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COMMERCIAL LAW

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**ARTICLES:**

AFTER LISBON: REGIONALIZATION, STANDARDIZATION, AND THE RISE OF  
SOCIAL AND ENVIRONMENTAL FACTORS IN EU INTERNATIONAL INVESTMENT

AGREEMENTS

*JULIA JOHNSON*

EUCLIDIAN PARALLELISM, LEGAL PLURALISM AND LEGAL TRANSPLANTS VIS-À-  
VIS TRANSPOSING THE CISG INTO THE UK LEGAL ORDER

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**NOTES:**

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FATCA: WHO FORGOT TO ATTACH THE CARROT TO THE STICK?

*RICH WHITE*

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**AFTER LISBON: REGIONALIZATION, STANDARDIZATION, AND THE RISE  
OF SOCIAL AND ENVIRONMENTAL FACTORS IN EU INTERNATIONAL  
INVESTMENT AGREEMENTS**

*Julia Johnson\**

*“One must never forget that monetary union . . . is ultimately a political  
project. It aims to give a new impulse to the historic movement toward  
union of the European states”*

*-Giscard d’Estaing, drafter of the EU Constitution 1997*

I. INTRODUCTION

The Lisbon Treaty (hereinafter “Lisbon” or “TFEU”),<sup>1</sup> which took effect on December 1, 2009,<sup>2</sup> has lasting implications for international investment policy in the European Union (hereinafter “EU”). These changes will affect bilateral investment treaties (hereinafter “BITs”)<sup>3</sup> between EU and non-EU nations.<sup>4</sup> Further, Lisbon has started to change global investment flows by consolidating and centralizing the EU’s investment framework.<sup>5</sup> Investment agreements may be increasingly standardized and regionalized. Consolidation will likely also promote the EU’s social and environmental goals by standardizing provisions in investment agreements.

Strengthened by new authorities under Lisbon, the EU, operating through the European Council, upon recommendation by the European Commission (referred collectively herein as “EC”),<sup>6</sup> and European

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<sup>1</sup> Consolidated Versions of the Treaty on European Union, 2008 O.J. C 115/01; Lisbon Treaty on the Functioning of the European Union, 2008 O.J. C 115/01, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:C:2008:115:TOC> [hereinafter TFEU].

<sup>2</sup> Press Release, European Commission “European Commission Welcomes the Entry Into Force of the Treaty of Lisbon,” (Dec. 1, 2009) (“The Treaty of Lisbon amends the current EU and EC treaties, without replacing them. It will provide the Union with the legal framework and tools necessary to meet future challenges and to respond to citizens’ demands.”).

<sup>3</sup> A BIT “protect[s] the investment of an investor in the territory of a host country.” Sean Cumberlege & Bryan Neihart, *THE LAW OF TRANSNATIONAL BUS. TRANSACTIONS* § 23:27 (Ved Nanda & Ralph Lake eds., 2014).

<sup>4</sup> Carrie E. Anderer, *Bilateral Investment Treaties and the EU Legal Order: Implications of the Lisbon Treaty*, 35 *BROOK. J. INT’L L.* 851, 854 (2010).

<sup>5</sup> *Id.* at 875; Thomas Daemen, *Why the European Union’s Lisbon Treaty Matters to In-House Counsel*, 28 *No. 5 ACC Docket* 88, 90 (2010).

<sup>6</sup> TFEU, art. 207 (“The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall adopt the measures defining the framework for implementing the common commercial policy . . . . The Commission shall make recommendations to the Council, which shall authorise it to open the necessary negotiations. The Council and the Commission shall be responsible for ensuring that the agreements negotiated are compatible with internal Union policies and rules.”).

Parliament (hereinafter “EP”), has greater capacity to centralize and govern BITs entered into by EU and non-EU nations.<sup>7</sup> The EU’s capacity to create a common investment policy, and to enter into BITs on behalf of all EU countries, may affect BITs entered into by individual EU member states with non-EU nations.<sup>8</sup> After Lisbon, non-EU nations may be concerned with possible drawbacks of a centralized EU investment policy. They may believe that centralization will disadvantage investors, causing a greater risk of expropriation or diminished returns.<sup>9</sup> Investors may be discouraged from investing, fearing the uncertainty will reduce the intended benefits of their investments.<sup>10</sup> Despite these drawbacks, Lisbon signifies a unification of EU member nations as they work together to reach shared goals. Unification will in turn benefit investors.<sup>11</sup>

Exclusive competence means the exclusive authority to govern over a particular topic or area.<sup>12</sup> How the EC and EP will use the exclusive competence authorized by Lisbon will become apparent with time.<sup>13</sup> The EU and its member nations currently have shared competence over many governance decisions,<sup>14</sup> meaning that the member nations may pursue binding acts on behalf of that EU member nation when the EU does not act.<sup>15</sup> When enacting policies, the EP incorporates non-economic factors such as political, social, environmental, and human rights issues. After Lisbon, many of these considerations may play greater importance in international investment policies.<sup>16</sup> Political, collective, and social issues, such as humanitarian and environmental rights, will likely be more prominent in future extra-EU BITs, (BITs entered into between EU members and non-EU nations), as well as EU investment decisions.<sup>17</sup> With the increased importance of the EP and the EC, member states will be more likely to abide by non-economic policies, positively reforming extra-EU BITs and developing a more transparent, efficient, and sustainable EU investment framework.<sup>18</sup> Lisbon’s changes to the EU investment structure may improve relationships between EU and non-EU nations, which may

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<sup>7</sup> *Id.* at 861; TFEU art. 207.

<sup>8</sup> *Id.* at 875.

<sup>9</sup> *Id.* at 875.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> TFEU, art. 5(3).

<sup>13</sup> See e.g., John R. Schmertz & Mike Meier, *EU Publishes the Text of the Treaty of Lisbon and Charter of Fundamental Rights on the European Union*, 13 INT’L L. UPDATE 205, 220 (2007).

<sup>14</sup> “FAQ on the EU Competence[s] of the European Commission Powers,” THE EUROPEAN CITIZENS’ INITIATIVE, <http://ec.europa.eu/citizens-initiative/public/competences/faq> (last visited Apr. 24, 2017).

<sup>15</sup> *Id.*

<sup>16</sup> Erika Szyszczak, *Building a Socioeconomic Constitution: A Fantastic Object?*, 35 FORDHAM INT’L L.J. 1364, 1369 (2012) (“The new emphasis upon social values and the role of solidarity is significant in a global economy increasingly leaning towards neoliberal values and a European economy heavily shaken by economic recession.”).

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 1389.

increase investment flows. Finally, extra-EU BITs often possess a stigma of bias in favor of investors in the host state, particularly in favor of the EU, but over time, this conflict of interest will likely be relaxed due to the rise of exogenous concerns in investment policy, thus linking policy with investor protection. Such exogenous concerns may include environmental, social, and public policy protections both within and outside the EU. However, as will be described further, political differences between the EC and EP could result in a disagreement between the EP and EC on key investment policies, leading to a potential deadlock.

This article will review the EU's international investment policy from several different parameters. First, this article will review the effects of transferring the competence to regulate investment from the member states to the EC and the EP. Second, this article will analyze how Lisbon affected the relationship between the EC and the EP, with special emphasis on possible overlaps and ambiguities in control, and how these will impact the EU investment regime. Third, this article will review the future of foreign direct investment ("FDI") in Europe's investment regime, arguing that allowing EU competence over FDI will result in a favorable effect upon investment policy. Although a possible rise in non-economic factors will make it more expensive for investors to invest internationally, the increased stability in the EU investment framework brought by Lisbon will likely outweigh any such increased costs. Finally, this article will analyze how the EU's changes to its investment policy will expand European policy goals and its possible impact upon relations with non-EU nations.

## II. BACKGROUND

### A. *Trade Policy Prior to The Lisbon Treaty*

Lisbon was signed on December 13, 2007,<sup>19</sup> superseding the Treaty on the European Union and the Treaty Establishing the European Community.<sup>20</sup> Generally, Lisbon expands the authority of the European Parliament, causes the Fundamental Rights Charter to become legally binding, and formally establishes the EU as a single legal personality.<sup>21</sup> Prior to Lisbon, it remained uncertain whether the EU had legal personality, meaning it had authority to enter into international agreements on behalf of all EU member states.<sup>22</sup> Article 47 makes clear that the EU acts as a single legal personality.<sup>23</sup> Lisbon also encompasses other broad areas affecting the

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<sup>19</sup> Schmertz, *supra* note 13.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> PHILIP RAWORTH, 1 INTERNATIONAL REGULATION OF TRADE IN SERVICES § 4c:2 (2018).

<sup>23</sup> *Id.*

EU, such as structural cooperation, which are not discussed further in this article.<sup>24</sup>

### 1. *Bilateral Investment Treaties (BITs)*

During BITs are a type of international investment agreement which are frequently used to encompass the terms of the investment relationship between governments and foreign investors, particularly in developing countries where investor protections are more uncertain.<sup>25</sup> A BIT requires an investor and an investment.<sup>26</sup> An investor may be a private person or company who is a national of the country under the BIT.<sup>27</sup> Usually, the citizenship laws of the contracting party determine whether a party is a national.<sup>28</sup> If the investor is a corporate entity, the place of incorporation, principal place of business, or place of ownership and control may be used to determine citizenship.<sup>29</sup> An investment may include any type of asset invested by the investor in the host nation.<sup>30</sup> These assets are broadly defined, and may include property, company shares and stocks, contract claims, intellectual property rights, and “rights to manufacture, use and sell products.”<sup>31</sup> Investments must comply with the host nation’s laws and regulations.<sup>32</sup> BIT disputes are typically resolved by an arbitral tribunal such as the International Centre for Settlement of Investment Disputes (“ICSID”) or the United Nations Conference on Trade and Development (“UNCTAD”).<sup>33</sup> Portfolio investments are short-term investments with earnings derived from the acquisition itself,<sup>34</sup> and are not discussed in this article. By contrast, BITs pertain to foreign direct investment, which is

<sup>24</sup> Schmertz, *supra* note 13.

<sup>25</sup> Andrew T. Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 642 (1998).

<sup>26</sup> Cumberlege & Neihart, *supra* note 3 at 1237.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at 1237-38; *see e.g.*, Agreement between Australia and the Republic of Poland on the Reciprocal Promotion and Protection of Investments, art. 1(1)(d) (Mar. 27, 1992), available at <https://investmentpolicyhub.unctad.org/Download/TreatyFile/163> (“national’ of a Contracting Party means a company or a natural person who is a citizen or a permanent resident of a Contracting Party under its law”); Treaty Between the Government of the United States of America and the Government of the Republic of Lithuania for the Encouragement and Reciprocal Protection of Investment, art. 1(1)(c) (Jan. 14, 1998), available at <https://www.congress.gov/treaty-document/106th-congress/42/all-info> (“National’ of a Party means a natural person who, for the United States of America, is a national of the United States under its applicable laws, and for Lithuania, is a citizen of the Republic of Lithuania under its applicable laws.”).

<sup>30</sup> *See* Cumberlege & Neihart, *supra* note 3, at 1234-35.

<sup>31</sup> *Id.* at 1235.

<sup>32</sup> *Id.*

<sup>33</sup> Adolfo Durañona, *Bilateral Investment Treaties*, 2005 No. 2 RMMLF-INST PAPER No. 4, ROCKY MOUNTAIN MINERAL LAW FOUNDATION (Apr. 2005) (Westlaw).

