures and implement in their domestic legal system three sets of provisions: 1) criminalisation of illegal manufacturing of, and trafficking in firearms based on the Protocol's requirements and definitions; 2) a licensing and authorization scheme to ensure legitimate manufacturing of, and trafficking in, firearms; 3) marking and tracing of firearms.
The Arms Trade Treaty	The Arms Trade Treaty establishes an international standard for the national regulation of the international trade in conventional arms. Under the treaty state parties are required to establish export and import controls for tanks, combat vehicles and aircraft, warships, missile and artillery systems, small arms and light weapons.

7. International legal instruments can play an important role in complementing action taken within the purview of IEL. Importing other international legal instruments when taking actions under IEL will be further discussed in section 3.2 of this memorandum.

2. DEFINITION AND SCOPE

2.1 DEFINITION OF 'ILLICIT TRADE'

8. The social-economic phenomenon that is 'illicit trade' is difficult to define. Nevertheless, in order to introduce illicit trade to IEL it would be useful to settle on a definition so as to provide a foundation for analysis.

9. A commonly cited definition of illicit trade is the WHO FCTC[10]. Article 1 of the Convention defines illicit trade as:

> *Any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase [of goods] including any practice or conduct intended to facilitate such activity.*[11]

10. This definition of 'illicit trade' is helpful for a number of reasons. Firstly, it is sufficiently broad to capture the breadth of activities illicit trade encompasses and the various contexts in which it occurs - from the production of fake medicines to trade in illegal logging. The definition also recognises that the trade in goods may be deemed 'illegal' at any stage of the supply chain. For example some goods, like those that are counterfeit, are illegal from the time of production. On the other hand, goods maybe legitimately produced but moved or enter the market illegally, such as through smuggling. Importantly, FCTC's conceptualisation of illicit trade acknowledges that in order to comprehensively address an illicit trade there needs to be measures that target all aspects of the supply chain.

11. Another important consideration is that illegality can arise from two different sources. Illegality can arise out of international law (and then is implemented by national law); and it can arise out of national law. Moreover, just because an activity is deemed illegal under one national legal system, does not necessarily mean that it will be illegal under another. For example, from a trade perspective, the trade in a certain good maybe legal in the exporting country, but illegal in the country of importation. The limitations arising out of this is further discussed in section 2.2 below.

12. This memorandum is primarily concerned with illicit trade in consumer goods that competes with the legitimate trade of those goods, such as counterfeited and pirated consumer goods, fake medicine and tobacco smuggling.

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[10] *The WHO Framework Convention on Tobacco Control*, opened for signature 16 June 2003, 2302 UNTS 166 (entered into force on 27 February 2005) ('WHO FCTC').
[11] Article 1 of the WHO FCTC.

2.2 CAVEAT ON DEFINING 'ILLICIT TRADE'

13. The use of words such as 'illicit' or 'illegal' to describe things often evokes certain emotions because of the gravity inherently suggested by such words.

14. The difficulty in adopting these words in the context of international law is the lack of a truly universal measure for determining what is legal or illegal and what is licit or illicit.

15. This definitional challenge has real effects in global trade. It is states that define what amounts smuggling and what does not, and such definitions may change over time as well. By the same token, a product may be licit in the production country and illicit in the importing country or the other way around.[12]

16. In the context of IEL, the unilateral determinations of 'legality' by individual states are problematic because they may be disguised by states as 'non-tariff' regulatory barriers to protect domestic industries or to default on obligations owing to foreign investors. Additionally, it may hamper efforts between states where co-operation and consistency is required to combat illicit trade. Therefore, in the emerging global efforts against illicit trade, this differing practice in what is 'illegal' is a reality that must be kept in check to avoid any unintended legal and political problems.

17. Nevertheless, this legal divergence of what constitutes 'illicit' trade in domestic jurisdictions may be harmonised at the global level through either the creation of international rules on illicit trade or requiring any governmental measures in the name of 'fighting illicit trade' to be consistent with international standards. Regarding the former method, the TRIPS Agreement of the WTO creates minimum international standards for the protection of IPRs. Similarly, a scheme of international rules for illicit trade may be established under the auspices of the WTO, where illicit trade is considered as

[12] Jacob Silberberg, 'Chapter 15 – The illicit Global Economy: The Dark Side of Globalization' in *The Illicit Economy in Historical Perspective* 382 – 395, 395.

a 'trade-related' issue. Regarding the latter method, the *Agreement on Technical Barriers to Trade* ('TBT Agreement')[13] and the *Agreement on Sanitary and Phytosanitary Measures* ('SPS Agreement')[14] provide a good illustration of how this may be applicable to illicit trade. For instance, for WTO disputes, a state enacting a restriction on illicit trade pursuant to an international standard is presumed to be 'necessary' under the TBT Agreement SPS Agreement, and is likely to be excepted from any violations of the TBT and SPS Agreements.

18. It is worth mentioning that another means to overcome the lack of the definition on illicit trade is through the process of recognition as adopted by the European Union ('EU') in dealing with the issue of illegal logging. Rather than promoting harmonisation by creating a new definition, the EU Timber Regulation, which came into force in 2013, prohibits operators from placing illegally harvested timber and timber products on the European market.[15] For example, the term 'illegally harvested' is defined broadly to encompass 'harvested in contravention of the applicable legislation in the country of harvest'.[16] Essentially, by recognising and acknowledging the 'legality' requirements existing in the domestic regulatory regimes on illegal logging, the EU Timber Regulations circumvent the definitional difference among its Members.

19. In summary, it is important to recognise the potential regulatory variances among states on what is deemed to be 'illegal' or 'illicit', and the potential ramifications of such determinations on the flow of international trade and investment. Without a more uniform definition of illicit trade and more harmonised rules on this issue, not only the efforts for combatting illicit trade remain fragmented, but they may also be used as trade-protectionist measures.

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[13] *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A ('Agreement on Technical Barriers to Trade'/TBT Agreement).
[14] *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A ('Agreement of the Application of Sanitary and Phytosanitary Measures'/SPS Agreement)
[15] EU, Regulation (EU) No.995/2010 of the European Parliament and of the Council of 20 October 2010, 'laying down the obligations of operators who place timber and timber products on the market', <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32010R0995:EN:NOT> ('EU Timber Regulation').
[16] Article 2(g) and (h) of the EU Timber Regulation.

Nevertheless the existing legal divergence on illicit trade may provide a good opportunity for remediation at the international level through regulatory harmonisation or recognition under IEL, noting that illicit trade is now an important aspect of the contemporary international economic reality.

3. INTERNATIONAL ECONOMIC LAW – AN INTRODUCTION

3.1 WHAT IS INTERNATIONAL ECONOMIC LAW (IEL)?

20. Before proceeding further, it is appropriate to elaborate on what the notion of 'IEL' encompasses in the present context.

21. Traditionally, laws that govern global economy could possibly be delineated in relation to three main areas: (i) rules between states, (ii) rules for how states treat individuals, and (iii) rules for individual to individual transactions.[17] However, the third category of the law for individual private transactions, is normally considered as 'private international law' and is distinguished from 'public' international economic law.[18] Essentially, IEL is a branch of 'public' international law that primarily covers the law of economic transactions, government regulation of economic matters, and litigation and international institutions for economic relations. [19]

22. The two most prominent branches of IEL today are International Trade Law ('ITL') and International Investment Law ('IIL'). ITL mainly embraces legal disciplines regulating trading relations between states. In this respect, the WTO, together with its predecessor - the GATT, have been laying down multilateral trading rules since 1947. IIL, on the other hand, has enjoyed a rapid development in the past few decades due to the proliferation of bilateral investment treaties and multilateral investment treaties.

[17] Steve Charnovitz, 'What is International Economic Law?' 14 (1) *Journal of International Economic Law* 3, 3.
[18] Ibid.
[19] Ibid,18.

23. Against this background, Section 4 and 5 of this memo seeks to show how illicit trade interacts with the existing legal framework of IEL, with a particular focus on the WTO and IIL. However, other useful IEL measures will also be discussed.

3.1.1 WTO – MULTILATERAL TRADING SYSTEM

24. The WTO, which was founded upon the legacy of GATT 1947, came to being in 1995.[20] The WTO is charged with the primary responsibility of regulating international trading relations among its Members, with its main function being ensuring that trade flows as smoothly, predictably and freely as possible.[21]

25. One key manifestation of such responsibility is through the administering of various multilateral trade agreements, which set down the legal foundation for global trade liberalization. The subject-matters of these trade agreements range from trade in goods as governed by the GATT 1994, to trade in services as governed by the *General Agreement on Trade in Services* ('GATS')[22] and intellectual property rights as governed by the TRIPS. In addition to the horizontal expansion of sectoral agreements, the WTO has also established trade rules that are specifically directed to tackle the issue of 'non-tariff barriers' to trade, such as standards and technical regulations, which is reflected in the increasing importance of the TBT Agreement and the SPS Agreement in the multilateral trading regime.[23]

26. It is important to underscore that only states that are WTO Members can utilise the Dispute Settlement Body ('DSB') by instituting proceedings against

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[20] *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) ('WTO Agreement'). Before the establishment of the WTO in 1995, the global trading relations were overseen by the GATT with a sole focus on regulating trade in goods. Unlike the WTO, the GATT was not a proper institution, as in essence it was a provisionally applied trade agreement - *General Agreement on Tariffs and Trade* 1947. See John H. Jackson, *Restructuring the GATT System* (the Royal Institute of International Affairs, 1990).

[21] At the time of this memo, the WTO has 159 member states. See http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm. For more information on the WTO, see http://www.wto.org/index.htm.

[22] Marrakesh Agreement Establishing the World Trade Organization, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A ('General Agreement on Trade in Services/GATS').

[23] See http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm4_e.htm#TRS.

another member state for violating WTO covered agreements. Private companies are in theory not permitted to litigate before the WTO. In practice, it is nonetheless common that private companies, whose commercial interests are harmed by regulatory measures of a WTO Member (say State A), may provide financial support to another WTO Member (say State B) in brining a case against State A before the DSB. Nevertheless, even successful remedies in the WTO proceedings do not typically mean monetary compensation to the winning Member. Rather, remedies are in the form of obliging the offending Member to bring any WTO-inconsistent measures 'into conformity' with the WTO covered agreements. Also, WTO remedies are not 'retrospective', and take effects prospectively. Therefore, private companies will not be compensated for accumulated losses caused by any WTO-inconsistent measures.

3.1.2 INTERNATIONAL INVESTMENT LAW – AN INTRODUCTION

27. IIL concerns the treatment of investors when they invest abroad - or conversely, how host states treat foreign investors and their investment – and provides international legal protections to foreign investors and their investments.

28. The regulatory framework of IIL is made up of a patchwork of interlocking but separate bilateral investment treaties ('BITs') and free trade agreements containing substantial provisions or chapters on investment.[24] In the last two decades there has been an exponential growth in bilateral treaties which today number more than 3000[25].

29. A key feature of investment treaties is a mechanism that provides for adjudication of investment disputes. These dispute settlement mechanisms - unlike international trade law or traditional diplomatic protection - mean that investors are not reliant on their home state to pursue an action against the host state. In other words, IIL provides for direct investor actions against host states

[24] Campbell McLachlan, Laurence Shore & Matthew Weiniger, *International Investment Arbitration* (Oxford University Press, 2007), 5.
[25] Roland Klager, *Fair and Equitable Treatment in International Investment Law,* (Cambridge University Press 2011) 26.

(including various governments agencies and sometimes state-owned enterprises) on the basis of a violation of standards of treatments and protections provided under an investment treaty.

30. Investment treaty claims do not necessarily require any prior contractual relationship between host state and the investor. The investor's recourse to arbitration is based on standing and general consent of the host state to nationals of the contracting state as provided under the dispute settlement provisions in the treaty or in the domestic legislations. Under such provisions, each contracting state sets forth their advance consent to submit investment disputes involving covered investors to international arbitration. Upon a covered investor's filing of a notice of arbitration, the host state's unilateral offer to arbitrate becomes legally binding and the two parties enter into a direct legal relationship allowing the investor to bring proceedings directly against state without the need of any further approval.