<sup>34</sup> *See* Siegfried Fina & Gabriel M. Lenter, *The Scope of the EU’s Investment Competence After Lisbon*, 14 SANTA CLARA J. INT’L L. 419, 428 (2016); *see also* OECD, BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT 22 (4th ed., 2008) available at <https://www.oecd.org/daf/inv/investmentstatisticsandanalysis/40193734.pdf>.

focused upon developing long-term economic relationships between the parties.<sup>35</sup>

## 2. *EU Competence Prior to Lisbon*

Before Lisbon came into effect, the EU lacked the explicit competence in all of the capacities incorporated in what is now the Common Commercial Policy (“CCP”).<sup>36</sup> Specifically, the EU lacked explicit competence to oversee “commercial aspects of international property rights,” trade in services, and FDI.<sup>37</sup> The EC shared its competence over international investment with the member states.<sup>38</sup> Correspondingly, agreements that were not solely limited to the trading of goods would be negotiated through mixed agreements of the member states and the EU.<sup>39</sup> Prior to Lisbon, the EC negotiated investment agreements for services, while the member states entered into investment agreements containing provisions for “investment protection and protection against unfair or uncompensated expropriation.”<sup>40</sup>

Seeking to devise a “common external economic policy,” the EC had sought to create the since the Maastricht Treaty negotiations in the early 1990s.<sup>41</sup> In 1997, the Treaty of Amsterdam furthered this aim, but did not achieve full external competence.<sup>42</sup>

Previous attempts to achieve exclusive competence for all aspects of international trade failed because the 1957 Treaty of Rome was “signed with only six relatively similar countries in mind.”<sup>43</sup> Early treaty drafters may have intentionally chosen to develop an international trade framework of mixed competence that failed to achieve exclusive competence because they believed EU member states would likely splinter amongst themselves and, thus, would not be unified during international negotiations.<sup>44</sup> Because EU membership is made up of member states which are economically

<sup>35</sup> See Fina & Lenter, *supra* note 34, at 428.

<sup>36</sup> Sean McClay, *Can It Lead from Behind? The European Union’s Struggle to Catch Up in International Investment Policy Making in the Wake of the Lisbon Treaty*, 51 *TEX. INT’L L. J.* 259, 260 (2016); see also Freya Baetens et al., *Determining International Responsibility Under the New Extra-EU Investment Agreements: What Foreign Investors in the EU Should Know*, 47 *VAND. J. TRANSNAT’L L.* 1203, 1215 (2014).

<sup>37</sup> McClay, *supra* note 36, at 260; see also Baetens et al., *supra* note 37, at 1216.

<sup>38</sup> Fina & Lenter, *supra* note 34, at 425.

<sup>39</sup> McClay, *supra* note 36, at 260-61; see also Gabriele Mazzini, *The European Union and Investor-State Arbitration: A Work in Progress*, 24 *AM. REV. INT’L ARB.* 611, 613 (2013).

<sup>40</sup> Fina & Lenter, *supra* note 34, at 425-6.

<sup>41</sup> McClay, *supra* note 36 at 261; Rafael Leal-Arcas, *Is EC Trade Policy up to Par?: A Legal Analysis Over Time--Rome, Marrakesh, Amsterdam, Nice, and the Constitutional Treaty*, 13 *COLUM. J. EUR. L.* 305, 347 (2007).

<sup>42</sup> *Id.*; Leal-Arcas, *supra* note 41, at 360-62.

<sup>43</sup> See *id.*

<sup>44</sup> *Id.* (There, the author furthers that “[a]dditionally, a lack of any meaningful role for the European Parliament in external trade matters pre-Lisbon created glaring ‘democratic deficit’ issues, which would have only been exacerbated if the EU had even more power to conclude trade and investment agreements.”) See also Leal-Arcas, *supra* note 41, at 376.

diverse, the treaty drafters believed such nations would not be able to act with a single unified voice.<sup>45</sup>

### B. Lisbon's Changes

Lisbon changed European trade and investment in several respects. A key provision of the Lisbon lies in Article 207, which shifted “trade in services, certain intellectual property issues, and FDI into the CCP.”<sup>46</sup> Lisbon represents the first time that the CCP was “explicitly embedded into a broader framework of EU external relations law.”<sup>47</sup> Accordingly, Article 207 gave the EU responsibility to negotiate treaties pertaining to FDI.<sup>48</sup> Lisbon differs from previous treaties in that it establishes more concrete policy objectives than its predecessors.<sup>49</sup> Lisbon explicitly expands upon existing policy objectives in areas of health care, labor laws, privacy, climate change and environment, energy and sustainable development.<sup>50</sup> Some issues, such as taxation, are dictated by the EU member states.<sup>51</sup>

Shifting the competence for foreign investment to the EU's central governing bodies increases investment protections.<sup>52</sup> Competence is the right to engage in certain acts.<sup>53</sup> EU governing bodies may only act pursuant to the competences which they have been granted by the member states.<sup>54</sup> Lisbon left unclear whether the member states retain certain, or any, competence for BITs.<sup>55</sup> Many member states believe they may still enter into BITs. In contrast, the EC has maintained that its investment competence is absolute and exclusive.<sup>56</sup> Under the doctrine of implied powers, certain competences imbued upon EU bodies are implied because they further the intent of EU treaties, further confusing the scope of the member states' authority.<sup>57</sup>

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*; see also Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community art. 207, Dec. 13, 2007, 2007 O.J. (C 306) 1 [hereinafter Lisbon Treaty]. The foregoing is part of the Consolidated Version of the Treaty on the Functioning of the European Union. Consolidated Version of the Treaty on the Functioning of the European Union art. 207, Oct. 26, 2012, 2012 O.J. (C 326) 47 [hereinafter TFEU].

<sup>47</sup> McClay, *supra* note 37, at 261; Boris Rigod, “Global Europe”: *The EU's New Trade Policy in Its Legal Context*, 18 COLUM. J. EUR. L. 277, 297 (2012).

<sup>48</sup> Fina & Lenter, *supra* note 34, at 424-25.

<sup>49</sup> Daemen, *supra* note 5, at 93.

<sup>50</sup> *See id.*

<sup>51</sup> *See id.*

<sup>52</sup> Fina & Lenter, *supra* note 34, at 421.

<sup>53</sup> TFEU, art. 5(2).

<sup>54</sup> *Id.*

<sup>55</sup> *See* Fina & Lenter, *supra* note 34, at 422-23; see also Press Release, Council of the EU, “Conclusions on a Comprehensive European International Investment Policy” (Oct. 25, 2010).

<sup>56</sup> Fina & Lenter, *supra* note 34, at 423.

<sup>57</sup> *Id.* at 424.

C. *The EC and EP Obtain Exclusive Competence over the CCP*

In Lisbon transfers exclusive competence over investment policies to the EC and EP. This enables the EU to enter into investment policies as a single unit and diminishes fragmentation between the individual member states during key decisions.<sup>58</sup> Consequently, through multiple mechanisms designed to redirect the focus of EU investment control, while also providing for the creation of supplementary institutions such as the Bank to legitimize this control, the amended TFEU effectively lays the groundwork for an EU-wide investment policy.<sup>59</sup>

The transfer of exclusive competence to the EC and EP is found in several provisions of the TFEU. Specifically, Articles 3 and 207(1) of the TFEU establish the exclusive competence for the EC and the EP to oversee a common commercial policy,<sup>60</sup> allow the EC to control the monetary policy of those member states using the euro, and grant the EC the power to install competition rules required for the internal market to function effectively.<sup>61</sup> Moreover, Article 207 of the TFEU incorporates FDI into the CCP overseen by the EU. The CCP establishes uniform principles for

“changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, foreign direct investment, the achievement of uniformity in measures of liberalization, export policy and measures to protect trade such as those taken in the event of dumping or subsidies.”<sup>62</sup>

Here, the TFEU’s reference to the CCP encompasses its jurisdiction over FDI flows, which includes extra EU-BITs.<sup>63</sup> In addition, Article 294 of the TFEU substantially increases the power of the EP, allowing for a shared decision feature with the EC, or “ordinary legislative procedure,” over the CCP.<sup>64</sup> Articles 207 and 294, read together, shift the control center for investment regulations out of the dominion of the member states and grant this right to the EC and EP, thus replacing the shared

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<sup>58</sup> Schmertz, *supra* note 13.

<sup>59</sup> See Anderer, *supra* note 4, at 874-75.

<sup>60</sup> Youri Devuyt, *The European Union’s Competences in International Trade After the Treaty of Lisbon*, 39 GA. J. INT’L & COMP. L. 639, 646 (2011).

<sup>61</sup> TFEU, art. 63 (Article 63 of the TFEU bars restrictions of all types placed on movement of capital between EU nations as between both EU and non-EU nations. BITs often exist to guarantee the enforcement of this provision.).

<sup>62</sup> Devuyt, *supra* note 60, at 653; *see also* TFEU, art. 207.

<sup>63</sup> *See* TFEU, art. 207.

<sup>64</sup> TFEU, art. 294. Fortunately for investors, BITs entered into prior to Lisbon’s ratification are likely to remain valid after the member states reconcile any legal incompatibilities, though some reconciliation may need to be undertaken between intra-EU BITs and extra-EU BITs, and transitional steps may need to be implicated in order to bridge any dissonance between extra-EU BITs prior to Lisbon’s ratification.

competence model, which had previously allowed the member states to share control with the EU over international investment.<sup>65</sup>

Other provisions of the TFEU also demonstrate this shift to a centralized system of shared powers for the EU. For example, Article 308 creates the European Investment Bank (“the Bank”)—to which the member states are participants—that finances projects for areas lacking funding, modernizing the domestic market and funding common interest projects.<sup>66</sup> Article 28 allows for “the adoption of a common customs tariff in [] relations between third countries” to promote the free and open transfer of goods.<sup>67</sup> Additionally, Article 127 gives responsibility to the European System of Central Banks (“ESCB”) to “define and implement the monetary policy of the Union.”<sup>68</sup> In conjunction with the development of the CCP as described in Articles 3 and 207(1) of the TFEU, Article 206 fosters a liberal, open trade policy by removing restrictions on international trade and FDI, as well as lowering customs and limiting other investment barriers.<sup>69</sup>

Accordingly, the TFEU liberalizes trade policies and promotes increased trade flows between the EU and non-EU nations.<sup>70</sup> As this article later discusses below, these changes will likely positively affect FDI and extra-EU BITs.

### III. ANALYSIS

Lisbon will likely affect BITs in a number of ways. First, Lisbon may increase tensions between the EU’s centralized governing bodies and EU member states. In particular, Lisbon may reduce the ability of EU nations to shape individual investment policy. Second, Lisbon may increase tensions between the EP and EC after Lisbon but may promote democratic accountability. Deadlocks between the EP and EC are also likely to arise. In order to break conflicts, creating a dispute settlement mechanism or enacting a line-by-line veto power for the EP would help reduce delays. Despite these setbacks, Lisbon is likely to further Europe’s policy goals by promoting consolidation, regional unification, and will improve relations with non-EU nations.

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<sup>65</sup> Fina & Lenter, *supra* note 34, at 421-22.

<sup>66</sup> TFEU, art. 308.

<sup>67</sup> TFEU, art. 28.

<sup>68</sup> TFEU, art. 127; *see also*, Ralph H. Folsom, § 28:14 The Reform Treaty of Lisbon, Ch. 28 Investing in Europe, 2 INTERNATIONAL BUSINESS TRANSACTIONS § 28:14 (3d ed.) (“[U]nder Lisbon, the European Central Bank was officially designated an EU institution.”).

<sup>69</sup> TFEU, art. 206.

<sup>70</sup> TFEU, art. 351. Extra-EU BITs conducted before 1 January 1958 are not affected by the TFEU.

- A. *Differing Needs of Stronger and Weaker EU Nations May Cause Uncertainty, Though Centralization May Also Promote Stability and Add Dimension for labor rights, Environmental Protections, and Other Public Policy Goals.*

Although the CCP carries many advantages, Lisbon may increase tensions between the EU's centralized governing bodies and its member states, especially as investment policy parameters are refined. Potential problems in international investment agreements include provisions for dispute settlement, redefining the parties who may enter into an investment and what an investment consists of, the instigation of sustainable business practices, as well as social and moral implications.<sup>71</sup> Lisbon is likely to change future extra-EU BITs by adding a dimension for labor protections (such as minimum wages and limiting work to an 8-hour day); environmental protections (including climate change); and a political and public policy dimension.<sup>72</sup> Further, the EU may transition into a "regional" BIT model, meaning BITs relating to several or many nations will replace those BITs entered into by individual nations. The shift to a regional BIT means that the text of these BITs will be less likely to include provisions for a single nation.<sup>73</sup> Instead, BITs may be increasingly drafted with EU-wide provisions.<sup>74</sup>

Despite the positive effects of installing an EU-centric investment policy, certain negative repercussions will likely follow. As described above, Lisbon's provisions require that EU member states cede numerous rights which had previously been accorded to them.<sup>75</sup> Shifting the power to regulate investment from the individual member states to the EC is important because the shared competence model previously allowed for significantly more policy power. The individual nations were able to develop an investment policy consistent with the state's particular economic

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<sup>71</sup> Dr. Nikos Lavranos, *Bilateral Investment Treaties (BITs) and EU Law*, ESIL Conference, 5 (2010) available at <http://ssrn.com/abstract=1683348>.

<sup>72</sup> See Anne Pollet-Fort, Implications of the Lisbon Treaty on EU External Trade Policy, EU Centre in Singapore, Background Brief No. 2 ( Mar. 2010), <http://www.eucentre.sg/articles/141/downloads/LisbonImpactonTrade-rev6Mar.pdf>. ("The enhanced role of the EP non-economic objectives such as human rights and social standards issues being included in future trade agreements.").

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> See David Bederman & Frank Schopkopf, International Decision, Case Nos. 2 BVE2/08, 2 BVE 5/08, 2 BVR 1010/08, 2 BVR 1022/08, 2 BVR 1259/08, AND 2 BVR 182/09. 123 BVERFGE 267 (2009) . [https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2009/06/es20090630\\_2bve000208en.html](https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2009/06/es20090630_2bve000208en.html); BUNDESVERFASSUNGSGERICHT (GERM. FED. CONST. CT.), June 30, 2009; see also 104 AM. J. INT'L. L. 259, 262 (Apr. 2010) (There, the German Court specified that certain rights are reserved to the individual state and held that "[b]eyond this specific authority already transferred to the EU, the Court defined certain domestic rights concerning 'the political formation of economic, cultural and social circumstances with which European unification shall not substantially interfere . . . .'").

concerns.<sup>76</sup> While Lisbon provides for a synthesized Europe acting as a single body, a corresponding consequence is that member states no longer have the capacity to shape investment policies.<sup>77</sup> Further, the interests of the EU generally and the interests of member states may be mutually exclusive in some aspects.<sup>78</sup> For instance, while smaller, weaker EU states may be struggling to attract inward FDI, larger EU nations may attract investment more readily.<sup>79</sup> Yet, EU investment policies may be drafted so that the interests of the larger EU nations are represented. Without a compensatory mechanism, smaller and less economically robust EU member states may not be represented in the drafting and enforcement of such policies, which in turn, further sharpens the economic inequalities among European nations.<sup>80</sup>

Monetary crises provide one example of how the policies for economically stronger and economically weaker nations may diverge.<sup>81</sup> Often, monetary policy is used as a tool during period of economic slowdown to help prevent excessive economic contractions and to buffer a possible recession.<sup>82</sup> If a fiscal downturn affects only part of the EU, while the remainder of the EU is not in the same fiscal downturn, then key aspects of EU monetary policy, such as inflation rates, are unlikely to be adjusted to prevent economic contractions in the smaller EU nation.<sup>83</sup> The smaller EU nation would then be left with fewer remedies to reduce the economic effects of this downturn.<sup>84</sup> A similar scenario could occur in an international investment framework, in which a smaller nation lags behind EU member states in foreign investment.<sup>85</sup> This nation would have fewer policy tools to attract investment.<sup>86</sup> Consequently, international investment policies may not reflect the investment policy needs of less economically strong EU member states.<sup>87</sup>

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<sup>76</sup> *See id.*

<sup>77</sup> *See id.*

<sup>78</sup> Matthias Niedobitek, *The Lisbon Case of 30 June 2009 - A Comment from the European Law Perspective*, 10 GERMAN L.J. 1267, 1268 (2009) (“the required involvement of the German parliament in the adoption of Union acts can conflict with the necessary “responsiveness to the needs of European integration” (*Europatauglichkeit*) of the German federal state.”)

<sup>79</sup> Commission Report for Annual Growth Survey 2012, COM (2011) 815 final (Nov. 10, 2011) (Macro-Economic Report to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions).

<sup>80</sup> *See, e.g., Foreign Direct Investment – flows*, COM (May-June 2017) available at [http://ec.europa.eu/eurostat/statistics-explained/index.php/Foreign\\_direct\\_investment\\_-\\_flows](http://ec.europa.eu/eurostat/statistics-explained/index.php/Foreign_direct_investment_-_flows) (last visited May 4, 2018).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> *See generally*, Council Recommendations on Greece’s 2012 National Reform Programme. COM(2012) 307 final (May 30, 2012) (Greece has experienced instability due to an unsustainable monetary policy instigated in order to join the European currency).

<sup>85</sup> *Foreign Direct Investment – flows*, *supra* note 80.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

There are other possible scenarios where EU investment policy may not reflect the policy goals of EU member states. A conflict may arise when the EU does not approve an investment engagement with a nation. For example, a particular EU Member state may desire to invest in a nation sanctioned for human rights or environmental violations, which may be forbidden under EU law. Though liberalizing trade and investment is an aim of the General Agreement on Tariffs and Trade (“GATT”), the EC may halt investment with a nation whose actions demonstrate moral or social concerns, such as a national industry egregious for dumping violations, raising tensions between the EU member state and the EU. Thus, a member state seeking to foster relations with this non-EU state may be unable to act independently from the EU, reducing member states’ autonomy to secure national interests. Regardless, the member states’ lost autonomy may be offset by the benefits of standardization, and member states will have other diplomatic channels through which to foster relations with this non-EU nation.

Even if the EC and EP could seek to install investment policies for all its member states, such a task would prove difficult because the policies that are most effective for one nation’s economy may not be the best for those of another. As a result of this diversity, EU investment policies may reflect policies made by the strongest EU nations. Since the strongest EU nations also often possess the greatest FDI flows, it makes good economic sense for the EU to develop its policies surrounding the concerns of its strongest nations. However, by constantly diminishing the needs of the EU’s smaller or weaker states, the EU’s actions may thwart the economic development of these nations.<sup>88</sup> This could become problematic as Eastern European nations increasingly seek to enter the EU.<sup>89</sup> These nations, including certain former Soviet Union members, may need special provisions or policies to spur re-development.<sup>90</sup> Of course, even if member states are constrained in their abilities to conduct BITs, weaker EU nations will benefit from a stable investment platform, which may increase the overall investment opportunities for such nations.<sup>91</sup>

Thus, a deliberate effort to consider the needs of under-developed nations is vital to increasing economic prosperity throughout the EU as a whole and to prevent stronger EU nations from dominating international

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<sup>88</sup> See Internal Market, Industry, Entrepreneurship and SMEs Reports, *Single Market integration and competitiveness in the EU and its Member States 2016*, EUR. COMM’N, available at [http://ec.europa.eu/growth/content/single-market-integration-and-competitiveness-eu-and-its-member-states-2016\\_en](http://ec.europa.eu/growth/content/single-market-integration-and-competitiveness-eu-and-its-member-states-2016_en) (last visited May 4, 2018); *Foreign Direct Investment*, EUR. COMM’N, [http://ec.europa.eu/internal\\_market/scoreboard/integration\\_market\\_openness/fdi/index\\_en.htm](http://ec.europa.eu/internal_market/scoreboard/integration_market_openness/fdi/index_en.htm) (last updated July 11, 2018).

<sup>89</sup> See *id.*

<sup>90</sup> See *id.*

<sup>91</sup> See *id.*

investment.<sup>92</sup> Developing accommodations for weaker nations is also in line with the General Agreement on Trade in Services (“GATS”), Part II, Articles IV and V.<sup>93</sup> Notably, Article IV(3) of GATS provides that “[p]articular account shall be taken of the serious difficulty of the least-developed countries in accepting negotiated specific commitments in view of their special economic situation and their development, trade and financial needs.”<sup>94</sup> Consistent with GATS, special efforts should be undertaken to promote cooperation between the EU member states and the EU so that trade and investment policies for weaker nations may be acknowledged and implemented.<sup>95</sup>

Shifting the CCP to a central ‘control nucleus’ will likely stabilize the EU’s investment framework. Though the loss of powers by the member states necessarily leads to the relinquishment of certain rights, the TFEU’s provisions are likely, on balance, to enable the EU to address international investment issues in a consistent, cohesive, and steadfast manner. Non-EU nations will also likely benefit from increase stability.<sup>96</sup> Instead of interpreting inconsistent obligations to invest in neighboring nations, the investors of non-EU nations may now expect increasing consistency and standardization in international investment agreements.<sup>97</sup>

### *B. Language of Section 21F*

Lisbon changes the investment regime from a system of shared competence as between the individual member states to the co-decision powers of the EP and the EC. The precise division of these rights remains ambiguous, leading to confusion and possible divergence from core EU interests.<sup>98</sup> Despite these drawbacks, allowing the EP a role in investment negotiations, by effectively providing the EP with a veto capacity will enable the EU to make decisions which are more democratic and accountable to the EU electorate.<sup>99</sup> Nevertheless, because the EP is elected directly by the people and the EC is not, tensions may arise between the EP and the EC, leading to potential deadlocks.<sup>100</sup>

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<sup>92</sup> *See id.*

<sup>93</sup> General Agreement on Trade in Services, Part II, Art. IV(3) (last visited Aug. 10, 2017) [http://www.wto.org/english/docs\\_e/legal\\_e/26-gats\\_01\\_e.htm](http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm) [hereinafter “GATS”].

<sup>94</sup> *See id.*

<sup>95</sup> *See id.*

<sup>96</sup> Proposal for a Regulation of the European Parliament and the Council Establishing Traditional Arrangements for Bilateral Investment Agreements Between Member States and Third Countries, COM (2010) 344 final (Jul. 7, 2010).

<sup>97</sup> Towards a Comprehensive European International Investment Policy, COM (2010) 343 final (Jul. 7, 2010) (Communication to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions).

<sup>98</sup> *See id.*

<sup>99</sup> Pollet-Fort, *supra* note 72.