31. In bringing an investment treaty claim, the company in question must be an 'investor' under the investment treaty. This generally means that they have to be of the nationality of the other contracting party to the treaty. In addition, the investors' affected assets or rights must qualify as an 'investment' under the treaty.

32. The substantive protections and treatment standards afforded to investors under investment treaties 'are formulated in terms of a relationship between the conduct of the state and its impact upon an investment or rights closely connected to an investment'[26]. The exact protections vary amongst treaties but generally include expropriation redress, fair and equitable treatment, full protection and security, national treatment and most-favoured nation treatment. Such provisions are typically drafted in vague terms, and despite the vast body of jurisprudence, the precise content of these substantive protections are yet to be defined. Notably, there are no express obligations or substantive protection directly referencing illicit trade or any particular illicit trade activity.

[26] Z. Douglas, 'Property, Investment and the Scope of Investment Protection Obligations' in Z. Douglas, J. Pauwelyn, J. Vinuales, *The Foundations of International Investment Law: Bringing Theory into Practice* (OUP: forthcoming), 4.

33. Due to its ability to provide international legal remedies to non-state actors, IIL has grown in considerable importance over the last two decades. Awards rendered by investment arbitral tribunals are enforceable in most countries around the world by virtue of a multilateral treaty regime for the recognition and enforcement of arbitral awards.[27] The enforceability of arbitral awards, coupled with the significant quantum of compensation that is often awarded, provide a lucrative incentive for investors to pursue what is an otherwise very expensive exercise.

3.2 How non-IEL international legal instrument can assist IEL actions in addressing illicit trade.

34. Given IEL is relatively deficient on substantive provisions specifically addressing illicit trade, other international legal instruments (such as those provided under section 1, Table 1) can play an important complementary role when taking actions to combat illicit trade under IEL. Importing other international legal instruments into IEL can be achieved in several ways. The first and perhaps the most obvious way is through the process of interpretation.

35. The regulatory framework that makeup IEL is mostly made up of treaties. Although it may be considered to be a specialised regime, it is nonetheless subject to the rules of treaty interpretation codified in Article 31 and Article 32 of the *Vienna Convention on the Law of Treaties*[28](‘Vienna Convention’). These Articles have been widely accepted as stating rules of customary international law on treaty interpretation, and have also been repeatedly accepted by investment arbitration tribunals as constituting rules of interpretation that are binding on them. In *AAPL v Sri Lanka*[29], the tribunal said BITs, as treaties, ‘must be interpreted according to the law of Nations, and not according to any municipal code’.[30] Similarly, the WTO agreements as treaties under the rubric of public international law are subject to the same

[27] *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards* , opened for signature on 10 June 1958, UNTS 330 (entered into force 7 June 1959) (‘New York Convention’).
[28] *Vienna Convention on the Law of Treaties,* opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980) (‘Vienna Convention’).
[29] *Asian Agricultural Products Ltd. v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3.
[30] McLachlan, Shore Weiniger, above n24, 66.

rules. Indeed DSU Article 3.2 explicitly confirms that WTO agreements must be clarified 'in accordance with customary rules of interpretation of public international law'.[31]

36. The relevance here is that the rules of treaty interpretation provides room to integrate other international legal norms into IEL. Article 31(3), of the Vienna Convention for instance, directs that in interpreting treaties, together with the context, the following should be taken into account: '*any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions*' and; '*any relevant rules of international law applicable in the relations between parties*'. [32]

37. Examples of how treaty interpretation has resulted in non-IEL norms imported into IEL can readily be found in international trade law. The WTO Panel and Appellate Body have exercised these rules of interpretation commonly in filling procedural gaps in the WTO agreements, but has also used it to interpret meaning of terms in the WTO Agreements.[33] For example in *US-Shrimp*[34], the Appellate Body referenced certain environmental treaties in interpreting 'exhaustible natural resources' in GATT Article XX(g).

38. Yet another way other international law may be invoked under IEL is through applying it as substantive law in a dispute. For example, in IIL, given the parties' autonomy to select the applicable law, international legal instruments designed to address illicit trade activities may be imported through the broadly drafted applicable law clause commonly found in investment treaties. [35] For instance, Article 8(6) of The Netherlands/Czech Republic BIT reads[36]:

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[31] Joost Pauwelyn 'How to win a WTO dispute based on non-WTO law' (2003) 37(6) *Journal of World Trade* 997.
[32] Vienna Convention, Art. 31(1)(c).
[33] Pauwelyn, above n 31 ,997
[34] *United States – Import Prohibition of Certain Shrimp and Shrimp Products* WTO Doc WT/DS58/AB/R (12 October 1998).
[35] Zachary Douglas, ' The Enforcement of Environmental Norms in Investment Treaty Arbitration' in P-M Dupuy & J. Vinuales, *Harnessing Foreign Investment to Promote Environmental Protection* (Cambridge University Press, 2013), 425.
[36] Agreement on Encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic (1991) < http://unctad.org/sections/dite/iia/docs/bits/czech_netherlands.pdf>

The arbitral tribunal shall decide on the basis of the law, taking into account in particular though not exclusively:

- *the law in force of the Contracting Party concerned;*
- *the provisions of this Agreement, and other relevant Agreements between the Contracting Parties;*
- *the provisions of special agreements relating to the investment;*
- *general principles of international law.*

Alternatively, in the absence of a choice of law clause, Article 42(1) of the *Convention on the Settlement of Investment Disputes between States and Nationals of other States* ('ICSID Convention')[37] provides for a default rule to allow for an arbitral tribunal to apply the law of the host state and such rules of international laws as may be applicable.

4. ADDRESSING ILLICIT TRADE THROUGH THE WTO

4.1 AN UNEASY RELATIONSHIP?

39. The objective of IEL is to increase the flow of trade and investment. However, governmental measures for combatting illicit trade can impede trade and investment flow. Such measures may be found to be inconsistent with the existing principles of IEL, especially those under the WTO. This is not necessarily a negative thing, as it ensures that states cannot implement measures in the name of combatting illicit trade whilst the true purpose of such measures is in fact trade-protectionist. Most of the WTO agreements have built-in safety valves by way of exceptions, if legitimate policy concerns, such as illicit trade, are involved.

40. There are also a few IEL provisions that oblige countries to take positive actions about illicit trade, with the most prominent example of such positive obligations being the WTO's TRIPS Agreement.

41. The TRIPS Agreement sets out global minimum standards of IPRs protection and enforcement, and also imposes certain specific obligations on WTO Members when dealing with 'counterfeit trademark goods' and 'pirated

[37] *Convention on the Settlement of Investment Disputes between States and Nationals of other State*s (entered into force on October 14, 1966), ('ICSID Convention'), Art. 42(1).

copyright goods'.[38] In other words, illicit trade within the WTO system is squarely premised upon infringements of IPRs with a particular focus on trade in counterfeit and pirated goods. So here in the typology discussed above, illicit product under the TRIPS is also illegal/infringing IPRs. Thanks to the international standards under the TRIPS, the IPRs are rights common to exporting and importing countries, and are not just illicit by the standard of one single country, e.g. importer.

42. Leaving aside the TRIPS Agreement, the relationship between illicit trade and the WTO seems rather distant, if not completely absent. This may be attributed to the institutional foundation of the WTO and nature of trade agreements in general. The WTO is mainly concerned with trade liberalisation through securing reciprocal market access and opportunities (not rights) to trade in goods and services by focusing on 'negative integration.'[39]

43. Traditional trade agreements such as the GATT and GATS reflect this approach as they oblige WTO Members 'not to do' certain acts, for example, not to impose tariffs or not to discriminate.[40] In this regard, the TRIPS Agreement is revolutionary as it is the first WTO agreement focusing on 'positive integration', setting positive obligations for WTO Members to comply with.[41] However, as outlined in the discussions below, even the role of the TRIPS Agreement in countering counterfeit goods has proved to be rather weak and limited.

44. Secondly, the WTO agreements may hinder or constrain states' efforts in curbing illicit trade, as any import or export measures enacted by WTO Members must not be in contravention of their WTO obligations. Nonetheless, a measure that is found to be *prima facie* WTO-incompliant may still be permissible, provided it can be justified by the stipulated exceptions in the relevant WTO agreements, such as Article XX in the GATT 1994.

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[38] Counterfeit trade in the TRIPS Agreement specifically refers to 'Counterfeit trademark goods' and 'pirated copyright goods' have very specific meanings in Art. 51 Note 14 of the TRIPS Agreement.
[39] Guzman, A.T., & Pauwelyn, J.H.B., *International Trade Law* (2nd ed., Aspen, 2012), 636.
[40] Ibid.
[41] Ibid.

45. In this respect, Article XX of the GATT 1994 represents the effort of reconciliation between trade liberalisation and other societal interests,[42] and gives Members some 'breathing space' to pursue certain legitimate non-economic policy objectives.

46. Among the various subparagraphs, Article XX(d) appears to be the most relevant one for illicit trade, as it makes the compliance of domestic laws, such as for customs enforcement, IPR enforcement or anti-deceptive conducts, as a non-trade objective that may prevail over WTO obligations. It may be employed as an exception for restricting trade in counterfeit goods.[43]

47. Article XX(b) on human, animal and plant health, and Article XX (g) on conservation of exhaustible natural resources are also relevant exceptions in this context, noting how illicit trade has inflicted upon our society, environment, and peoples' well-being. However, the contexts in which these exceptions are invoked to justify anti-illicit trade measures would vary depending upon the different type of 'illicit trade'. Goods can be illicit because of the inherent nature of the products, such as fake drugs, but they can also be illicit because of violating IP rights. In other cases, goods are illicit because they are endangered species, ivory trade for instance, or they are illicit due to the method of production, such as illegal logging. Smuggling is another type of illicit trade, not so much because of the goods involved, but due to the means the goods being transported across international borders.

48. Since illicit trade is inherently a multifaceted issue, theoretically a *prima facie* WTO-inconsistent measure addressing illicit trade could be justified by the health, environmental or social dimension of the issue. Still, the chance of success is very much depended upon the particular measure at issue and the overall context that gives rise to the measure.

[42] Peter van den Bossche, *The Law and Policy of the World Trade Organization: Text, Cases and Materials* (2nd ed, CPU, 2008), 615.
[43] Joost Pauwelyn, 'The Dog That Barked But Didn't Bite: 15 Years of Intellectual Property Disputes at the WTO' *J Int. Disp. Settlement* (2010), 2.

49. The relationship between illicit trade and the existing rules of the WTO will be further illustrated through the following:

    a. The subsection **4.2 - 'Positive WTO obligations to restrict illicit trade & offensive actions for failure to do so before the WTO'**. This section relates mainly to the positive obligations required under the TRIPS Agreement, and how Members can potentially bring a claim against another WTO Member for breaching the TRIPS obligations. This sub-section will also discuss whether 'situation complaints'[44] under Article XXIII:1 (c) of the GATT 1994 may be applicable to illicit trade.

    b. The subsection **4.3 WTO obligations that may prevent countries from combatting illicit trade & exceptions that countries can invoke in defense.** This section will mainly examine the legal parameters for justifying *prima facie* WTO-inconsistent policies aimed at addressing illicit trade through the application of relevant provisions of exceptions in the WTO agreements. It also discusses the relevance of the TBT Agreement to measures targeting illicit trade.

4.2 POSITIVE WTO OBLIGATIONS TO RESTRICT ILLICIT TRADE & OFFENSIVE ACTIONS FOR FAILURE TO DO SO, BEFORE THE WTO

4.2.1 TRIPS AGREEMENT

50. The universal minimum standards of IPRs protection and enforcement in the TRIPS Agreement have been widely adopted by most WTO Members through their national legislations, which become the common denominators among the WTO Members for the protection of IPRs.[45] Even China has undertaken a complete overhaul of its IPRs regime since its accession to the WTO in 2001.[46]

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[44] Under Article XXIII of the GATT 1994, there are three types specific circumstances in which a WTO Member is entitled to a remedy, namely a violation complaint (Article XXIII(a)), a non-violation complaint (Article XXIII(b)) and a situation complaint (Article XXIII(c)). See http://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c4s2p1_e.htm.

[45] European Parliament, *DISCUSSION REPORT COMMENTS ON ANTI-COUNTERFEITING TRADE AGREEMENT* (ACTA) (May 2008) EXPO/B/INTA/2008/13, 14.

[46] Peter K. Yu, *The US-China Dispute over TRIPS Enforcement*, <http://www.law.drake.edu/clinicsCenters/ip/docs/ipResearch-op5.pdf>.

51. However, notwithstanding this positive development, international trade in counterfeit and pirated goods continues to flourish.[47]

52. The key reason for this is the weak enforcement of IPRs in the TRIPS Agreement. TRIPS only attempts to establish general standards to be implemented according to the framework determined by each Member, and it recognises the existence of different standards in enforcement of IPRs among countries.[48]

53. For example, Article 41.1 establishes a general obligation requiring WTO Members to ensure 'effective action' against infringements, including expeditious remedies to prevent infringements and remedies which constitute a deterrent to further infringements. In this respect, a number of observations can be made:

    a. 'Effective action' is not defined in the TRIPS Agreement. The varying developments of IPRs in different countries give rise to a discrepancy of what would constitute 'effective' protection over IPRs among WTO Members.

    b. Article 41.5 also makes clear that a WTO Member does not need to devote more resources to IPRs enforcement than to other areas of law enforcement. This provision is said to be included at the request of developing countries to alleviate their IPRs enforcement obligations.[49]

    c. Article 46 empowers domestic judicial authorities to order the uncompensated destruction or disposal of infringing goods seized at the border to create an effective deterrent to infringement.

    d. Article 51 requires Members to adopt procedures to enable a right holder, who validly suspects that the importation of counterfeit trademark or pirated copyright goods may take place, to apply to

[47] Pascal Lamy, 'The TRIPs Agreement—Ten Years Later', Report of a Conference Commemorating the 10th Anniversary of the TRIPs Agreement held on 23rd and 24th June 2004. European Commission, DG Trade. <http:// trade.ec.europa.eu/doclib/docs/2004/october/tradoc_119347.pdf>.
[48] European Parliament, *DISCUSSION REPORT COMMENTS ON ANTI-COUNTERFEITING TRADE AGREEMENT* (ACTA) (May 2008) EXPO/B/INTA/2008/13, 15.
[49] Yu, above n46, 8.

competent authorities for the suspension by the customs authorities of the release into free circulation of such goods. However, according to the text of Article 51, the mandatory border measure thereunder is concerning allegedly infringing 'importing' goods only, and it is mandatory for 'counterfeit trademark and pirated copyright goods' only. Members are not required to do the same for goods in transit and are not required to cover other types of IPRs infringements such as patent infringements. That being said, last sentence of Article 51 does give the option for a Member to implement corresponding measures concerning the suspension of the release of infringing goods destined for exportation from their territories.

e. Article 61 explicitly demands criminal enforcement at least 'in the case of wilful trademark counterfeiting or copyright piracy on a commercial scale'. 'Commercial scale' is not defined in the TRIPS Agreement, which gives national states a level of discretion to determine under what circumstances criminal procedures should be implemented.

54. The common view on the enforcement mechanism of the TRIPS Agreement is that most of the provisions do not establish straightforward obligations, but are limited to empower judicial or other competent authorities to order certain acts. Therefore, national authorities may order certain procedural remedies, but they are not obliged to do so, and can exercise discretion in applying the mandated rules.[50] There is much more scope of manoeuvre for Members to decide how enforcement should be undertaken within their jurisdictions.

Hypothetical Scenario: Can a WTO Member bring a claim against China for its failure to prevent the production of mass counterfeit goods within its territory?

55. In essence, to challenge a country on the basis of the lack of IPRs enforcement (Part III of TRIPS) is likely to be more difficult than challenging the lack of IPRs protection (Part II of TRIPS). The main reasons are as follows:

[50]European Parliament, *DISCUSSION REPORT COMMENTS ON ANTI-COUNTERFEITING TRADE AGREEMENT* (ACTA) (May 2008) EXPO/B/INTA/2008/13, 15.

a. First of all, most TRIPS enforcement obligations are not 'substantive' in nature. The WTO Panel in the case of *China-IP Rights* confirmed this point.[51] The Panel underscored that the TRIPS obligations on domestic IPR enforcement are generally limited to providing 'access' or 'authority' to do things at the request of private right holders.[52]

b. Secondly, the preamble of the TRIPS Agreement recognizes that IPRs are essentially private rights. The private nature of such rights means that, ultimately it is the private rights holders that must take proactive actions to enforce their rights.[53] The Panel in *China-IP rights* emphasised that 'the phrase "shall have the authority" does not require Members to take any action in the absence of an application or request.' In other words, the TRIPS Agreement merely created a regime under which private IPRs holders are responsible for taking steps to enforce their rights. Importantly, government generally are not under substantive obligations to 'police' the private interests of IPRs holders.[54]

c. Thirdly, since joining the WTO, Chinese authorities have been trying to crack down on counterfeit production, notwithstanding China remains no.1 originator of the most global counterfeit goods.[55] To argue that China is not doing enough about enforcing IPRs may not be a sufficiently strong contention. China has implemented the TRIPS minimum standards of IPR protections and enforcement in its national system. Surprisingly, in *China-IP rights*, the Panel even praised that China has 'a level of protection higher than the minimum standard required by the TRIPS Agreement'.[56] For example, border measures under the TRIPS Agreement only relate to 'importation' of

[51] *China - Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WT/DS362/1, Panel Report, ('*China-IP rights*').
[52] Yu, above n46, 38-40.
[53] Yu, above n46, 39.
[54] Abbott, Cottier & Gurry, *International Intellectual Property in an Integrated World Economy*, (Aspen 2007), 608.
[55] UNODC, *Transnational Organized Crime (TOC) East Asia and the Pacific: A Threat Assessment* (April, 2013), http://www.unodc.org/southeastasiaandpacific/en/2013/04/tocta/story.html.
[56] China-IP Rights, [7.228].

goods, and are specifically limited to 'counterfeit trademark' and 'pirated copyright' goods.[57] In this respect, China has extended its border measures to all forms of infringement, and cover both import and export.[58]

d. Lastly, since there is no express TRIPS provision on Members to stop or even reduce the manufacture of counterfeit or pirated goods within its territory, a case against China concerning such illegal production may be based on the breach of a general obligation under Article 41.1 for lacking effective enforcement regime. Such a claim may be characterized more as a 'general complaint'.[59] Traditionally, it is more challenging to win a general complaint than a specific complaint (involving the breach of a specific obligation). The difficulty may be multiplied for an enforcement case under the TRIPS, because of the absence of a clearly defined 'effective action' under Article 41.1 and also the non-substantive nature of the enforcement TRIPS obligations in general.

Possible Measures by Transiting Countries

56. As briefly mentioned above, the first sentence of Article 51 of the TRIPS Agreement obliges Members to adopt procedures enabling trademark and copyright owners to apply for the suspension of release of **counterfeit or pirated** '**importing**' goods into circulation into the commerce of the country. However, second sentence of Article 51 does permit the extension of such border measures to other types of IPRs infringements at the discretion of WTO Members.

57. Importantly, footnote 13 to Article 51 provides that there is 'no obligation to apply such procedures... to goods in transit'. Yet, footnote 13 does not prohibit WTO Members from imposing border measures (those covered by Article 51) to goods in transit.

[57] Article 51 of the TRIPS Agreement.
[58] Yu, above n46, 22.
[59] Yu, above n46, 4.

58. On this basis, WTO Members may, but are not obliged to, extend border measures against IPRs infringements to transit goods. This is consistent with the fact that the TRIPS Agreement was intended to only establish 'bottom line' standards for Members, but preserves the right for WTO Members to enter into more stringent obligations to protect IPRs. [60]

59. Importantly, Article 52 then requires IPRs holders initiating the procedures under Article 51 to provide 'adequate evidence to satisfy the competent authorities that, under the laws of the country of importation, there is prima facie an infringement of the right holder's intellectual property right', and to supply a sufficiently detailed description of the goods to make them readily recognizable by the customs authorities.[61]

60. From a purely legal perspective, the crux of any border measures against goods in transit is the existence of a *prima facie* infringement of IPRs rights in the **country of importation**. As such, the success of a 'goods-in-transit' border measures depends upon a cohesive co-ordination between private rights holders and the competent authorities in both importing and transiting countries.

61. To maximize the chance of success in seizing infringed goods, it is strongly recommended that a private right holder should resort to notify not only importing states (which are under a mandatory TRIPS obligation to enable such an application), but also any transiting states that have adopted 'TRIPS-Plus' provisions concerning border measures. If goods are seized unilaterally by transiting countries without consulting importing countries, it may run the risk of violating Article 52 of the TRIPS Agreement. Such seized goods, whilst potentially violating the IPRs in the transiting country, may not infringe the IPRs in the importing country.

[60] Bryan Mercurio, 'Seizing Pharmaceuticals in Transit: Analysing the WTO Dispute that Wasn't', Vol 61 April 2012 *International and Comparative Law Quarterly* 389, 405.
[61] Ibid.

62. Additionally, seizures of transiting goods may also violate Article V of the GATT 1994, which specifies the conditions to allow for freedom of transit through the territory of each Member for transports to or from the territory of other Members. In particular, Article V:3 mandates not to impose unnecessary delays or restrictions on transiting goods.

EU – India/Brazil: Seizing Pharmaceuticals in Transit

63. Border measures concerning goods in transit are not mandatorily required by the TRIPS Agreement, hence, are arguably 'TRIPS-Plus' measures.[62] Nevertheless, as evidenced in the series of seizures by the EU of generic medicines involving India and Brazil, such measures can become quite legally complicated and politically controversial.

64. Between 2008 and 2009, a number of consignments of generic drugs originating from India were detained by the EU under Council Regulation (EC) No 1383/2003, which authorized EU customs officials to take certain measures (including suspension or detention) against goods suspected of infringing IPRs.[63] India as the country of origin and Brazil as the country of importation for some of these confiscated consignments brought actions against the EU before the WTO.

65. Council Regulation (EC) No 1383/2003 and the EU's actions concerning these generic medications are arguably evidence of twin-expansion of Article 51, because they applied to patented goods and to transiting goods, neither of which are required by Article 51.[64]

66. Although the parties eventually reached a mutual agreement through an amicable diplomatic solution, the dispute left some complex legal questions unanswered. Particularly relevant to the current context is the key issue that

[62] Regarding 'TRIPS-Plus', please see Cynthia Ho, 'Chapter 8 – an overview of "TRIPS-Plus" standards' in *Access to Medicine in the Global Economy: International Agreements on Patents and Related Rights* (Oxford, May 2011).
[63] See Council Regulation (EC) No 1383/2003 of 22 July 2003 'Concerning customs action against goods suspected of infringing certain intellectual property rights and the measures to be taken against goods found to have infringed such rights' OJ (2003) L 196/7, third recital and arts 4, 9.1 and 11.
[64] Mercurio, above n60, 405.

whether the EU's actions would be legal under Article 52 of the TRIPS Agreement. This is because that these generic medications destined for Brazil would not be deemed to infringe the IPRs of the private right holders in the country of importation, which is Brazil.

67. It is for this very reason, transiting states are strongly advised to proactively liaise with importing states to avoid any potential contraventions of WTO obligations.

Possible Measures by Countries of Importation

68. As importing countries, the TRIPS Agreement has positive obligations concerning counterfeit goods that must be complied with.

TRIPS – Article 51 - Suspension of Counterfeit Goods into Importing Markets

69. Article 51 of the TRIPS requires that a Member must have certain procedure in place for the possible 'suspension of release by customs' of imported 'counterfeit trademark or pirated copyright goods'. Nevertheless, consistent with the rationale that private rights holders have the ultimate responsibility to enforce their IRPs, any release is subject to the application by the rights holder, who has valid grounds for suspecting that the importation of counterfeit trademark or pirated copyright goods may take place.[65] Hence, the mandatory obligation is no more than create procedures to facilitate private right holders to make applications to competent authorities.