<sup>100</sup> *Id.*

1. *A Dispute Settlement Mechanism Will Break Conflicts Between the EP and EC*

A dispute settlement mechanism must be created to break potential filibusters in the event of a deadlock between the EP and the EC. The EP is directly elected by universal adult suffrage, whereas each EC Commissioner is appointed by the national government of each EU member state. EC Commissioners do not represent their state. Because the EP had not been directly involved in EU investment policy prior to Lisbon, increased flexibility may be needed as the entities transition in power.<sup>101</sup> Such flexibility may include an increased role by the member states, through recommendations or other assistance.<sup>102</sup>

Prior to Lisbon, the EP was a minor player in EU investment policy and was effectively excluded from the negotiations surrounding entering into BITs and other trade negotiations with non-EU nations.<sup>103</sup> Instead, the member states, along with the EC, had this capacity. The EC was formally in charge of initiating trade negotiations and proposing its recommendations to the Council of Ministers.<sup>104</sup> Separately, the EC, non-EU nation, and representatives of the EU member state would negotiate the trade terms.<sup>105</sup> Upon agreement and formal signature, the EC would then authorize the document.<sup>106</sup> The EP did not play a role in this process.<sup>107</sup>

However, although the EP retained little authority on trade and investment matters prior to Lisbon, it was not completely absent from such decisions.<sup>108</sup> The EP made decisions on substantial budgetary considerations and new institutional arrangements affecting the EP.<sup>109</sup> Even so, the EP's approval was rarely compulsory.<sup>110</sup> The EC and the member states maintained responsibility for creating BITs and otherwise forging the future of EU international investment, while the EP participated in these discussions without a compulsory vote.<sup>111</sup>

The changes in the relationship between the EP and EC can also be found in Article 207 and other key provisions of Lisbon. Article 207 of the TFEU provides that “[t]he European Parliament and the Council . . . in accordance with the ordinary legislative procedure, shall adopt the measures . . . for implementing the common commercial policy.”<sup>112</sup> In effect, the EC

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<sup>101</sup> Anderer, *supra* note 4.

<sup>102</sup> *Id.*

<sup>103</sup> Pollet-Fort, *supra* note 72, at 9.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> *Id.* at 9-10.

<sup>109</sup> *Id.* at 10.

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> TFEU, art. 207.

and the EP become co-decision-makers on issues pertaining to the CCP.<sup>113</sup> In addition to installing the EP with effective legislative and veto power, the EC President must present its EC meeting reports to the EP.<sup>114</sup> Moreover, the EC High Representative must “regularly consult” with the EP regarding its “basic choices” in order to “ensure that the views of the European Parliament are duly taken into consideration.”<sup>115</sup> Lisbon also grants the EP the right to supervise the instigation of trade measures, thus that any such decision is implemented.<sup>116</sup>

Although the TFEU broadly shifts authority away from the member states,<sup>117</sup> any possible conflict may be subordinated to the effects of a potential clash between the EP and the EC.<sup>118</sup> After Lisbon, the EP must provide approval before any EU investment agreement with a non-EU nation may be authorized.<sup>119</sup> The EP’s approval now becomes mandatory for an investment agreement to take effect.<sup>120</sup> The EC retains the powers to enter into trade negotiations.<sup>121</sup> This means that although the EP must ratify investment agreements, it defers to the EC to enter into negotiations. In order to avoid a delay, the EP must accept an agreement’s terms early in the negotiation process.<sup>122</sup> If an investment agreement is not approved by the EP, it may prevent it from taking effect.<sup>123</sup> The individual personalities of the EP members may also politicize the process in a way that Lisbon’s drafters never intended.<sup>124</sup>

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<sup>113</sup> See *id.*; Pollet-Fort, *supra* note 72, at 11.

<sup>114</sup> TFEU, art. 207; Pollet-Fort, *supra* note 72, at 3.

<sup>115</sup> TFEU, art. 36.

<sup>116</sup> Pollet-Fort, *supra* note 72, at 11. The current international investment regime is comprised of literally thousands of individual treaties, leading to complexity, gaps, and ambiguity in coverage. *Id.* As a result, methods of treaty interpretation are strained and arbitration awards are often found to be unpredictable. *Id.* Moreover, there is often little to no relationship between a nation’s investment policies and its national policies as a whole – this “interconnect” is missing. *Id.* A central aim as government policies merge with investment should be to restore this connection. *Id.*

<sup>117</sup> See Frank Schorkopf, Case Nos. 2 BvE 2/08, 2 BvE 5/08, 2 BvR 1010/08, 2 BvR 1022/08, 2 BvR 1259/08, and 2 BvR 182/09 - 123 BVerfGE 267 (2009), 104 AM. J. INT’L L. 259, 262 (2010) (“The Court held that to avoid imminent unconstitutionality the EU must cautiously exercise any new or expanded power brought by the Lisbon Treaty ratification. The Court asserted that member states must maintain their right to control the legal and practical “precondition of a living democracy.”)

<sup>118</sup> Article 294 of the TFEU’s instigation of a co-decision function between the EC and the EP, as well as a qualified voting mechanism become the “ordinary legislative procedure,” thus resulting in a wrestling for power, is currently ambiguous as to how this change will shift the outcome of key investment decisions, and thus paving the way for a potential conflict between these entities. See TFEU, *supra* note 1, art. 294; see also, Pollet-Fort, *supra* note 72, at 11, 15.

<sup>119</sup> Pollet-Fort, *supra* note 72, at 3.

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

<sup>122</sup> See *id.*

<sup>123</sup> *Id.* at 3, 11.

<sup>124</sup> *Id.* at 15.

2. *A Line-by-Line Veto EP Power Will Help Ensure Parity of Agreements*

In light of possible deadlocks, the rights conferred to the EP by Article 207 may have been potentially more effective if the EP were conferred a line-by-line veto power over investment policies, or another mechanism to address disagreements. Unnecessary delays may affect relationships with non-EU nations and reduce extra-EU trade flows. When a deadlock arises, investment could be slowed or even halted, leading to a situation whereby the interests of the EU as a whole are short-changed due to a conflict in political or economic ideology.<sup>125</sup>

Nonetheless, while passing investment provisions will likely become more difficult due to the consent needed by both the EC and the EP, allowing for the possibility of an insurmountable deadlock, final decisions could potentially prove more equitable and representative of the interests of EU investors.<sup>126</sup> Given that the EP is directly elected through universal suffrage, future decisions may prove to be more democratically accountable.<sup>127</sup> However, the EC may also have greater insight into the trade and investment considerations for a particular state.<sup>128</sup> The EP may make policies that are politically motivated, but that are disconnected from economic considerations.<sup>129</sup> Due to this disconnect, EU member states may be inclined to act outside the EC when their interests are not represented.<sup>130</sup> If EU member states begin dictating their own investment policies, then the EC and EP may lose legitimacy, consequentially curtailing Lisbon's efficacy.<sup>131</sup>

In addition, EU international treaty-making, in practice, affects a broad number of issues. Prior to Lisbon, treaty-making was generally

<sup>125</sup> Article 64 of the TFEU effectively provides power for a qualified majority to govern measures pertaining to capital investments, though Article 45 states that any such restrictions may not discriminate based upon nationality. *See* TFEU, arts. 45, 64. Moreover, Article 50 imbues the EC and the EP with substantial authority to carry out such duties, including competence over investment policy. *See* TFEU, art. 50.

<sup>126</sup> *See* Pollet-Fort, *supra* note 72, at 15.

<sup>127</sup> *See* Sebastian Kurpas, *The Treaty of Lisbon – How Much ‘Constitution’ is Left?*, 147 CEPS POL'Y BRIEF 1, 9 (2007). The EU Energy Charter provides a good example of a dispute settlement protection provision, *see generally* *Summaries of EU Legislation: European Energy Charter*, EUR-LEX, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM:I27028> (last updated Jan. 30, 2007) [hereinafter *European Energy Charter*].

<sup>128</sup> Pollet-Fort, *supra* note 72, at 3. (“This means that the opinion of the EP becomes essential and this even before the initiation of any future trade negotiations if one wants to avoid the risk of having the entirety of the agreement blocked by the EP.”).

<sup>129</sup> Kurpas, *supra* note 127, at 2.

<sup>130</sup> Article 9D of Treaty of Lisbon does not automatically go into effect but instead requires a unanimous vote by the Council, and at the earliest will be implemented in 2014. *See* Treaty of Lisbon art. 9D(5).

<sup>131</sup> Pollet-Fort, *supra* note 72, at 3. (“The increased role given to the EP in the EU trade policy may therefore contribute to increased politicization of future trade negotiations leading to uncertainties and possible delays in getting a trade agreement through.”).

conducted on a national scale, though numerous treaties were required to cover its expanse throughout the EU.<sup>132</sup> By taking away this competence from the member states, the EP and EC are now required to replace a vast expanse of investment treaties.<sup>133</sup>

Therefore, shifting from a shared competence model to an exclusive competence regime will likely increase disagreements between the EP and EC.<sup>134</sup> On one end, even if there is an increased risk of deadlock, as the EP may halt investment negotiations; on the other end, the—shared decision-making function may promote egalitarian decisions.<sup>135</sup> Many of these changes will now rest upon the EP's politicization, as well as shared policy aims.<sup>136</sup>

<sup>132</sup> See Lorenza Mola, *Which Role for the EU in the Development of International Investment Law?* 8 (Soc'y of Int'l Econ. L., Working Paper No. 26/08, 2008), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1154583](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1154583).

<sup>133</sup> U.N. Conference on Trade and Development, *Investment Policy Monitor*, 7, UNCTAD/WEB/DIAE/IA/2011/12 (Oct. 12, 2011) [hereinafter *Investment Policy Monitor*].

<sup>134</sup> *Towards a Comprehensive European International Investment Policy*, *supra* note 97, at 2. There is evidence that the EU is moving towards operating as a regional unit. For instance, on September 12, 2011, an EU-wide investment doctrine was entered into with Singapore, India, and Canada, *Investment Policy Monitor*, *supra* note 132, at 7. Though these collective EU BITs generally resembled BITs entered into by individual nations, many scholars have suggested that the EU-wide BITs will include “preambular references to corporate social responsibility (CSR), environmental and social issues,” *id.* at 7-8.

<sup>135</sup> See Pollet-Fort, *supra* note 72, at 15 (“The increased role of the European Parliament may lead to a ‘politicization’ of the Common Commercial Policy and the use of conditionality in trade policy may be reinforced.”) (citing Marc Bungenberg, *Going Global? The EU Common Commercial Policy After Lisbon*, in EUROPEAN YEARBOOK OF INTERNATIONAL ECONOMIC LAW 2010, 123, 130 (Christoph Herrmann & Jörg Philipp Terhechte eds., 2010)); see also Roger J. Goebel, *Supranational? Federal? Intergovernmental? The Governmental Structure of the European Union After the Treaty of Lisbon*, 20 COLUM. J. EUR. L. 77, 138 (2013) (discussing opposition by smaller nations to the creation of an EU President, the author notes “[p]resumably the smaller State political leaders were concerned [influence by the President] would give greater weight to the views of the larger States”). *But see* U.N. Conference on Trade and Development, *World Investment Report 2012 - Towards a New Generation of Investment Policies*, overview, UNCTAD/WIR/2012 (July 5, 2012) [hereinafter *World Investment Report 2012*]. Moreover, increased transparency and absolute standards should be applied to investor-state dispute settlement mechanisms, and unifying the EU investment regime makes this increasingly possible, *see id.* at xxx. This is consistent with the EU's policies in following the provisions set forth by the WTO, which is looking to promote a policy of openness and transparency, *Towards a Comprehensive European International Investment Policy*, *supra* note 97, at 10. *See also* Pollet-Fort, *supra* note 72, at 15 (“[The democratic accountability of EU trade policy] will give more importance to the political dimension of any future trade negotiations”) (citing *The Impact of the Lisbon Treaty on Trade Policy*, Report from the DG Trade Civil Society Meeting 2 (Jan. 27, 2010), [http://trade.ec.europa.eu/doclib/docs/2010/february/tradoc\\_145757.pdf](http://trade.ec.europa.eu/doclib/docs/2010/february/tradoc_145757.pdf)). The EU Energy Charter is a good example of present negotiations, *see* Press Release, “New International Energy Charter Adopted,” European Commission (May 21, 2015), <https://ec.europa.eu/energy/en/news/new-international-energy-charter-adopted>.

<sup>136</sup> *See* Anderer, *supra* note 4, at 874-75.

C. *Despite the Increased Likelihood of deadlock, Consolidation Will Likely Increase FDI And Will Effectuate Policy Changes in Non-EU Nations*

The FDI flows emerging from both the EU and global level are moving toward regionalization. This trend will cause regional investment blocks to development, which will further promote investment.<sup>137</sup> Despite possible drawbacks associated with the shift to exclusive competence, an increase in transparency and efficiency will likely positively affect FDI.<sup>138</sup>

Since FDI is important to European GDP, bringing FDI into the domain of the exclusive EU competence, through Article 207 of the TFEU,<sup>139</sup> will likely promote market access.<sup>140</sup> Due to its magnitude, FDI is likely more effectively regulated by a centralized governance framework, especially since the EU may obtain resources from the member states.<sup>141</sup> Although a centralized, stable investment policy does not solely determine flows both into and out of the EU, it does serve to increase transparency, efficiency, and mitigate instability.<sup>142</sup> However, an inconsistent trend emerges. If there is a rise in exogenous considerations in an investment treaty, FDI flows may decrease or otherwise face downward pressures.<sup>143</sup>

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<sup>137</sup> *Id.* at 875 (“While the transfer of competence over FDI from the individual EU Member States to the EU creates a number of problems, if these problems are adequately dealt with, then the changes to FDI embodied in the Lisbon Treaty will represent an improvement over the EU’s prior international investment regime.”).

<sup>138</sup> *See id.*; Pollet-Fort, *supra* note 72, at 3 (“All these changes to bring trade in goods and services and FDI under the exclusive competence of the EU are expected to contribute to a streamlining of the trade policy.”).

<sup>139</sup> TFEU, art. 207.

<sup>140</sup> *See Final Report on Impacts of EU Outward FDI on EU Economy*, COM 6 (June 24, 2010), <http://trade.ec.europa.eu/doclib/html/146270.htm> [hereinafter *Report on Impacts of EU Outward FDI*]. From 2001 to 2006, outward FDI alone has increased the GDP of the EU by over €20 billion, *id.* at 59.

<sup>141</sup> *See id.* at 24-25.

<sup>142</sup> *Towards a Comprehensive European International Investment Policy*, *supra* note 97, at 4. The value and role of outward FDI has been hotly debated by EU and non-EU nations alike, though most nations generally cede that inward FDI is worth attracting. *Id.* at 3. However, outward FDI will likely provide value to the EU as well. *Id.* For instance, Copenhagen Economics, on a report commissioned by the Directorate General for Trade of the European Commission, states that the number of jobs going abroad generally represents only between 0.5% and 2.0% of the total number of jobs leaving the nation; moreover, for every 100 jobs that move overseas, about 50 of the jobs were newly created altogether, *Report on Impacts of EU Outward FDI*, *supra* note 142, at 5. Panel economists undertook a study in which they analyzed the effects of outward FDI on the EU economy and determined that outward FDI leads to increases in productivity and efficiency of EU companies – thus increasing their competitiveness on the global marketplace, *id.* at 58. While the US and EU continue to promote outward FDI, many other nations have undertaken measures to curtail such investment in the belief that these resources should instead be developed domestically. *Id.* at 6.

<sup>143</sup> *See Report on Impacts of EU Outward FDI on EU Economy*, *supra* note 142, at 13.

Increased EU regulations may increase the costs of investing internationally.<sup>144</sup>

While the EU comprises nearly half of all FDI worldwide, European FDI flow has been steadily losing ground per its relative standing as compared to other regions.<sup>145</sup> As Europe has lost ground in relative FDI, developing nations, such as China, India, and Brazil, have begun altering global trade flows, causing renewed consideration of their investment opportunities.<sup>146</sup> Even though the EU is a developed nation, foreign investors may be reticent to invest if the EU's investment framework appears unstable.<sup>147</sup> If implemented effectively, Lisbon can promote stability for both outside investors seeking to invest in the EU, and EU investors seeking to invest in outside nations.

EU investors investing in outside nations may be reticent to engage in such investment deals due to fears that these nations do not have the governance or infrastructure to deal with the industrial impact.<sup>148</sup> Because, under Lisbon, environmental and social goals will likely become a comparatively larger factor in investment agreements, creating mechanisms to help developing nations reach environmental targets will help these nations reach parity.<sup>149</sup> After Lisbon, international investment policies can promote environmental and social goals domestically and abroad.<sup>150</sup> However, because EU member states are frequently in a stronger position to

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<sup>144</sup> *World Investment Report 2012*, *supra* note 135, at 83. Given the far-reaching implications of the 2008 recession, including a lackluster and slow recovery, national governments may be less likely to encourage outward FDI – thus leading to a collective action problem in which overall economic wellbeing is diminished across the world. Moreover, the company may experience a loss of efficiency or competitiveness had it not chosen to invest overseas, though this measure is of course speculative. *Id.*

<sup>145</sup> *Id.* at xviii, 85.

<sup>146</sup> Victor Mosoti, *Bilateral Investment Treaties and the Possibility of a Multilateral Framework on Investment at the WTO: Are Poor Economies Caught in Between?*, 26 *NW. J. INT'L & BUS.*, 95, 113-15 (2005) (“Most African countries now do everything in their power to create an environment that is conducive to FDI, which represents a tectonic shift from prevailing autarchic thinking of the 1970s. The vast majority of [developing] countries now universally welcome foreign investment almost unreservedly, have signed many BITs and have heavily engaged in negotiations, especially those sponsored by UNCTAD.”).

<sup>147</sup> *See id.*; *Towards a Comprehensive European International Investment Policy*, *supra* note 97, at 4; Anderer, *supra* note 4, at 875 (“If foreign investors believe that the EU's system does not provide adequate protection, they may choose to retract their investments. This will make it difficult for the EU to attract new foreign investors who will likely forego opportunities in the EU to avoid the problems associated with an unstable investment regime.”).

<sup>148</sup> *World Investment Report 2012*, *supra* note 135, at 83.

<sup>149</sup> The Montreal Protocol instilled time-adjusted regulations for meeting Protocol provisions based upon the unique needs of developing nations. *See* The Montreal Protocol on Substances that Deplete the Ozone Layer art. 5, 1522 *U.N.T.S.* 3 (Sept. 16, 1987)

<sup>150</sup> Goebel, *supra* note 137, at 86 (“As successive Treaty amendments have authorized social and employment policy, environmental protection, consumer rights and other fields of action, the [EC] has promoted each with equal vigor on a Community-wide basis through action programs and initiatives for legislation.”). *See also* PHILIPPA WATSON, *EU SOCIAL AND EMPLOYMENT LAW* 53-64 (2d ed.2014).

invest in non-EU developing nations than vice versa, EU investors may disproportionately bear the costs of environmental cleanup, or ensuring protections for laborers.<sup>151</sup> In short, while Lisbon will place renewed emphasis on environmental and social goals, EU investors may disproportionately bear these costs.

Furthermore, as the EU moves towards increasingly unitary actions, with the possibility of its most powerful nations domineering its investment agenda, most favored nation (“MFN”) clauses should possess renewed significance, and should be enforced in such a manner as to protect weaker EU and non-EU nations.<sup>152</sup> A MFN clause generally provides that “investments or investors of one contracting party are entitled to treatment by the other contracting party that is no less favourable than the treatment the latter grants to investments or investors of any other third country.”<sup>153</sup> There are numerous initiatives that may be undertaken to ensure that the practical effects of BITs are preserved, while increasing protections in certain less prosperous areas. The MFN and national treatment provisions may be drafted in such a way so as to ensure that all nations under the BIT receive the same protections.<sup>154</sup> New clauses, such as post-admission “fair and equitable treatment” and “full security and protection” will possess renewed significance as they help develop a threshold standard for investor protection adopted across nations.<sup>155</sup> Consequently, the EU must deviate

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<sup>151</sup> See Goebel, *supra* note 137, at 86.

<sup>152</sup> *Europe 2020 - Other Tools for Growth and Jobs*, EUR. COMM’N., [https://web.archive.org/web/20170519213010/http://ec.europa.eu:80/europe2020/europe-2020-in-a-nutshell/eu-tools-for-growth-and-jobs/index\\_en.htm](https://web.archive.org/web/20170519213010/http://ec.europa.eu:80/europe2020/europe-2020-in-a-nutshell/eu-tools-for-growth-and-jobs/index_en.htm) (last updated July 4, 2015). Consequently, the MFN clauses for each individual BIT should be drafted with particularity, while the EC should perhaps formulate a ‘model’ MFN clause as a default provision. Moreover, the ‘model’ MFN clause should be drafted with the weaker nations’ specific needs in mind. For example, an MFN clause may propose that standards of treatment are to be considered from the view of the weaker nation, or that a particular dispute (in some instances, and admittedly not all) be resolved as against the nation most capable of dealing with the consequences, *id.*

<sup>153</sup> Anderer, *supra* note 4, at 859 n. 60 (citing UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking*, 38, U.N. Doc. UNCTAD/ITE/IIA/2006/5 (2007)).

<sup>154</sup> See Ross Eventon, *Future Forms of EU Investment Competence: The German Model BIT as a Minimum Level of Protection*, in *EU INVESTMENT AGREEMENTS IN THE LISBON TREATY ERA: A READER*, 22, 22 (2010), <http://corporateeurope.org/sites/default/files/S2b%20investment%20reader%20-%2050%20pages!.pdf>.

<sup>155</sup> *Towards a Comprehensive European International Investment Policy*, *supra* note 97, at 8. However, in achieving these aims, the EU should work to ensure that investors receive, at the very least, equal treatment as to that which they received under the BITs they would otherwise have entered into with individual member states. *Id.* at 11. This is a tall aim – though vital to ensuring a strong reception to increased EC competence – and will require collaboration between the EC and the member states. *Id.* In order to secure increased cooperation between the EC and the member states, binding statements should be secured to ensure the open flow of investment and the maintenance of standards of care. Such standards should be developed in accordance with the ‘best practices’ by the member states. *Id.* Moreover, in the interim, stand-alone investment negotiations should continue to be available as a transitional mechanism. *Id.*

from other previous model treaties, such as the German Model Treaty, which, in Article 3(1) and 3(2),<sup>156</sup> does not provide for exceptions in areas where a local industry or group may need special preference in order to develop or sustain itself.<sup>157</sup> Such a need for special preferences, as outlined in Section IIIA, is necessary due to economic inequalities between the EU member states.<sup>158</sup>

Further, as the EU transitions to a unified investment framework, increased flexibility will be necessary to allow for an amended interpretation in the interest of fairness.<sup>159</sup> Allowing for increased flexibility accords with GATS, Part IV, Article XIX, which provides that “[t]here shall be appropriate flexibility for individual developing country members for opening fewer sectors, liberalizing fewer types of transactions, [and] progressively extending market access in line with their development situation.”<sup>160</sup>

Even more, Lisbon’s common investment scheme may be limited by a continued lack of true European unification, as EU member states continue to assert autonomy. The United Kingdom (“UK”) is a recent example of backlash against further EU integration efforts.<sup>161</sup> Most recently, the UK voted in a referendum to leave the EU, and thus, this move allows the UK to possess complete control over its investment policy.<sup>162</sup> The UK is now in the process of renegotiating its trade and investment agreements, including free trade agreements and bilateral trade pacts with developing nations.<sup>163</sup> The UK also loses advantages associated with the single European market.<sup>164</sup>

As furthered portrayed by the fact that individual member states continue to enter into treaties separately,<sup>165</sup> efforts toward European

<sup>156</sup> GER. FED. MINISTRY FOR ECON. & TECH., GERMAN MODEL TREATY – 2008 arts. 3(1), 3(2); Eventon, *supra* note 154, at 22 (“The National Treatment and Most Favoured Nation provisions restrict states from taking measures to enhance local production or enterprise for fear of breaking this provision.”).