4.2.2 ARTICLE XXIII:1(C) OF THE GATT 1994: SITUATION COMPLAINTS

70. Article XXIII:1(c) of the GATT 1994 lists three specific conditions under which a WTO Member is entitled to invoke the dispute settlement system. A WTO Member has a cause of action, '*if any contracting party should consider that <u>any benefit</u> accruing to it directly or indirectly under this Agreement is being <u>nullified or impaired</u> or that the attainment of <u>any objective of the Agreement</u> is being <u>impeded</u> as the result of*':

[65] Article 51 of the TRIPS Agreement.

- the failure of another [Member] to carry out its obligations under GATT 1994 - **Violation complaints in Article XXIII:1(a);**
- any measure applied by another Member, even if it does not conflict with GATT 1994 - **Non-violation complaints in Article XXIII:1(b);**
- the existence of any other situation - **Situation complaints in Article XXIII:1(c).**

71. Among the three types of claims, 'violation complaints' are the most common, followed by 'non-violation complaints'. However, to date, there has never been a case successfully brought on the ground of 'situation complaints' under Article XXIII:1(c) of the GATT 1994.[66]

72. A literal and textual interpretation of Article XXIII:1(c) of the GATT 1994 would suggest that a WTO Member may bring a claim based on any situation whatsoever (which may not necessarily involve government measures), as long as it results in '*nullification or impairment' of accrued benefits or impediment to 'the attainment of any objective of the Agreement*' (the GATT 1994).

73. So can 'situation complaints' under Article XXIII:1(c) be expanded to apply to international illicit trade? Although the vague and broad text of Article XXIII:1(c) may be utilized creatively as a ground to bring a claim, a successful legal outcome is unlikely to be achieved for the following reasons.

A. 'Situation Complaints': Political rather than Legalistic

74. In practice, neither the GATT nor the WTO jurisprudence sheds any light on the criteria for a legitimate situation complaint. Under the GATT system (prior to 1994), although a few situation complaints were initiated, none of them has in fact ever resulted in a panel report. These cases mainly related to complaints concerning withdrawn concessions, failed re-negotiations of tariff

[66] World Trade Organization, *A Handbook on the WTO Dispute Settlement System* (CUP, 2004), 33-34.

concessions and non-realized expectations on trade flows.[67] Under the WTO regime, Article XXIII:1(c) of GATT 1994 has not ever been invoked by any complainant.

75. This under-use of Article XXIII:1(c) may be explained by its historical roots. Article XXIII:1(c) of the GATT 1994 on 'situation complaints' is carried over from the same provision in the GATT 1947. The negotiating history of the GATT 1947 suggests that the 'situation complaints' provision was initially intended to play a role in situations of macro-economic emergency, such as general depressions, high unemployment, collapse of the price of a commodity.[68] The admission of 'situation complaints' in Article XXIII:1(c) is one clear example of making diplomatic bargains and political concessions at the expense of legal precision and certainty.

76. Given the brevity of the 'situation complaints' in the GATT 1994 and the lack of any substantial jurisprudence on this issue, the negotiating history is likely to be heavily relied upon by panels when deciphering the applicable scope of 'situation complaints' under Article XXIII:1(c) of the GATT 1994. On this basis, it is arguable that if situations concerning illicit trade would fall under the category of 'situations' as envisioned by the drafters of the GATT 1947.

B. Adoption of Panel Reports – No Reverse Consensus

77. Procedurally, Article 26.2 of the DSU prescribes a few requirements for 'situation complaints'.

78. In particular, Article 26.2 stipulates that '*the dispute settlement rules and procedures contained in the Decision of 12 April 1989 (BISD 36S/61-67) shall apply to consideration for adoption, and surveillance and implementation of recommendations and rulings*.'[69]

79. The Decision of 12 April 1989 referred to the old GATT legal system, which was operated on a 'positive consensus' regime. It required that all Members

[67] Ibid.
[68] Ibid.
[69] BISD 36S/61-67.

must reach an agreed consensus for the adoption of GATT reports. It means that the losing party could block the adoption of a GATT report by persistently opposing to such adoption. This is why there were many 'unadopted' GATT reports prior to the creation of the 'negative consensus' regime under the WTO.

80. The consequence of Article 26.2 is that for 'situation complaints', the 'positive consensus' applies, and Members can easily block panel decisions, even if such decisions are in favour of the complainants.

C. Difficulty with finding a 'test Complainant'

81. Considering the legal uncertainty and the high risk of panel reports being blocked by the losing party, WTO Members are unlikely to be willing to initiate a claim on the basis of 'situation complaints' under Art XXIII:1(c) of the GATT 1994. This is further exacerbated by the fact that WTO proceedings are not only lengthy but also rather expensive. Democratically elected governments (which most developed states are) are likely to have a hard time convincing their constituents to fork out legal fees for litigating before the WTO with the possibility of not even getting a legally binding decision.

82. Therefore, in practice, it may be difficult to find a government that would be interested in becoming the 'test complainant' for a 'situation complaint'.

Possible Value of a Situation Complaint

83. Whilst a legally binding decision may not be resulted from a 'test situation complaint', such a complaint is likely to attract attention from the WTO, not only because it is a rare case of 'situation complaint' but also that it involves a rather novel issue of illicit trade. This may be a creative way to put the issue of illicit trade on the WTO discussion table, with a potential of triggering debates concerning the lack of any WTO rules on disciplining illicit trade.

84. The key purpose of a situation complaint concerning illicit trade therefore lies in its strategic value in compelling the WTO to take a look at the issue, to

consider its potential role in combatting illicit trade and to generate a constructive policy debate. Essentially, filing a situation complaint is the 'means' to an end, rather than the end in itself. This may help planting the seeds of future substantive WTO rules on regulating illicit trade.

'Situation Complaints' under TRIPS

85. It is worth pointing out that presently 'situation complaints' are not a cause of action for dispute settlements under the TRIPS Agreement.

86. For the time being, Members have agreed not to use non-violation cases, such as situation complaints for the TRIPS Agreement. Under Article 64.2 of the TRIPS Agreement, this 'moratorium' (i.e. the agreement not to use TRIPS non-violation cases) was initially to last for the first five years of the WTO from 1995 to 1999.

87. Article 64.3 of the TRIPS Agreement requires the TRIPS Council to submit recommendations to the Ministerial Conference for approval by consensus on the issue if non-violation claims including situation complaints should be allowed.

88. In May 2003, the TRIPS Council listed four possibilities for a recommendation: (1) banning non-violation complaints in TRIPS completely, (2) allowing the complaints to be handled under the WTO's dispute settlement rules as applies to goods and services cases, (3) allowing non-violation complaints but subject to special "modalities" (such as ways of dealing with them), and (4) extending the moratorium.[70]

89. Although most members appeared to have favoured banning non-violation complaints completely or extending the moratorium,[71] no consensus was reached at that time.

[70] WTO, *'Non-Violation' Complaints for the TRIPS*, see <http://www.wto.org/english/tratop_e/trips_e/nonviolation_background_e.htm>.
[71] Ibid.

90. In the meantime, the moratorium has been extended from one ministerial conference to the next. Effectively, non-violation claims including situation complaints are not permitted at present. Therefore, any 'test situation complaints' should be instituted under Article XXIII:1(c) of the GATT 1994 in accordance with the procedural requirements under Article 26.2 of the DSU.

4.3 WTO OBLIGATIONS THAT MAY PREVENT COUNTRIES FROM COMBATTING ILLICIT TRADE & EXCEPTIONS THAT COUNTRIES CAN INVOKE IN DEFENSE TO JUSTIFY THEIR ANTI-ILLICIT TRADE MEASURES

4.3.1 GATT 1994

91. As noted previously, any measures that are designed to alter the patterns of international trade are likely to interact with the trade rules administered by the WTO. Measures developed by Members to curb illicit trade are no exceptions, and must be brought into alignment with the WTO principles. Since the focus of illicit trade in this Memo is illicit 'goods' trade, the GATT 1994 is particularly important because it establishes the basic rules for trade in goods.

Core Principles – GATT 1994

92. The core principles of the GATT 1994 are reflected in the following key provisions:

- **Articles I** ('**Most Favoured Nation' Treatment**) and **Article III** ('**National Treatment**') prohibits discrimination. WTO Members are not allowed to discriminate between traded 'like products' produced by other WTO Members, or between domestic and international 'like products'.

- **Article XI** ('**Elimination of Quantitative Restrictions**') bans any prohibition or restrictions other than duties, taxes or other charges on imports from and exports to other WTO Members.

Fighting Illicit Trade with Trade-related Measures?

93. When discussing the TRIPS Agreement, the focus is on the positive obligations of the WTO Members to enforce IRPs, and how a lack of enforcement contributes to the rise of counterfeit trade.

94. However, what if countries take active actions to curb illicit trade by imposing trade-related measures to control flow of the goods?

95. The simple answer is that as long as such measures are not of a quantitative nature (**Article XI - Elimination of Quantitative Restriction)**, do not discriminate imports as against domestic products (**Article III – National Treatment**), nor between imports of different origins (**Article I – Most Favoured Nations Treatment**), these measures are generally accepted under WTO disciplines.

96. Most often, states choose to enact border measures, customs control measures or technical regulations in order to counter illicit trade. In practice, the measures could run the risk of violating WTO rules, and could be challenged by other WTO Members as being protectionist. For example, Colombia issued a series of Resolutions in 2005 and 2006 limiting the number of ports of entry available to textiles and footwear products arriving from Panama and China as a means to improve customs control and counteract smuggling, under-invoicing and asset-laundering.[72] Countries have also implemented border measures to supervise the collection of tax revenue, particularly for excisable goods. For instance, Dominican Republic required the affixation of tax stamps on imported tobacco products under the supervision of the tax authorities in its territory to combat tobacco smuggling.[73] Both examples resulted in disputes before the WTO. Colombia and Dominican Republic sought to justify their respective measures pursuant to Article XX of the GATT 1994.

4.3.2 'SAVING CLAUSE' - GATT ARTICLE XX (GENERAL EXCEPTIONS)

[72] ICTSD, 'the Challenge of Implementing Domestic Trade Policy Measures: The Colombia Ports of Entry Case', < http://ictsd.org/downloads/2010/10/case_brief_colombia-ports_v5-1.pdf>.
[73] Physicians for a Smoke-Free Canada, 'Tax Treatment of Imported Cigarettes', <http://www.smoke-free.ca/trade-and-tobacco/DominicanRepublic.htm>.

97. As mentioned above, if a WTO member is utilising trade restraints as part of its policy framework to tackle illicit trade, such restraints would only be WTO-consistent if they can be 'saved' under the provisions of Article XX of the GATT 1994. Other WTO Members, adversely affected, can bring a case to challenge these measures before the DSB.

98. According to the well-established WTO case law, to justify a measure under Article XX, a two-tiered approach is adopted[74]:

(1). the measure at issue is provisionally justified under one of the subparagraphs of Article XX. This requirement is more related to the **substance** of the measure. In relation to illicit trade, subparagraphs (b), (d) and (g) lend the strongest support for justifying WTO-inconsistent measures:

(b) ***necessary*** *to protect human, animal or plant life or health*; ...

(d) ***necessary*** *to secure compliance with laws or regulations... including those relating to customs enforcement… the protection of patents, trade marks and copyrights, and the prevention of deceptive practices*; ...

(g) ***relating to*** *the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption*;

AND

(2). the measure complies with the chapeau of Article XX. This requirement pertains to the **manner** in which the measure is applied. This means that the measure is:

... not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.

Article XX(b)

[74] Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc WT/DS58/AB/R (adopted 6 November 1998) [117]–[120] ('*US – Shrimp*').

99. To be justified under Article XX(b), the measure at issue must be **necessary** to protect 'human, animal or plant life or health'. Illicit trade is a well-recognized global problem that has serious adverse effects on many levels of the society. Depending upon the particular sector, it should not be difficult to establish that a measure is linked to one or more policy objects under Article XX(b). For example, measures against illegal logging are important for the protection of 'plant life', and measures against fake medicines are important for the protection of 'human or health.' However, the critical question is – are such measures 'necessary'?

Necessity Test

100. 'Necessary', according to the WTO, suggests that the measure should be making an 'indispensable' contribution to the objective in question.[75] When determining if a measure is necessary, it is a well-established practice for a WTO panel and the Appellate Body to weigh and balance a number of factors[76]:

a. how important the objective pursued is;

b. the extent to which the measure is contributing to the achievement of the said objective;

c. how trade-restrictive the measure is upon international trade;

d. once it is preliminarily concluded that the measure is 'necessary', it must then proceed to consider whether a less trade-restrictive alternative exists, noting that such alternative should be reasonably available to the Member and should achieve the Member's chosen level of protection.

101. Overall, a measure is necessary if it is 'apt to make a material contribution to the achievement of its objective'.[77] The contribution of the measure will then be weighed against its trade-restrictive effects, whereby the less trade-

[75] Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WTO Doc WT/DS161/AB/R (10 January 2001) [161] ('*Korea – Beef*').
[76] Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WTO DOC WT/DS332/AB/R, AB-2007-4 (3 December 2007, adopted 17 December 2007) ('*Brazil – Retreaded Tyres*'); Appellate Body Report, *Korea – Beef*, [162]–[164].
[77] Appellate Body Report, *Brazil – Retreaded Tyres*, [151]

restrictive the measure is, the more likely it would be characterized as 'necessary'. With respect to reasonable alternatives, it appears that if the measure belongs to a network of comprehensive policies to pursue the objectives, it would be easier to argue that the measure is a 'necessary' component of a broader strategy.

102. However, each measure must be examined on a case by case basis to ascertain if it passes the necessity test. Take illegal logging as an example - is the documentary proof of legality of timber by exporting states a 'necessary' measure to protect 'plant life'? The challenge is likely to be the effectiveness of such measure and assessing any reasonable alternatives. In this case, improving law enforcement at the production level maybe more effective and less trade-restrictive on international timber trade. Because of the multiplicity of the factors at issue, when developing particular measures, policy drafters must be cognizant of the relevant elements to ensure that the necessity test is satisfied.

Article XX(d)

103. Arguably, Article XX(d) is the most relevant exception relating to illicit trade, as its wording makes specific references to the objectives of 'customs enforcement, the protection of patents, trademarks and copyrights, and the prevention of deceptive practices'.[78]

104. Two elements are required under Article XX(d). Firstly, the domestic laws themselves must be GATT-consistent, and secondly, the measure at issue must be 'necessary' to ensure compliance with such domestic laws. The interpretation of 'necessary' is the same as in Article XX(b).

105. To fall under Article XX(d), there must be domestic laws or regulations pertaining broadly to the many facets of illicit trade. For instance, such laws

[78]Appellate Body Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WTO Doc WT/DS308/AB/R (6 March 2006) [69]–[71] ('*Mexico – Taxes on Soft Drinks*'). Mitchell, A., & Ayres, G, 'Out of Crooked Timber: The consistency of Australia's Illegal Logging Prohibition Bill with the WTO Agreement', (2012) 29(6) *Environmental and Planning Law Journal 462*, 480.

can be customs regulations and intellectual property laws that aim at battling counterfeit and pirated goods or taxation laws and regulations that fight tax evasion and prevent smuggling of excisable goods or competition laws that prohibit misleading and deceptive conducts. In general, this threshold is not difficult to overcome.

106. The next question is whether the measure at issue is 'necessary' to secure compliance with the relevant domestic laws. The 'necessity' test as set out earlier should be followed, taking into account the importance of the objective pursued, the level of contribution, trade-restrictiveness and reasonably available alternatives. The objectives pursued in the context of Article XX(d) should be accorded with 'common interests or values that the law or regulation to be enforced is intended to protect'.[79] The other three factors are likely to be analogous to the analysis under Article XX(b).

107. For example, Country A, a developing WTO Member, has implemented the minimum standards of the IPRs protection under the TRIPS Agreement through its domestic legislation. To further strengthen its domestic IPR protection, Country A has also adopted the practice of conditioning the allocation of export licenses upon the exporter providing documentary evidence that the overseas buyer is entitled to use the trademark affixed to the goods in the country of destination.[80] This measure is likely to violate Art XI of the GATT 1994 as an export restriction other than duties and taxes. But can this export restriction be justified under Article XX(d)?

108. The importance of IPRs protections is unlikely to be challenged today. Arguably, the trade-restrictiveness of the measure is minimum as the goods are already sold to buyers abroad, and the level of contribution is material since it exerts greater assurance of the legitimacy of the buyers. A plausible alternative is for Country A to set up a registration system of buyers' data for verification purposes. Yet, a strong contention against this proposal could be

[79] Appellate Body Report, *Korea – Beef*, [162].
[80] GATT, Group of Experts on Trade in Counterfeit Goods, 'Trade in Counterfeit Goods: Preliminary Background Note by the Secretariat', 10 January 1985 MDF/W/19, Special Distribution, para 83. This was a recommendation on treatment of exports by the Group.

the costs and expertise associated with this undertaking, which is not reasonably feasible for Country A. On this basis, theoretically this measure could be provisionally justified by Article XX(d).

Article XX(g)

109. Article XX(g) may be especially relevant to illicit trade in environmental goods or natural resources. One of the most well-known WTO cases to date, *US-Shrimp* set forth the key principles for interpreting this provision[81]:

- 'exhaustible natural resources' are not limited to non-living resources but also cover living species that are susceptible to depletion.
- the measure at issue should be 'primarily aimed at' or 'reasonably related' to the conservation of exhaustible natural resources.
- there must be an element of 'even-handedness' between measures enforced upon domestic and foreign products.

110. Since Article XX(g) does not base on the stringent 'necessity' test, it may be preferable to Article XX(b) should a measure be potentially justifiable under these two provisions. However, the key challenge under Article XX(g) is likely to surround on the factor of 'even-handedness', in the sense that if an equilibrium of effects between export measures and import measures can be shown upon actual evidence.[82] In *China-Raw Materials*,[83] China failed to demonstrate that the mere existence of production restrictions on its raw materials alongside export restrictions is sufficient to strike a balance on effect between the domestic consumers and international consumers.

111. For instance, in order to preserve its sharply declining fish stocks due to illegal fishing within its water, Country A applies annual quota on how much fishes could be caught as well as how much fishes could be exported. The

[81] Guzman & Pauwelyn, above n39, 387. Appellate Body Report, *US – Shrimp*, [141].
[82] Panel Report, *China Raw – Materials*, WTO DOC WT/DS394/R, WT/DS395/R, WT/DS396/R, [7.464 – 7.465] (July 5, 2011).
[83] Appellate Body Report, *China—Measures Related to the Exportation of Various Raw Materials*, WT/DS394/AB/R (circulated Jan. 30, 2012); WT/DS395/AB/R; WT/DS398/AB/R.

combination of such measures may not be sufficient to prove 'even-handedness', because whatever amount is not exported could be diverted to the domestic market, ultimately benefiting the domestic consumers at the expense of foreign consumers. Hence, Country A needs to do more by showing that the effect of the applied export quota on foreign consumers is somehow balanced with similar measures imposing restrictions on domestic consumers, not just production quota.

The Chapeau of Article XX

112. Once a measure is qualified as an exception under Article XX (b), (d) and (g), as a second step, a respondent must demonstrate that the measure also satisfies the 'chapeau' of Article XX. In a nutshell, the chapeau forbids the application of a measure as would consist of:

    e. 'a means of arbitrary or unjustifiable discrimination' (between countries where the same conditions prevail); or
    f. 'a disguised restriction' on international trade'.

113. More specifically, 'arbitrary or unjustifiable discrimination' is established to mean discrimination that is not rationally linked to the objective pursued under the relevant subparagraph of Article XX or that would go against that particular objective.[84] In a similar vein, 'disguised restriction' appears to have a slightly broader scope and includes 'disguised discrimination' in international trade.[85] Fundamentally, the point of inquiry here is the application of the provisionally justified measure for the avoidance of any abuse or illegitimate use of Article XX exceptions.

[84] Appellate Body Report, *Brazil – Retreaded Tyres*, [227]. Also Mitchell & Ayres, above n76, 482.
[85] Ibid.

Case Study: Appellate Body in Dominican Republic – Import and Sale of Cigarette

114. This dispute initiated by Honduras concerned a measure imposed by the Dominican Republic requiring the affixation of tax stamps under the supervision of the tax authorities in its territory ('Tax Stamp Requirement').

115. The Panel found that the Tax Stamp Requirement is inconsistent with the National Treatment obligation set out in Article III:4 of the GATT 1994, because the Tax Stamp Requirement has modified the conditions of competition in the marketplace to the detriment of imports.[86] Dominican Republic's appeal focused on whether its breach of Article III:4 can be justified by Article XX(d) of the GATT 1994, in that the tax stamp requirement is necessary to secure compliance with its tax laws and to prevent smuggling of cigarettes.[87]

116. The Appellate Body confirmed that the 'necessity' test under Article XX(d) involves a process of weighing and balancing of factors, including the importance of the common interests protected by the domestic law, the contribution made by the compliance measure to the enforcement of that law, and the trade-restrictiveness. Inquiry must also be made regarding the availability of any reasonable alternative measures. [88]

117. The Appellate Body upheld the Panel's finding that tax collection is 'a most important interest for any country', and the measure 'had not had any intense restrictive effect on trade', because it did not prevent Honduras from exporting cigarettes to the Dominican Republic.[89]

118. However, the Tax Stamp Requirement was found to be ineffective in preventing tax evasion and cigarette smuggling, as the measure in and of itself

[86] Appellate Body Report, *Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302, *('Dominican Republic-Import and Sale of Cigarette'),* para 57.
[87] Ibid.
[88] Ibid, para 64-70.
[89] Ibid, para 71.

would not prevent the forgery of tax stamps nor smuggling and tax evasion. The Panel was of the view that security features incorporated into tax stamps and police controls at various point of distribution and sale of cigarettes could make more contribution in preventing forgery, tax evasion and smuggling of tobacco products.[90] The Panel also opined that providing tax stamps to foreign exports as reasonably available alternatives. The Appellate Body ultimately upheld the Panel's findings that Dominican Republic failed to prove that its Tax Stamps Requirement could be justified by Article XX(d) of the GATT 1994.

119. The lesson from this case is that the effectiveness of the measure in preventing illicit activities is an important consideration for the Panel and the Appellate Body in determining if the 'necessity' test has been satisfied.

Summary – Trade Measures Concerning Illicit Trade

120. As outlined above, even with the best intentions by states to combat illicit trade, governments and policy drafters must minimize the risks of trade measures being challenged as WTO-incompatible, and in the meanwhile must maximise the chance of success of being justified through the gateway of Article XX. A few key points:

a. Making the objectives under Article XX(b), (d) and (g) as the primary objectives of a trade measure, rather than developing a measure solely on the basis of fighting illicit-trade related issues;

b. The less trade-restrictive the measure is, the more likely it would be WTO-consistent;

c. Ensuring sufficient amount of evidence to demonstrate the effectiveness of the measure concerned in fulfilling the particular policy objective of combatting illicit trade;

d. Developing the particular measure as part of a broader framework of comprehensive policies for the purpose of achieving non-trade objectives instead of a single unilateral measure increases the chance of being WTO-consistent.

[90] Ibid.

4.4 TBT AGREEMENT

121. The TBT Agreement is aimed at disciplining the increasing use of technical regulations as a non-tariff barrier to international trade. In this regard, the TBT Agreement promotes the harmonization of technical regulations by advancing legal advantages to those measures which comply with international standards.[91]

122. But, how can the TBT Agreement be potentially relevant to the regulation of illicit trade? As briefly discussed under '**Caveat on Defining Illicit Trade**', at the policy level, the TBT Agreement can act as a catalyst for advocating adherence to international standards for determining the 'legality' of the products. In other words, the TBT can be a safety net for a WTO complaint over illicit trade should the measure at issue be implemented in accordance to international standards.