<sup>157</sup> Eventon, *supra* note 154, at 22. An example of an industry which may need special treatment in order to survive would be the US automobile industry, which would likely have collapsed after being unable to compete with foreign manufacturers.

<sup>158</sup> *See supra* Section IIIA.

<sup>159</sup> Sabina Voogd, *A Sustainable Balance? International Investment Agreements: How They Reflect the Right and Responsibilities of Different Stakeholders*, Presentation before European Commission Issue Group on Investment 4 (Feb. 27, 2001), <http://trade.ec.europa.eu/doclib/html/122164.htm>.

<sup>160</sup> GATS, *supra* note 93, art. XIX.

<sup>161</sup> *See generally* Jean Heilman Grier, *Brexit: Trade Implications*, 16-11 BRIEFING PAPERS 1 (Oct. 2016) (discussing Brexit and future trade policy options for the UK.).

<sup>162</sup> *See id.* at 1.

<sup>163</sup> *See id.* at 2.

<sup>164</sup> *Id.*

<sup>165</sup> Allan Rosas, *The Status in EU Law of International Agreements Concluded by EU Member States*, 34 FORDHAM INT’L L.J. 1304, 1305 (2011).

unification may be slowing or coming to a halt.<sup>166</sup> If so, EU efforts to unify its investment policy could have the opposite of its intended effect: instead of presenting a unified image to the world that the EU is a stable and vibrant location in which to invest, the EU may in fact be perceived as weaker and less unified after Lisbon. Individual member states will also no longer be able to entice FDI into their nations.<sup>167</sup> Moreover, given that the EU has stagnated in its market position pertaining to FDI flows,<sup>168</sup> a perceived lack of European unification could further hasten this trend. Additional guidance will also be required to determine when an EU member state may act and when the EU should act as a single legal body.<sup>169</sup> The EU has not clarified to what extent individual member states will retain control over their domestic markets.<sup>170</sup> This issue will likely remain complicated in the near term as consolidation and centralization are balanced against growth and stability of the individual EU member states.<sup>171</sup> Finally, the EU will be required to replace over one-thousand individually created BITs and transform them into a common body of European investment law.<sup>172</sup> Such a task will likely take decades.

In sum, Lisbon is likely to lead to increased regionalization of investment agreements and will promote economic goals. However, recent backlash against European unification suggests that Member states will continue to assert autonomy in key decisions.

*D. By Standardizing Investment Provisions, Lisbon Will Improve Relations With Key Trading Partners And Will Promote Shared Goals.*

Lisbon is likely to further Europe's policy goals by promoting consolidation, regional unification, economic modernization, and by improving relations with non-EU nations.<sup>173</sup> Lisbon may also benefit the EU's relationship with key investment partners.<sup>174</sup>

<sup>166</sup> KRISTIN ARCHICK, CONG. RESEARCH SERV., RS21372, THE EUROPEAN UNION: QUESTIONS AND ANSWERS 13 (2018).

<sup>167</sup> *See id.* at 11.

<sup>168</sup> *See Foreign Direct Investment*, EUR. COMM'N, [http://ec.europa.eu/internal\\_market/scoreboard/integration\\_market\\_openness/fdi/index\\_en.htm](http://ec.europa.eu/internal_market/scoreboard/integration_market_openness/fdi/index_en.htm) (last updated July 11, 2018).

<sup>169</sup> *See* Vaughne Miller, *Legislating for Brexit: EU external agreements*, HOUSE OF COMMONS LIBR. BRIEFING 5 (Jan. 5, 2017), <http://researchbriefings.files.parliament.uk/documents/CBP-7850/CBP-7850.pdf>.

<sup>170</sup> *See id.*

<sup>171</sup> *See Europe 2020: A strategy for smart, sustainable and inclusive growth*, COM 8, 18 (2010) 2020 final (Mar. 3, 2010).

<sup>172</sup> Armand De Mestrel, "Is a Model EU BIT Possible – or Even Desirable?" COLUMBIA FDI PERSPECTIVES, VALE COLUMBIA CENTER ON SUSTAINABLE DEVELOPMENT 1-2 (24 Mar. 24, 2010) <http://academiccommons.columbia.edu/catalog/ac%3A125914>.

<sup>173</sup> *Europe 2020*, *supra* note 171, at 3-4, 21-22.

<sup>174</sup> *See id.* at 20.

First, the provisions delineated by the TFEU accord with public policy goals by bringing EU international investment policy in line with the general aims of European policy goals, which promote increased economic modernization and certain social goals.<sup>175</sup> Though Lisbon appears to promote EU investment interests, while shortchanging the needs of non-EU nations, this result is unlikely to be Lisbon's main consequence.<sup>176</sup> Environmental, social, and democratic provisions will likely be featured in international investment agreements to a greater extent than previously.<sup>177</sup> Placing heightened emphasis on such provisions will promote environmental and social goals while affording investor protections.<sup>178</sup> A common international precedent could spread the fulfillment of these goals across the globe.

Secondly, the EU's relationship with key investment partners will likely improve.<sup>179</sup> For example, the EU and US have continually affirmed their commitment to an open investment policy between the two continents, and the move toward an EC-centric investment policy will facilitate increased trade between the two regions, especially as nondiscriminatory policies which "provide [] clear guidance" on investment restrictions are applied.<sup>180</sup>

The EU and US rely heavily on the other for its own economic wellbeing.<sup>181</sup> The EU and US are each's biggest investor,<sup>182</sup> representing roughly one-half of each region's total FDI.<sup>183</sup> EU investment policies also typically align with US investment policies, as shown in April 2012, when the EU and US jointly issued their "Shared Principles for International Investment," describing their goal of providing a "level playing field" and creating "open and non-discriminatory investment climates" for investors

<sup>175</sup> *Europe 2020 - Other Tools for Growth and Jobs*, *supra* note 152. In so doing, the EU is looking to modernize its labor force, technologies, and infrastructure. *Id.* The EU seeks to lower its unemployment rate, particularly among older workers. Increasing FDI flows will have the ramifications of increasing employment rates, at least, this is the hope of the EU. Additionally, increased investment will force the EU to modernize its economic and physical infrastructure – as increasing investment, both inward and outward, will hopefully cause EU companies to become both more competitive and more efficient; *id.*

<sup>176</sup> *Towards a Comprehensive European International Investment Policy*, *supra* note 97, at 6.

<sup>177</sup> *See id.* at 9.

<sup>178</sup> *Id.* at 5.

<sup>179</sup> *USA-EU - International Trade in Goods Statistics*, EUROSTAT STATISTICS EXPLAINED, [http://ec.europa.eu/eurostat/statistics-explained/index.php/USA-EU\\_-\\_international\\_trade\\_in\\_goods\\_statistics](http://ec.europa.eu/eurostat/statistics-explained/index.php/USA-EU_-_international_trade_in_goods_statistics) (last updated Aug. 23, 2018).

<sup>180</sup> European Commission Statement, EU-US Open Investment Statement (May 13, 2008), [http://trade.ec.europa.eu/doclib/docs/2008/may/tradoc\\_138822.pdf](http://trade.ec.europa.eu/doclib/docs/2008/may/tradoc_138822.pdf). Both the EU and US openly seek to avoid protectionist mechanisms, and consequently allow for the free flow of trade, with the exception of national security issues, *id.*

<sup>181</sup> *See id.*

<sup>182</sup> European Commission Press Release MEMO/09/118, Global Partners: EU-US Trade and Investment (Mar. 18, 2009), [http://europa.eu/rapid/press-release\\_MEMO-09-118\\_en.htm?locale=en](http://europa.eu/rapid/press-release_MEMO-09-118_en.htm?locale=en).

<sup>183</sup> *Id.*

between the two nations.<sup>184</sup> Buoyed by support from US and EU international investment policies, environmental and social goals will likely play a greater role in international investment policies.<sup>185</sup> Furthermore, there are already numerous current non-binding guidelines describing the advantages of such policies.<sup>186</sup> Allowing for these considerations also fits into the EU's aims under Article 205 of the TFEU, which provides for the creation of general policies for "human rights and sustainable development."<sup>187</sup>

How the changes brought about by Lisbon will affect nations outside the EU, particularly China and India, is less clear.<sup>188</sup> The EU most effective approach may be to keep investment flows between non-EU nations as open as possible.<sup>189</sup> As EU nations enter into trade agreements with developing nations, making an effective dispute settlement mechanism available will most likely be the best method in which to bolster investment.<sup>190</sup>

#### IV. CONCLUSION

In conclusion, BITs will likely exist in the coming decades, though they may become increasingly regionalized. Non-EU investors may perhaps one day look to a series of EU-wide international investment agreements. Such an outcome will promote transparency and efficiency. After Lisbon, coupled with provisions assisting weaker EU nations, the EU investment framework will likely become more stable.<sup>191</sup> Therefore, unification of the EU's investment regime corresponds with the public policy aims

<sup>184</sup> European Commission Statement, Statement of the European Union and the United States on Shared Principles for International Investment (Apr. 10, 2012), [http://trade.ec.europa.eu/doclib/docs/2012/april/tradoc\\_149331.pdf](http://trade.ec.europa.eu/doclib/docs/2012/april/tradoc_149331.pdf). Notably, some of these exogenous considerations are invoked in the statement, including the promotion of ethically responsible behavior by businesses, *id*.

<sup>185</sup> *See id*.

<sup>186</sup> Such documents include the 2011 UN Guiding Principles on Business and Human Rights, the 2011 Revision of the OECD Guidelines for Multinational Enterprises (1976), and the 2012 Revision of the International Chamber of Commerce's Guidelines for International Investment (1972). *World Investment Report 2012*, *supra* note 135, at 91

<sup>187</sup> *Towards a Comprehensive European International Investment Policy*, *supra* note 97, at 9.

<sup>188</sup> In fact, it is quite difficult to see how the EU's relationship with China will develop in the future, given that China does not share the same penchant for exceedingly liberal trade flows, nor is it a democratic society. Other nations, in crafting their future relations with the EU will likely fall somewhere on this continuum, with those nations sharing the most political, economic, and social commonalities with the EU most likely to benefit from Lisbon's changes to the EU's investment regime. *See generally* European Commission Statement, Consultation on the future investment relationship between the EU and China (May 2, 2011), [http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc\\_147866.pdf](http://trade.ec.europa.eu/doclib/docs/2011/may/tradoc_147866.pdf).

<sup>189</sup> *Investment*, EUR, COMM'N, <http://ec.europa.eu/trade/creating-opportunities/trade-topics/investment/> (last updated Sept. 14, 2017).