Case Study: 'Tracking & Tracing' Measure & the TBT Agreement

123. One example for a potential connection between the TBT Agreement and illicit trade is the increasing importance of using 'tracking and tracing' measure in global supply-chain security for curbing illicit trade. This is most evident in the fight against illicit tobacco trade.[92] For example, in the *Protocol to Eliminate Illicit Trade in Tobacco Products* ('WHO Protocol'), adopted by the Parties to the WHO FCTC[93] in 2012 November, the parties agreed to establish a global 'tracking and tracing' system to reduce and eventually eradicate illicit trade.[94] This technological solution of 'tracking and tracing' is not exclusive to illicit tobacco trade. In September 2013, the United States ('US') also passed a legislation that calls for the creation of a 'tracking and tracing' system to crack down on counterfeit drugs.[95] Therefore, it is likely

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[91] L. Gruszczynski, 'The WHO Framework Convention on Tobacco Control as an International Standard under the TBT Agreement' *TMD – Legal Issues in Tobacco Control* Vol 9 Issue 5 November 2012, 2.
[92] British American Tobacco, 'Enhancing Supply Chain Security and Fighting the Illicit Trade in Tobacco Products',<http://www.bat.com/group/sites/uk__3mnfen.nsf/vwPagesWebLive/DO6TNLZ2/$FILE/medMD82AFTE.pdf?openelement>.
[93] WHO Framework Convention on Tobacco Control, May 21, 2003, 42 LL.M. 518 (2003), < http://www.who.int/*fctc*/>.
[94] WHO, <http://www.who.int/mediacentre/news/releases/2013/fctc_20130110/en/>.
[95] Zachary Brennan, 'US House passes track and trace bill after reconciling differences with Senate' (30 September 2013), <http://www.in-pharmatechnologist.com/Regulatory-Safety/US-House-passes-track-and-

that the 'tracking and tracing' system will gain an increasingly important and more expansive role in ensuring the legality of future international trade.

WHO's 'Tracking and Tracing' as Technical Regulations?

124. Article 8 of the WHO Protocol is on 'Tracking and Tracing'. In particular, Article 8.3 of the WHO Protocol obliges parties to affix unique identification markings ('Identification Markings') such as codes or stamps on cigarettes manufactured in or imported into their territory.[96] Subparagraph 4 of Article 8 further requires that information such as 'date and location of manufacture', 'manufacturing facility' and 'product description' form part of Identification Markings. So, can the 'Tracking and Tracking' measures be 'technical regulations'?

125. The TBT Agreement defines 'Technical regulations' as documents that lay down 'product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory'.[97] Such regulations may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.[98]

126. In *EC-Asbestos*, the Appellate Body explained that 'product characteristics' may include 'any objectively definable features, qualities, attributes, or other distinguishing mark of a product and product characteristics include, not only features and qualities intrinsic to the product itself, but also related characteristics, such as the means of identification, the presentation and the appearance of a product.'[99]

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trace-bill-after-reconciling-differences-with-Senate?utm_source=copyright&utm_medium=OnSite&utm_campaign=copyright>.

[96] Article 8.3 of the WHO Protocol.

[97] TBT Agreement Annex 1(1).

[98] Ibid.

[99] Appellate Body Report, *European Communities - measures affecting asbestos and asbestos-containingproducts,7* 67, WT/DS135/AB/R (Mar. 12, 2001) ('*EC – Asbestos*').

127. On this basis, the 'Tracking and Tracing' measures may be characterized as relevant to markings and labeling, hence, are arguably 'technical regulations' for the purposes of the TBT Agreement.

Is the WHO Protocol an International Standard?

128. Article 2.2 of the TBT Agreement requires that technical regulations should not be 'unnecessary obstacles to international trade', in which case technical regulations must not be more trade-restrictive than necessary to fulfill a legitimate objective. Article 2.2 further provides a list of exemplary objectives, including: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment.

129. Nevertheless, as stipulated in Article 2.5 of the TBT Agreement, the obligation under Article 2.2 (not to create an unnecessary obstacle to international trade) is presumed to be satisfied when the technical regulation accords to relevant international standards.

130. But is the WHO Protocol an international standard pursuant to the TBT Agreement?

131. In *US – Tuna II (Mexico)*, the Appellate Body concluded that a required element of an 'international' standard for the TBT Agreement is the approval of the standard by an 'international standardizing body', which is, a body that 'has recognized activities in standardisation and whose membership is open to the relevant bodies of at least all Members'. [100] The Appellate Body ruled that the Dolphin-Safe labeling standard created under the Agreement on the International Dolphin Conservation Program ('AIDCP') was not an 'international standard', on the basis that the AIDCP is not an international standardising body for it was not "open" for all WTO members to join.[101]

[100] Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, WT/DS381/AB/R, ('*US – Tuna II (Mexico)* AB Report) para 359.
[101] *US – Tuna II (Mexico),* AB Report, para 356.

132. In the current context, the WHO is a well-recognized international body with 194 member states, and all countries which are Members of the United Nations may become members of the WHO by accepting its Constitution.[102] Further, any parties to the WHO FCTC can become a party to the WHO Protocol. Most members of the WHO FCTC are also WTO Members.

133. Does the WHO have 'recognized activities in standardization'? In a way, the development of the WHO Protocol, which relates to the characteristics for products and packaging, marking and labeling requirements, arguably is a form of standardization. The recognition can be sufficiently inferred to from the participation by countries in the development of such a standard.[103]

134. Overall, there may be a reasonable chance to characterize the WHO Protocol as an international standard within the meaning of the TBT Agreement.

135. Should the WHO Protocol be recognized as an international standard, the implementation of the Tracking and Tracing measures is less likely to be challenged as TBT-inconsistent. Also, the Tax Stamp Requirement in the *Dominican Republic-Import and Sale of Cigarette*, which was found to violate the National Treatment obligation under Article III:4 of the GATT 1994 can be substituted with the Identification Markings, which provide legal security and certainty in the process of implementation.

4.5 KIMBERLY PROCESS MODEL – ANOTHER OPTION?

136. Aside from potential retaliatory measures that can be taken against states who fail to address illicit trade, opportunities exist to take broader anti-illicit trade activities through positive cooperation amongst states and co-ordination between non-WTO measures with the WTO law. The waiver granted with respect to the Kimberley Process Certification Scheme for Rough Diamonds ('Kimberley Scheme') presents such an example.

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[102] WHO, 'Countries' <http://www.who.int/countries/en/>.
[103] *US – Tuna II (Mexico),* AB Report para 389-390.

The Legal Basis of Waivers

137. The adoption of waiver decisions is based on Article IX:3 of the WTO Agreement which authorises the WTO Ministerial Conference to waive an obligation of the WTO Agreement or any of the Multilateral Trade Agreements. Waivers are granted on an exceptional basis and in deciding to grant a waiver the Ministerial Conference is required to state 'the exceptional circumstances justifying the decision, the terms and conditions governing the application of the waiver, and the date on which the waiver shall terminate'.[104] Waivers granted for more than one year is subject to an annual review in order to asses whether the exceptional basis still exists.

The Kimberley Scheme

138. The Kimberley Scheme evolved from the UN's response to the trade in conflict diamonds: firstly, the Security Council Resolution on embargoes on diamond importation from Angola and Sierra Leone; and then the General Assembly resolution which called on members to devise measure to address the trade of conflict diamonds. [105]

139. The Kimberley Scheme is a non-binding instrument. It requires participants to ensure that only rough diamonds certified under the scheme are imported and exported; and further, to refrain from importing and exporting rough diamonds to non-participants. States that fail to implement the minimum requirements can be considered as non-participants, with the consequence that they are excluded from the market. Given the potential trade distortive effects of the requirements, many participants were concerned that they violate WTO norms, in particular the prohibition of quantitative restrictions (Article XI (1) of GATT), the obligation to administer quantitative restrictions non-discriminatorily (Article XIII(1) of GATT), and the obligation to grant most-favoured nation treatment (Article I (1) of GATT). [106]As a result, participants

[104] WTO Agreement, Art. IX:4.
[105] Isabel Feichtner, ' The waiver power of the WTO: Opening the WTO for political debate on the reconciliation of competing Interest' (2009) 20(3) *The European Journal of International Law* 622.
[106] Ben McGrady *Trade and Public Health: The WTO, Tobacco, Alcohol and Diet* (CPU, 2011) 226.

(who were also WTO members) requested - and were granted - a waiver, which effectively immunised participants from WTO-illegality claims.

140. The waiver granted in respect to the Kimberley Scheme is an interesting case for the topic of illicit trade, not only because of the subject matter – trade in conflict diamonds – but in the way that anti-illicit trade measures may be considered WTO consistent. Moreover, it illustrates how WTO Members may pro-actively ensure that anti-illicit trade measures are immune from WTO prosecution without resorting to the general exceptions provided by the GATT 1994. Nonetheless, critics have argued that the waiver for the Kimberly Scheme has not gone far enough. For example, if the Kimberley Scheme was deemed an 'international standard' under the TBT,[107] it would compel WTO Members to use the standard as a basis of its own technical regulation and non-compliance would give rise to a cause of action before the WTO dispute panel. Nonetheless, the Kimberley Scheme and the accompanying waiver provides a creative way forward on how the WTO can be engaged to address illicit trade issues.

4.6 Generalised System of Preferences – a trade carrot to induce states to address illicit trade?

141. Another non-retaliatory measure employed by states to compel a change in behaviour of other states is through the offering of trade incentives as part of their Generalised System of Preferences ('GSP').

142. Under the 'Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries', better known as the 'Enabling Clause', developed members of the WTO are permitted (but not obligated) to provide differential and more favourable treatment to developing country members, without violating the MFN provision (Article 1 of GATT).

143. The Enabling Clause provides the legal justification for developed countries to institute a GSP scheme under their domestic legislation. Under such

[107] Steve Charnovitz ,' The World Trade Organisation and Law Enforcement' (2003) *Council on Foreign Relations,* < http://www.cfr.org/world/world-trade-organization-law-enforcement/p5860>

schemes, developed countries offer non-reciprocal preferential treatment, such as duty-free access, to selected products originating from designated countries.[108] It is the preference-giving country that unilaterally decides the products and countries to be included in their GSP scheme.[109]

144. It is not uncommon for countries to offer GSP benefits on a conditional basis. Under the European Community GSP program, for example, GSP benefits may be temporarily suspended from a country that fails to comply with international money laundering conventions.

145. GSP schemes have already been used to compel beneficiary countries to take measures relating to illicit trade activity. In the US[110], the *Trade Act 1974* authorised the US President to withdraw, suspend, or limit GSP benefits on the basis of, among other factors, where a beneficiary country fails to provide adequate and effective protection to intellectual property.[111] In 2001, after receiving a petition from the International Intellectual Property Alliance, the US government launched a review of Brazil's practices in respect of the protection of intellectual property rights. The review alone prompted the Brazilian Government to undertake various measures to address US concerns. Among other steps, the Brazilian Government established the National Council for Combating Piracy and Intellectual Property Crimes, saw some improvement in the prosecution of civil copyright infringement cases and led to improved dialogue and information sharing between the US and Brazil on copyright and piracy related matters.

146. As the US/Brazil case illustrate, GSP schemes can be an influential tool for developed countries to compel beneficiary countries to address illicit trade issues. Moreover, given that GSP schemes are part of a country's domestic legal system, countries have a great deal of latitude on how, and on what basis,

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[108] Guzman, & Pauwelyn, above n39,
[109] Ibid.
[110] The legal basis for the US GSP program had expired on 31 July 2013. Therefore goods that were previously part of the GSP program are now subject to regular trade duties. At the time of drafting, it is the authors' understanding that US Congress is considering legislation that would renew the GSP scheme.
[111] Office of the United States Trade Representative, 'GSP', <http://www.ustr.gov/trade-topics/trade-development/preference-programs/generalized-system-preferences-gsp/gsp-documents-1>.

they offer GSP benefits.[112] For developing countries, GSP benefits are much needed trade concessions that facilitate the penetration of larger, but more competitive markets of developed countries. At the time of the US review, for example, Brazil's duty-free GSP exports to the US totaled US$2.5 billion, accounting for 14% of total exports from Brazil to the US.[113] Therefore, there is a strong economic incentive for beneficiary countries to conform to conditional GSP schemes.