<sup>190</sup> *World Investment Report 2012*, *supra* note 135, at 97.

<sup>191</sup> *See supra* Section III.A.

demonstrated by future policy goals for a unified Europe and may improve economic relations between non-EU nations, and in particular, with the US.<sup>192</sup> Shifting competence over trade and investment to the EC and the EP also aligns with the EU's environmental and social goals. Lisbon allows for the opportunity to create a new framework upon which to de-emphasize member-state BITs at the behest of a rise of 'regional' BITs. In so doing, continuous discussion between the EU and its member states, while balancing these considerations with a liberal investment policy. By replacing the existing BIT structure with a body of collective EU investment law, the EU's trading platform will be bolstered, solidified, and imbued with new vigor.

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<sup>192</sup> See *USA-EU – International Trade in Goods Statistics*, *supra* note 179.

APPENDIX A  
PROPOSED CHANGES TO THE LISBON FRAMEWORK

1. Resolve Disputes Between the EP and the EC By Creating A Veto Authority
2. Develop Guidelines for Weaker Nations During Trade Discussions
3. Develop Regional BITs for Certain EU Member Nations Seeking to Achieve Similar Objectives
4. Install Explicit Guidance For Negative Externalities Associated With BITs, Such as drafting Key Environmental, Social, and Policy Provisions
5. Promote Autonomy of Member States By Installing Explicit Limits on the Scope of Lisbon's Authority In Creating and Overseeing Investment Guidelines

APPENDIX B  
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# EUCLIDIAN PARALLELISM, LEGAL PLURALISM AND LEGAL TRANSPLANTS VIS-À-VIS TRANSPOSING THE CISG INTO THE UK LEGAL ORDER

Katerina Georgiada\*

## I. INTRODUCTION

To the ordinary man, Euclidian Parallelism and the UN Convention on Contracts for the International Sale of Goods 1980 (hereinafter “CISG”) have nothing in common. Nevertheless, this article will illustrate how a model created by the author and inspired by the great mathematician of Ancient Greece could simplify the transposition of the CISG into the UK legal order. Therefore, this article proposes and analyzes the *parallel model* in depth and argues how this model can be applied from theory to practise.

When the CISG was drafted, it aimed at simplifying international business transactions either by diminishing legal costs or by making resolutions less time consuming.<sup>1</sup> There was cooperation from scholars around the globe to create the CISG, and thus it balances elements from both common and civil law systems.<sup>2</sup> However, the CISG has been criticised for a number of reasons. One of those criticisms is that it only affects international sales contracts which encompass a diminutive percentage of all the sales contracts concluded within the contracting countries, but these arguments are largely unfounded and surveys show that following an initial rejection of the CISG, people in the business world seem more and more willing to recognise the new regime.<sup>3</sup>

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<sup>1</sup> Troy Keily, *How Does the Cookie Crumble? Legal Costs Under a Uniform Interpretation of the United Nations Convention on Contracts for the International Sale of Goods*, 1 NORDIC J. COMM. L. 3, (Jul. 2003) available at <https://www.cisg.law.pace.edu/cisg/biblio/keily2.html>.

<sup>2</sup> *Id.*

<sup>3</sup> Ingeborg Schwenzer & Pascal Hachem, *The CISG - Successes and Pitfalls*, PACE L. SCH. INSTITUTE OF INT’L COMM. L. (May 8, 2009), available at <http://www.cisg.law.pace.edu/cisg/biblio/schwenzer-hachem.html>.

Filip De Ly, *Opting Out: Some Observations on the Occasion of the CISG’s 25th Anniversary*, in *Quo Vadis CISG* (Franco Ferrari ed, 2005) 25 et seq, in particular at 28 (with reference to the commodity trade) and 30 et seq (analysing the main objectives of parties in excluding or not excluding CISG).

Several States with common law systems such as Canada, New Zealand, Australia and the United States have already successfully ratified the CISG.<sup>4</sup> Furthermore, leading civil law countries such as Germany and the Scandinavian nations have also implemented the CISG.<sup>5</sup> The march of the CISG around the world continues. Another major trading power, Japan, has already pushed ahead with the incorporation of the Convention into their domestic law.<sup>6</sup> Due to its widespread adoption by UK's trading partners, if ratified by the UK, the Convention will prove advantageous as most of UK's trading partners have implemented the CISG and it would thus facilitate the trading process, allowing UK commerce to flourish further.<sup>7</sup> Arguably, from a political perspective, the UK presents a negative image as being a hesitant participant in international trade law schemes.<sup>8</sup> More importantly, UK law does not provide a special body of rules relevant to international sales has an established instrument of common law-inspired rules, the Sale of Goods Act of 1979, but these rules were not created to accommodate modern international transactions. In essence, this article will examine the possibility of transforming the CISG into the UK legal order through a proposed model, the *parallel model*.

The name of the *parallel model* emerged from the fact that this model proposes the parallel existence in the UK legal order of both a CISG Act and the Sales of Goods Act of 1979. In other words, the model allows parties wishing to enter into an international transaction to conclude a contract either on CISG terms or under the Sales of Goods Act of 1979. This model requires legislation. A CISG Act could be created through a legislative acknowledgment of the Convention by the UK parliament. In turn, this, acknowledgement would result in a widespread acceptance of this legal instrument by the UK trading community. Recognition is given to the fact that UK traders can already deploy the CISG by way of the freedom of

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<sup>4</sup> CISG: Table of Contracting States, PACE LAW SCHOOL INSTITUTE OF INTERNATIONAL COMMERCIAL LAW (Jan. 8, 2016), available at <http://cisgw3.law.pace.edu/cisg/countries/cntries.html>.

<sup>5</sup> *Id.*

<sup>6</sup> The CISG took effect in Japan on the 1<sup>st</sup> of August 2009. *CISG Participating Countries - Japan*, PACE LAW SCHOOL INSTITUTE OF INTERNATIONAL COMMERCIAL LAW (July 4, 2008), <http://cisgw3.law.pace.edu/cisg/countries/cntries-Japan.html>.

<sup>7</sup> In addition, by advantageous "the author denotes that such a transformation would reduce legal costs and make dispute resolutions less time consuming for traders and practitioners. Moreover, it would benefit the UK economy as a whole as all of its main trading partners are contracting States to the CISG and it would facilitate the trading process if the UK proceeded with such a transformation." See Katerina Georgiadi, *The Transformation of the UN Convention on Contracts for the International Sale of Goods (CISG) Into the UK Legal Order: Two Legislative Models*, UNIV. OF DERBY (Aug. 2014), available at <https://derby.openrepository.com/derby/handle/10545/337282>.

<sup>8</sup> Barry Nicholas, *The United Kingdom and the Vienna Sales Convention: Another Case of Splendid Isolation?*, PACE LAW SCHOOL INSTITUTE OF INTERNATIONAL COMMERCIAL LAW (Mar. 1993) available at <http://www.cnr.it/CRDCS/nicholas.htm> (last visited July 7, 2009). Professor Nicholas was the UK's representative in the preparatory stages of the CISG. However, he did not live to see the incorporation of the CISG into the UK legal order.

contract doctrine.<sup>9</sup> Since the full abolition of the Sale of Goods Act of 1979 is highly unlikely, the *parallel model* would satisfy both the traders who wish to employ modern law<sup>10</sup> especially designed for international contracts and those who are rather conservative and prefer to employ the old and familiar Sale of Goods Act of 1979.

Nevertheless, it is worth mentioning that the parallel model's proposal might make someone wonder whether there is a fundamental reason to transform the CISG through this model as the UK current approach towards the Convention appears to be very similar. Both the parallel model and the UK current CISG approach allow the traders to opt into the Convention whenever they wish and they both agree on the coexistence of the domestic Sale of Goods Act 1979 and the CISG.<sup>11</sup> Therefore, this is one of the major criticisms the parallel model might suffer. However, if one examines in depth the parallel model's proposal, he or she will conclude that simply allowing the traders to opt into the CISG whenever they wish is very different from passing legislation on the matter. The first reason why the parallel model would be more beneficial for the UK than the current approach is that one puts forward the idea that the careful implementation in New Zealand and Germany, which has been observed, could prove beneficial to the UK's efforts in bringing the CISG to life in the international trade law element of its domestic legal order.

## II. EUCLIDIAN PARALLELISM

Before one proceeds with the substantives of the model, it is worth exploring the notion of parallelism to which the model in question relates. Parallelism is a term found in our everyday lives and in almost every aspect of the society. We often use it to give directions, "parallel road,"<sup>12</sup> to describe a forbidden affair, "parallel relationship,"<sup>13</sup> and to refer to the hypothetical set of multiple possible universes, "parallel universe."<sup>14</sup> Nonetheless, the term "parallel" is very old, actually ancient, as it was established by the Greek mathematician Euclid, often referred to as the "Father of Geometry."<sup>15</sup> Euclid had a unique fascination with parallel

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<sup>9</sup> See generally *Proforce Recruit Ltd v The Rugby Group Ltd* [2006] EWCA Civ 69; *The Square Mile Partnership Ltd v Fitzmaurice McCall Ltd* [2005] EWHC Civ 1565; *Chartbrook Limited v Persimmon Homes Limited et al.* [2009] UKHL 38.

<sup>10</sup> As compared to the initial Sale of Goods Act 1893. See generally *Sales of Goods Act, 1893 C.71* (U.K.).

<sup>11</sup> See Nicholas, *supra* note 8.

<sup>12</sup> James Nicol, *On the Origin of the Parallel Roads of Glen Roy*, Q. J. GEOL. SOC. 282 (London, Aug. 1869).

<sup>13</sup> H L Zetterberg, *Sexual Life in Sweden* (Transaction Publishers 2002) at 65.

<sup>14</sup> BRIAN GREENE, *THE HIDDEN REALITY: PARALLEL UNIVERSES AND THE DEEP LAWS OF THE COSMOS* 5 (2011).

<sup>15</sup> *Euclid*, MATH OPEN REFERENCE, <http://www.mathopenref.com/euclid.html> (last visited Feb. 2, 2017).

lines. He discovered that systems of parallel lines were great tools in verifying abstract geometrical truths.<sup>16</sup>

In geometry parallelism is a term that refers to a Euclidean space property of two or more planes or lines, or a combination of these. Two lines in a plane that do not touch or intersect at a point are said to be parallel. These are lines that meet *ad infinitum*, that is to say, never.<sup>17</sup> Parallelism is a common concept and it occurs regularly. For instance, house construction is a parallel activity. A number of employees can execute separate tasks at the same time, such as wiring, furnace duct installation, plumbing, and so on.<sup>18</sup> The majority of manufacturing, such as household electrical appliances, cars and aeroplanes is completed using a pipeline, or assembly line, in which several parts of the product are under construction simultaneously.<sup>19</sup> Another organisation that applies parallelism by which many employees service customers at once, is the call centre.<sup>20</sup> Furthermore, parallelism is also used in computing; “parallel computing” is a type of computation in which many calculations are executed at the same time, functioning on the principle that big problems can frequently be separated into smaller ones, which are then solved simultaneously, in parallel.<sup>21</sup>

The *parallel model* of this article follows the Euclidean parallelism, where two lines never intersect, that is the CISG and the Sale of Goods Act of 1979 would not conflict with one another. In that sense the CISG would become a body of domestic sales law applicable to international transactions in the UK. Thus, within the UK, two parallel instruments of sales law would exist, one related to domestic sales and one related to international sales, which would not intersect in their field of application. In other words, the Convention would become domestic law which would lay down the rights and obligations for parties involved in international commercial transactions.<sup>22</sup>

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<sup>16</sup> *Euclid's Fifth Postulate*, UNIVERSITY OF PITTSBURGH, available at [https://www.pitt.edu/~jdnorton/teaching/HPS\\_0410/chapters/non\\_Euclid\\_fifth\\_postulate/index.html](https://www.pitt.edu/~jdnorton/teaching/HPS_0410/chapters/non_Euclid_fifth_postulate/index.html) – Fifth.