5. ADDRESSING ILLICIT TRADE THROUGH INTERNATIONAL INVESTMENT LAW

147. Where a relevant investment treaty is in place, foreign investors whose covered investment suffers damage as a result of illicit trade activities in their host state, may be able to seek recourse under IIL. Any such action will require drawing a connection between the illicit trade activity affecting the investment and the host state; and will largely be based on the omission or the failure of the host state to implement measures to address that illicit trade. In *Eureko*, the ad hoc tribunal said it was 'obvious that the rights of an investor can be violated as much by the failure of a contracting state to act as by its actions'.[114]

148. Given the absence of any express provision relating to illicit trade under any investment treaty, the claim can be supplemented with a reference to the failure on the part of the host state to comply with its domestic and/or international obligations with respect to addressing certain illicit trade activities. The notice of arbitration brought by Canadian national Peter Allard against Barbados under the terms of the Canada-Barbados BIT provides an analagous claim. In support of his claim, Allard argued that he suffered substantial losses as a result of Barbados' failure to enforce applicable international and domestic environmental law to protect the natural wetland ecosystem the ecotourism facility (the investment) relied upon. Allard claimed that these and other acts and omission of Barbados amounted to a breach of

[112] Ibid.
[113] Ibid.
[114] *Eureko BV v Poland*, Partial Award, 19 August 2005, para 186.

full protection and security, fair and equitable treatment and indirect expropriation of his investment.

149. The possibility of bringing such an action in respect of illicit trade activities will be explored using the following hypothetical and will be considered in respect of the common substantive protections found in investment treaties. Each substantive protection will be addressed in turn.

Hypothetical

Suppose, for example, a foreign-owned tobacco company has operations in a state (host state) where the smuggling of tobacco products and counterfeit cigarettes are a significant problem. The host state has ratified the WHO FCTC and the WHO Protocol, and subsequently introduced domestic legislation giving effect to the various obligations arising under each instrument. However, over time, the host state fails to enforce these laws and as a result, the smuggling of tobacco products remains a significant problem in the country. The company considers that this failure has detrimentally affected the value of its investment because it has inhibited the company's ability to penetrate the domestic tobacco market and further, forced it to reduce its prices in order to compete with the illicit products.

5.1 FAIR AND EQUITABLE TREATMENT ('FET')

150. The obligation to accord foreign investors fair and equitable treatment is acknowledged as one of the most commonly used substantive protections in investment treaties. In assessing a breach of FET standards, arbitral tribunals have assessed it in accordance to the principles of reasonableness, consistency, non-discrimination, transparency and due process.[115] Central to these

[115] Voon T & Mitchell A, 'Time to Quit? Assessing International Investment Claims against plain tobacco packaging in Australia' 14(3) *Journal of International Economics Law* 515, 534.

principles and the FET standard is the idea of the protection of legitimate expectations of the investor. [116]

151. The protection of legitimate expectations is primarily related to the idea that private persons need to know if they can rely on statements or decisions made by the host state or its public agencies. Claims alleging breach of FET in this regard generally involve situations where the state has represented that they will follow or have been following certain policies, but the authority subsequently deviates from the representation.[117] Another common situation is where administrative decisions are revoked, such as the withdrawal of a previously granted licence.[118]

152. Tribunals have generally upheld the legitimate expectations of investors where host states have made *specific* representations or assurances to a particular investor to induce them to make an investment in their country. [119] In addition some tribunals have also recognised that legitimate expectations may also arise where the host state has made specific representation not directly to a particular investor, but in a general sense, in order to attract investors from a certain sector or industry. [120] Argentina, for instance, introduced certain measures in an attempt to attract foreign investors to the gas transportation sector. [121] These measures included such laws and regulations that gave effect to fixing the Argentinian peso with the US dollar and the calculation of gas tariffs in US dollars and conversion to pesos at the billing amongst other concessions in the gas tariff regime. However, to the detriment of the foreign investors, these laws were significantly changed by Argentina's measures to overcome its economic crisis between 2000-2002. In the various arbitrations commenced against Argentina in response to its amendments to the earlier measures, the tribunals held that the earlier measures were

[116] Ibid.
[117] Klager, above n 25, 166.
[118] Ibid.
[119] Felipe Mutis Tellez, 'Conditions and Criteria For The Protection of Legitimate Expectations Under International Investment Law (2012) 27 (2) *ICSID Review*, 434.
[120] Ibid.
[121] Ibid.

'guarantees' to the investor and that they had a 'right' to the concessions to the gas tariff regime offered by Argentina.[122]

153. In the present case study the investor may be able to formulate a claim on the basis that the host state has treated them unfairly and inequitably by undermining their legitimate expectations. In advancing this claim, the investor can argue that it had *legitimately expected* that by ratifying the FCTC and Protocol and enacting the domestic legislation, the government had represented to the tobacco industry that those laws would also be enforced. Instead, by failing to enforce its own laws and abide by its international legal obligations, the host state has not acted in accordance with its representations. This inaction by the government has significantly devalued their investment.

154. In considering a claim of breach of legitimate expectations a tribunal is likely to assess whether it was reasonable for the investor, taking into account all the circumstances (political, economic, historical conditions), to rely on the alleged representations made by the host state.[123] The host state, in this instance, may be a least developed country with very limited capacity, financial and otherwise, that would enable them to effectively enforce their laws. There may also be other reasons why the investor was not able to penetrate the domestic market and affecting its sales, or even events from third neighbouring states contributing to the illicit trade in cigarettes that the host state had no control of. As such, it may be difficult to attribute the inaction of the state to the alleged damage sustained by the investor. In any case, the host state is likely to argue that the investor had prior knowledge that the smuggling of cigarettes and the trade of counterfeit cigarettes were significant issues in the host state and therefore were on notice of the risks of making such an investment. In *International Thunderbird Gaming Corporation v The United Mexican States*[124], the tribunal said that the investor could not reasonably rely on a legal opinion given by the Government, not only because such opinion was based on misrepresentation made by the investor, but also because the

[122] Ibid.
[123] Ibid.
[124] *International Thunderbird Gaming Corporation v The United Mexican States,* UNCITRAL, Award, paras 149–64 (26 January 2006).

investor knew that gambling was an illegal activity in Mexico. Lastly, the host state may also argue that their decision to become a party to the FCTC and the Protocol, and the subsequent introduction of domestic laws giving effect to their international obligations, were motivated by public interest concerns, rather than an attempt to attract foreign investment from tobacco companies.

5.2 Full Protection and Security

155. There are many iterations of provisions providing for full protection and security to foreign investments, but in essence the standard is viewed to concern the failures by the host state to protect the investment from adverse effects from the acts of third parties. The standard has generally been preoccupied with the protection of physical protection of the investment [125], but arbitral decisions, including *Azurix*, has extended the standard beyond mere physical security to affording a certain level of stability and a secure investment environment. [126]

156. In the present case study, the investor may argue that in failing to enforce its domestic legislation, the state has failed to afford full protection and security to its IPRs from third parties who participate in the sale and distribution of smuggled or counterfeit cigarettes. IPRs are generally perceived to fall within the definition of 'investment' in international investment agreements, and therefore within the scope of IIL. [127]

157. In assessing the due diligence that should have been exercised by the host state, a tribunal will look at the resources available to it:

> *'Although the host state is required to exercise an objective minimum standard of due diligence, the standard of due diligence is that of a host state in the circumstances and with the resources of the state in question. This suggests that due diligence is a modified objective standard—the host state must exercise the level of due diligence of a host state in its particular circumstances. In practice, tribunals will likely consider the state's level of development and stability as relevant circumstance in*

[125] Klager, above n25, 293.
[126] Ibid.
[127] Bryan Mercurio 'Awakening the Sleeping Giant: Awakening Intellectual Property in International Investment Agreements' (2012) 15(3) *Journal of International Economic Law* 871.

determining whether there has been due diligence. An investor investing in an area with endemic civil strife and poor governance cannot have the same expectation of physical security as one investing in London, New York or Tokyo'.[128]

158. Accordingly, in applying this to the present case study, a tribunal would consider the capacity of the state, in determining the level of due diligence that should have been applied by that state. Therefore if the host state is one that has very limited capacity to enforce its domestic laws, including protecting intellectual property rights, a tribunal is unlikely to find a breach of the standard of full protection and security.

5.3 NATIONAL TREATMENT

159. Provisions providing for national treatment oblige the host state to afford a foreign investor, with treatment no less favourable than the one granted to its own nationals. The object of these provisions is to provide a level playing field for foreign investors in relation to domestic competitors. In applying this to the case study, the investor will have to demonstrate that the treatment afforded to it, is in some way less favourable than what is afforded to local tobacco companies. This would be difficult to prove because the government's inaction would equally affect all investors.

5.4 MOST-FAVOURED-NATION ('MFN')

160. MFN standards serve to create competitive equality between foreign investors. That is, a MFN clause in an investment agreement obliges the host country to treat the foreign investor from a contracting states at least as favourably as investors from any third country. In applying this to the case study, the investor will have to demonstrate that the treatment afforded to it, is in some way less favourable than other foreign tobacco companies operating in the host state. This would be difficult to prove because the government's inaction would equally affect all investors.

[128] *Pantechniki v Albania*, Award, IIC 383 (2009) para 81.

5.5 EXPROPRIATION

161. The concept of expropriation concerns the governmental taking of property for which compensation is required. A classic situation that would be tantamount to expropriation is where the government takes over an investment, depriving the investor of all meaningful benefits of ownership and control[129]. As IIL has evolved, so has the nature and range of expropriatory acts. For example, indirect deprivation of a foreign investor's asset has come to characterize modern expropriation claims. In *Valentine Petroleum*, the tribunal commented that the definition of expropriatory acts [in the contract] was broad enough to cover 'creeping expropriation' and 'constructive taking', noting that the latter also comprises ' interference with the use or enjoyment of property'.[130]

162. As expropriation focuses on positive acts of states (and not omissions), an investor is more likely to bring an expropriation claim to challenge government measures which have been introduced to address illicit trade, but have also had a damaging effect on their investment. The arbitral proceedings involving Phillip Morris Asia and Australia under the Hong Kong-Australia BIT ('PMA Claim') illustrate how this may unfold.[131] The case centers around the introduction of the *Tobacco Plain Packaging Act 2011* which requires mandatory plain packaging for all tobacco products. Under the scheme, all tobacco products will have to be packaged in conformance with specific shape, size and colouring. Further, tobacco companies are not permitted to use trademarks or others marks, with the exception of 'brand, business or company name … and any variant name for the tobacco products' in a manner that is prescribed by the regulation.[132] The Australian government's purported objective of introducing the legislation is to improve public health and meet its international obligations under the FCTC.[133] In response to this legislation, the

[129] *Feldman v United Mexican States* (Award) 7 ICSID Rep 341.
[130] McLachlan, Shore & Weiniger, above n 24, 266
[131] Written Notification of Claim by Philip Morris Asia Limited to the Commonwealth of Australia pursuant to Agreement between the Government of Hong Kong and the Government of Australia for the Promotion and Protection of investments (27 June 2011)
[132] Ibid,
[133] Voon & Mitchell, above n 115, 517.

tobacco companies have launched multiple proceedings including domestic constitutional challenges, WTO disputes and an investment claim.[134] Among the claims, Phillip Morris Asia argue that the legislation is plainly equivalent to deprivation of its investment in Australia because the value of the investment is 'heavily dependent' on the use of its intellectual property on its packaging; and the legislation 'destroys the commercial value of the intellectual property and the goodwill'.[135]

163. The PMA claim should serve as a warning to governments on how IIL may allow foreign investors to challenge measures adopted to protect public interest, including measures designed to address illicit trade. Thus, in entering into a BIT (or an FTA with an investment chapter), governments should consider the inclusion of safeguards so as to have greater certainty when regulating on public interest objectives. In respect of expropriation, this can be in the form of an express provision, which stipulates that non-discriminatory regulatory actions that are designed to achieve public interest objectives, such as security, the environment and public health do not constitute (indirect) expropriation.[136] Additionally, governments should be mindful of any IIL implications when adopting measures to address illicit trade.

164. For investors, BITs may provide a cause of action where a government has adopted regulatory measures purportedly to address illicit trade or has deemed an activity to be illegal and then use those grounds to expropriate an investment. Again, the discussion on who deems an activity to be illegal and on what basis is relevant here – see section 2.2 Caveat on Defining Illicit Trade.

5.6 CONCLUSION

165. The above discussion indicates that investors who have suffered damage as result of illicit trade activities in their host state may be able to formulate an investment claim based on the breach of substantive obligations of a relevant

[134] Details of the claims are available at < http://www.ag.gov.au/internationalrelations/internationallaw/pages/tobaccoplainpackaging.aspx>.
[135] Ibid.
[136] See Australia-Korea FTA for an example.

investment treaty. In doing so, the investor will have to demonstrate that it was the failure of the host state to address the illicit activity that has led to the alleged damage. For the reasons outlined in this section, this is likely to be a difficult task. Notwithstanding this, the success of bringing an investment claim will depend on a number of different factors, including the particular circumstances of the case, the legal arguments and evidence supporting them and the arbitrators selected to preside over the case.[137] Equally, states should be cognisant of potential IIL issues that may arise both when introducing measures to address illicit trade.

6. RECOMMENDATIONS

6.1 MULTILATERAL LEVEL – WTO

6.1.1 ILLICIT TRADE AS A 'TRADE-RELATED' ISSUE

166. Considering the strong rule-based system of the WTO, it is important to seize the WTO machinery as a preferred legal forum for combatting illicit trade. At this stage, international investment law regime is still in an early stage of evolution, and the system itself has not developed a coherent approach to the interpretation of various legal notions inherent to investment law.

167. In the context of the WTO, illicit trade should be characterised as a salient 'trade-related' issue of the 21st century in order to gain support for a stronger link between the WTO and illicit trade. Illicit trade is a by-product of trade liberalisation - an objective that has been faithfully promoted by the GATT/WTO, and it continues to flourish as trade and investment become more globalized than ever. If IPRs can be categorised as a trade-related issue, and can harness sufficient force to create a separate WTO agreement, arguably, illicit trade should also deserve a place within the WTO paradigm.

168. One possible way of attracting attention from the WTO concerning the issue of illicit trade is to file a strategic 'situation complaint' pursuant to Article XXIII:1(c) of the GATT 1994. As emphasised under the section of 'Situation

[137] Voon & Mitchell, above n 115, 552.

Complaints', such a case is unlikely to result in a successful legal decision. However, it may have a strategic value of getting the WTO's attention on this issue.

169. Also, the WTO can be instrumental in ensuring that its rules would not hinder governmental measures against illicit trade by promoting regulatory harmonization and standard setting concerning illicit trade. This is likely to resolve the dilemma created by the divergent determinations of what constitutes 'illegality' under domestic jurisdictions. This may be achieved either by creating new substantive rules as the TRIPS Agreement, or by promoting the conformity to international standards.

6.1.2 Strengthen WTO Rules for Combatting Illicit Trade

170. Currently, the WTO does not have any specific rules regulating illicit trade, especially concerning the non-IP related aspects of illicit trade. Without any substantive obligations, it is difficult to bring a successful claim before the DSB. Therefore, the most direct way to link the WTO with the issue of 'illicit trade' is to create rules within the WTO system disciplining illicit trade.

171. However, the slow progress at the ongoing Doha Round negotiations does not provide any comfort for the realistic prospect of reaching consensus within the WTO on creating new rules for illicit trade. The ill-fated *Anti-Counterfeiting Trade Agreement,* which was negotiated outside the WTO but among a small group of developed states, foreshadows the challenging task of concluding a WTO multilateral agreement on illicit trade.[138]

172. Nevertheless, treaty negotiations are 'long-term projects'. For example, the seed of the TRIPS Agreement was planted in 1978 by the 'anti-counterfeiting code'.[139] Yet, it took another 16 years for the TRIPS Agreement to come to fruition. For now, the task at hand is to put the issue of illicit trade on the agenda of the General Council or the TRIPS Council for discussions. The

[138] Jacob Anbinder, 'EU Parliament Rejects Anti-Counterfeit Pact', *the Wall Street Journal* 4 July 2012, < http://online.wsj.com/news/articles/SB10001424052702303962304577506784228773546>.
[139] Susan Sell, *Private Power, Public Law: the Globalization of Intellectual Property Rights* (CPU, 2003), 40-43.

WTO as an institution needs to be made aware of the absence of WTO disciplines on this particular issue and also of the potential contribution that could be made by the WTO.

173. In addition, instead of a multilateral agreement, a more feasible alternative may be a plurilateral agreement on illicit trade. This would be analogous to the *Agreement on Government Procurement* (1996), which has been signed by some WTO members but not all.[140] It is hoped that gradually the membership of such a plurilateral agreement will be expanded over years. Although the realisation of this objective may still take a long time, it would be easier to gain political support to have the negotiations of the plurilateral agreement started.

174. Another way of strengthening WTO rules for combatting illicit trade is through promoting regulations harmonization. By requiring governmental measures targeting illicit trade to accord more uniform international standards, the WTO is able to remedy the potential conflict caused by the divergent definitions of 'legality' among domestic jurisdictions. By adhering to international standards, WTO Members are consequentially at a lower risk of being found to violate WTO disciplines. Also mentioned earlier, in addition to regulatory harmonization, regulatory recognition as adopted in the EU Timber Regulations may also be a creative way to resolve the lack of a universally agreed definition on illicit trade.

6.1.3 Strengthening Co-operation with other International Organizations

175. Illicit trade is a multifaceted problem that covers various types of articles and products, and occurs at all stage of the global supply-chain. Also of importance is the fact that illicit trade is not merely an economic or trade issue, but it also underscores social and criminal concerns.

[140] USTR, *The WTO Agreement on Government Procurement*, <http://www.ustr.gov/trade-topics/government-procurement/wto-government-procurement-agreement>.

176. Therefore, the combat against illicit trade must be approached in a holistic manner. It is recommended that the WTO should collaborate with other international organisations, NGOs and civil societies through knowledge and information sharing and open consultations. For example, organisations such as the World Wide Fund for Nature has long been involved in the fight against illicit trade, and have developed substantive knowledge in illicit activities pertaining to its mandated thematic area. To this end, such cooperation may lead to the potential development of another Kimberly-Scheme-type solution for curbing illicit trade in wildlife products.

177. Further, the WTO should strengthen its partnership with the WCO, which is the main inter-governmental body representing approximately 180 customs administration around the globe. In 2013, the WCO published its first edition of the WCO Illicit Trade Report, covering drugs, revenue, IPRs, environment, security and the customs enforcement.[141] Whilst the WCO focuses principally on the role of Customs officers in combating illicit trade, the partnership between the WTO and the WCO holds special relevance, especially after the recent conclusion of the *Trade Facilitation Agreement* at the 9th WTO Ministerial Conference in Bali of December 2013.[142] Such partnership will enhance the detection of illicit goods and enable the early seizure of such goods both before exporting and importing.

6.2 Bilateral & Regional Level – PTAs (FTAs & RTAs)

178. In addition to the multilateral trading framework created under the WTO, countries have increasingly engaged in FTAs negotiations on a bilateral and regional basis to establish preferential trade arrangements ('PTAs').[143]

179. Whilst the phenomenon of PTAs is not new, the recent trend of such negotiations seems to suggest that modern PTAs go far 'deeper' and 'wider' in their coverage, traversing a wide range of issues such as environment,

[141] WCO, *WCO published its First Illicit Trade Report* <http://www.wcoomd.org/en/media/newsroom/2013/june/wco-publishes-its-first-illicit-trade-report.aspx>.
[142] WTO, Trade Facilitation, <http://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm>.
[143] WTO, *World Trade Report 2011: The WTO and preferential trade agreements: from co-existence to coherence*, <http://www.wto.org/english/res_e/publications_e/wtr11_e.htm>.

investment protection, labour standards and WTO-Plus IP protections. Negotiating parties are more flexible to make concessions as in theory any 'opportunity costs' or 'trade-offs' in one area (such as tighter labour standard) would be compensated by other gains (such as more market access to legal service) acquired under the agreement. In effect, PTAs are the alternative 'testing' grounds for creating new rules pertaining to emerging challenges and issues, such as illicit trade.

180. A positive sign of such development is evident in the recently concluded FTA between China and Switzerland.[144]

Example: FTA between China and Switzerland – TRIPS Plus

China and Switzerland have committed to higher standards of IPRs protections than the standards under the TRIPS Agreement. For example:

- Measures taken by customs authorities to combat counterfeiting and piracy are to be applied not only at import of goods but at export as well.
- The seizure of suspect products (on an ex officio basis or at the request of the rights holder), as well as the possibility to analyse samples and specimens of retained goods shall apply in the event of the infringement of trademarks and copyrights, as well as of patents and protected designs.
- Both civil and criminal proceedings are available to prosecute breaches of the laws and to claim compensation.
- It must be possible to order precautionary measures and immediate provisional measures (interim relief). In civil proceedings, measures against both infringing goods and materials and tools that were used for the production of such goods must be available (including confiscation and destruction).

181. It is relevant to note that China does not yet have any FTAs with the EU, the US nor Japan. This may provide future opportunities for constructive developments in this respect.

182. Finally, from an investment law perspective, when states conclude FTAs with investment chapters (or BITs), they should include sufficient safeguards to ensure that the substantive protection obligations provided to foreign investors

[144] Swiss State Secretariat for Economic Affairs SECO Foreign Economic Affairs Directorate, 'Factsheet: Free Trade Agreement (FAT) between Switzerland and China', <http://www.news.admin.ch/NSBSubscriber/message/attachments/31348.pdf>.

do not preclude states from adopting good faith regulatory measures in pursuit of legitimate public interest measures, including measures designed to address illicit trade. This can be achieved through the inclusion of explicit textual support, such as the general exception found in the investment chapter of the Singapore-Australia Free Trade Agreement:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between the Parties where like conditions prevail, or a disguised restriction on investments in the territory of a Party by investors of the other Party, nothing in this Chapter shall be construed to prevent the adoption or enforcement by a Party of measures:
> (a) necessary to protect public morals or to maintain public order;
> (b) necessary to protect human, animal or plant life or health;
> (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Chapter including those relating to:
> (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on a contract;
> (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;
> (iii) safety;
> (d) imposed for the protection of national treasures of artistic, historic or archaeological value;
> (e) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.[145]

6.3 UNILATERAL LEVEL – GSP

183. At the unilateral level, the GSP regime is likely to be one of the more effective means to respond to ineffective actions or inactions on the part of developing countries. Developed states, such as the EU and the US, by unilaterally giving preferential accesses to developing states, can reinforce the incentives for tighter regulations on illicit trade activities through the GSP arrangement.

184. It should be however noted that not all developing states are receiving benefits under GSP schemes from the developed states. The list of the beneficiary-states is determined in accordance with the domestic policies of the offering states, as essentially GSP schemes are domestic laws that are deemed to be consistent with the WTO rules. In its reformed GSP system

[145] *Singapore – Australia Free Trade Agreement between the Government of Australia and the Government of the Republic of Singapore*, 2257 UNTS 103(signed 17 February 2003, entered into force 28 July 2003), Ch 8, Article 21.

2014, the EU has reduced the number of its GSP beneficiaries from 177 to 90.[146] In particular, countries that have been listed in the World Bank classification as high or upper middle income economies during the most recent three years would cease to be beneficiaries.[147] It is worth noting that both China and Thailand have been classified as upper middle income economies since 2011, and will thus be removed from the EU's GSP scheme after 1 January 2015.[148] Without such trade benefits offered to China and Thailand, EU may have less bargain power to convince these countries to invest more resources in combating illicit trade.

185. That being said, using GSP to induce compliance from developing and least developed states that heavily rely on GSP benefits is likely to be effective.

[146] EU, Generalised Scheme of Preferences (GSP), <http://trade.ec.europa.eu/doclib/docs/2013/september/tradoc_151705.%2013-07%20GSP%20InfoPack%20Update%20Final.pdf>.
[147] Ibid.
[148] EU, 'Commission Delegated Regulation (EU) No. 1421/2013 of 30 October 2013', *Official Journal of the European Union* L 355/1.