<sup>17</sup> *Angles, Parallel Lines and Traversals*, MATH PLANET, <https://www.mathplanet.com/education/geometry/perpendicular-and-parallel/angles-parallel-lines-and-transversals>.

<sup>18</sup> Simone Atzeni, *Formal Verification of Parallel Computing: ISP - In-Situ Model Checker*, UNIV. OF ROME (2009), available at <http://www.simoneatzeni.net/old/Thesis/Thesis.pdf>.

<sup>19</sup> *Id.*

<sup>20</sup> Larry Snyder, *Principles of Parallel Programming* (Feb. 10, 2017) (unpublished manuscript), available at <http://www.cs.washington.edu/education/courses/csep524/07sp/poppChaper1.pdf>.

<sup>21</sup> Schwenzer, *supra* note 3.

<sup>22</sup> *Id.*

Nonetheless, the author also refers to the discipline of astronomy's parallel universes to illustrate parallelism.<sup>23</sup> Parallel universes, parallel worlds or multiverses, all have the same meaning and they're all words employed by scientists to describe not just our universe but a range of others that may exist out there.<sup>24</sup> An outstanding actuality is that a lot of the main advancements in fundamental theoretical physics have led us to consider the existence of one or another ranges of parallel universes.<sup>25</sup> Some paradigms of such theoretical physics are the quantum physics, the unified physics, the cosmological physics, the computational physics and the relativistic physics.<sup>26</sup>

Similarly, as the developments in theoretical physics have resulted in the consideration of the existence of parallel universes, in legal terms a set of rules that exists in parallel to another statute may also be seen as a parallel universe. In addition, parallel universes could be compared to the CISG existing in parallel to the Sale of Goods Act 1979, in the sense that it might be criticised for the complications which may result. In other words, in the same way that there is a veil of mystery as to what happens in an actual parallel universe,<sup>27</sup> the business community might oppose the parallel model on the grounds of uncertainty.<sup>28</sup> In other words, one might argue that the two sets of parallel rules governing international transactions creates uncertainty in the business community.

### III. TWO SYSTEMS OPERATING IN ONE REGIME-OPTIONALITY

Despite the power of globalisation, various systems for the enforcement of international sales contracts prevail in different parts of the world. Certainly, there are points of overlap and convergence. Yet, for all intents and purposes, significant differences persist between the principle forms of legal systems.

The CISG was developed by United Nations Commission on International Trade Law ("UNCITRAL") as a multilateral treaty that sets out substantive provisions of law to govern the formation of international

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<sup>23</sup> Andrew Zimmerman Jones, *What Are the Types of Parallel Universes?*, ThoughtCo. (Feb. 15, 2018) available at

<http://physics.about.com/od/astronomy/f/ParallelUniverseTypes.htm>; Jean Tate, *Parallel Universe*, Universe Today (Nov. 11, 2009) <http://www.universetoday.com/44769/parallel-universe/>.

<sup>24</sup> Greene, *supra* note 14, at 4.

<sup>25</sup> LAWRENCE M. KRAUSS, *A UNIVERSE FROM NOTHING: WHY THERE IS SOMETHING RATHER THAN NOTHING* 125-126 (Free Press 1<sup>st</sup> ed. 2012).

<sup>26</sup> Greene, *supra* note 14, at 5.

<sup>27</sup> See Greene, *supra* note 14, at 5.

<sup>28</sup> See Alison E. Williams, *Forecasting the Potential Impact of the Vienna Sales Convention on International Sales Law in the United Kingdom*, PACE INT'L L REV. (2001) available at

<http://www.cisg.law.pace.edu/cisg/biblio/williams.html#158> (accessed June 8, 2017).

sales contracts.<sup>29</sup> Its overall goal is to promote worldwide uniformity in dealing with sales disputes arising from international trade.<sup>30</sup> Therefore, one may conclude that the CISG is a tool for globalisation, or that it was generated through globalisation.<sup>31</sup> However, uniformity is difficult to achieve in practice, taking into account the complexity of international trade and the differences in the legal regimes involved.<sup>32</sup> Consequently, the CISG has awarded traders the right of optionality; it is rather obvious that there is a correlation between globalisation, the CISG and optionality.<sup>33</sup>

Globalisation illustrates the business perspective that the world is developing into harmonisation and that dissimilarities among markets are not only becoming less significant, but, for certain services or goods, will vanish.<sup>34</sup> Nonetheless, one might say that a globalised legal environment is rather complex.<sup>35</sup> States, as in the UK's case, cannot or do not wish to abolish their national laws. Therefore, we see two regimes operating in one system<sup>36</sup> and this is what the parallel model suggests. In the last thirty years or so, there have been numerous key forces that have encouraged the shift toward globalisation. These consist of:

1. Lowering of trade and investment barriers,<sup>37</sup> at first in the course of the General Agreement on Tariffs and Trade ("GATT"),<sup>38</sup> drafted through various negotiations, known as *Trade*

<sup>29</sup> *United Nations Convention on Contracts for the International Sale of Goods*, AUDIOVISUAL LIBRARY OF INTERNATIONAL LAW, <http://legal.un.org/avl/ha/ccisg/ccisg.html> (last visited April 10, 2018).

<sup>30</sup> *Id.*

<sup>31</sup> *See id.*

<sup>32</sup> *See* Adam Newhouse & Tanaka Tsuneyoshi, *CISG—A Tool for Globalization (1): American and Japanese Perspectives*, 29 RITSUMEIKAN L. R. 1, 4 (2012) available at <http://www.ritsumeikai.ac.jp/acd/cg/law/lex/rtr29/AdamTanaka.pdf>.

<sup>33</sup> *See id.*

<sup>34</sup> R J Hunter and R E Shapiro, 'A Primer on Important Legal Aspects of the International Business Environment' (2008) 2 JMIB

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> R J Hunter and R E Shapiro, 'A Primer on Important Legal Aspects of the International Business Environment' (2008) 2 JMIB.

<sup>38</sup> The General Agreement on Tariffs and Trade (hereinafter "GATT") was originally created by the Bretton Woods Conference as part of a comprehensive plan conceived of by the United States and Great Britain for economic recovery after World War II. *See Bretton Woods-GATT, 1941-1947*, OFFICE OF THE HISTORIAN, <https://history.state.gov/milestones/1937-1945/bretton-wo> (last visited Dec. 19, 2018). The GATT was organized in order to reduce barriers to international trade through the systematic reduction of tariff barriers, quantitative restrictions and subsidies on trade through a series of intergovernmental agreements. *See id.* The GATT was an *agreement, not an organization*. *See id.* The founder of the GATT envisioned that it would one day become a full international organization like the World Bank or IMF called the international Trade Organization. However, the agreement was never ratified, and the GATT remained in its original form. *See id.* The functions of the GATT have been replaced by the World Trade Organization which was established through the final round of negotiations in the mid- 1990s. *See id.*

*Rounds*,<sup>39</sup> the advancement of Intellectual Property Rights (“IPRs”)<sup>40</sup>, and the establishment of the World Trade Organization (“WTO”);<sup>41</sup>

2. The development of information technology,<sup>42</sup> mainly in finance, banking, medical technology and E-Commerce; and
3. Economic transformation through privatisation,<sup>43</sup> either through political privatisation (generated by an alteration in the governing economic attitude in a nation) or economic privatisation (generated by the collapse of the previous command-and-control regime).<sup>44</sup>

A State’s legal system supplies the methods and means which control the context of business transactions, defines both the rights and duties of parties involved in business dealings, specifies the boundaries within which individual traders and companies carry out their transactions, and addresses the process of legal treatment to those who consider themselves entitled to some type of remedy in the legal system.<sup>45</sup> Each nation has established a comprehensive regime for deciding which law is more appropriate in any given case and where legal action should take place if a dispute between transnational parties arises.<sup>46</sup> Individual traders and larger companies involved in multinational business dealings ought to include a choice of forum clause, which would predetermine the forum for any dispute that may arise in the contract,<sup>47</sup> and a choice of law clause that stipulates which law will apply in a dispute.<sup>48</sup> In order to resolve legal

<sup>39</sup> Rounds are a cycle of multilateral trade negotiations under the authority of the GATT, culminating in simultaneous trade agreements among participating countries to reduce tariff and non-tariff barriers to trade. *See The GATT Years: From Havana to Marrakesh*, WTO, [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact4\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm) (last visited Dec. 19, 2018). Eight “rounds” have been completed thus far: Geneva, 1947-48; Annecy, France, 1949; Torquay, England, 1950-51; Geneva, 1956; Geneva, 1960-62 (the Dillon Round); Geneva, 1963-67 (the Kennedy Round); Geneva, 1973-79 (the Tokyo Round); and Geneva, 1986-1993 (the Uruguay Round). The present round of negotiations is termed the “Doha Round”. *Id.*

<sup>40</sup> R J Hunter and R E Shapiro, ‘A Primer on Important Legal Aspects of the International Business Environment’ (2008) 2 JMIB

<sup>41</sup> *See The GATT Years: From Havana to Marrakesh*, *supra* note 39.

<sup>42</sup> R J Hunter and R E Shapiro, ‘A Primer on Important Legal Aspects of the International Business Environment’ (2008) 2 JMIB

<sup>43</sup> *Id.*

<sup>44</sup> For instance, the case study of economic privatisation in Poland, *see e.g.*, Richard J. Hunter Jr., & Leo V. Ryan, C.S.V., *Privatization and Transformation in Poland*, 49 THE POLISH REV. 3, 919, 943 (2004) (JSTOR).

<sup>45</sup> R J Hunter and R E Shapiro, ‘A Primer on Important Legal Aspects of the International Business Environment’ (2008) 2 JMIB

<sup>46</sup> *Id.*

<sup>47</sup> Hannah Buxbaum, “Forum Selection in International Contract Litigation: The Role of Judicial Discretion” (2004). *Articles by Maurer Faculty*. Paper 326. <http://www.repository.law.indiana.edu/facpub/326>.

<sup>48</sup> Marks & Weinberg, ‘Choice of Law and Forum Selection Provisions’ <https://docs.google.com/viewer?a=v&q=cache:wEV9dQGHM5cJ:www.leaseawyer.com/casesandarticles/Articles/ChoiceofLawandForumSelectionPr.pdf+choice+of+forum+clause+definiti>

disputes occurring under international contracts, many States subscribe to the CISG.<sup>49</sup>

When working in an international business transaction environment it is also fundamental to understand the legal environment within which one operates. One might say that there is a variety of legal traditions among nations as their main legal variables are formed through a number of factors such as religion, custom, tradition and precedent. Moreover, in attempting to understand one legal system, it is vital to recognise who is the decision maker within a country's legal system.<sup>50</sup> However, in order to avoid the complications that would arise from this situation; the parallel model awards the role of the decision maker to the trader.<sup>51</sup> If the trader is free to choose between the Sale of Goods Act of 1979 and the CISG, the trader will be offered the choice of opting for the instrument which is more beneficial for the particular transaction.

Furthermore, optionality is of great significance in the business transaction world. A simple example is how a contract is formed: offer, acceptance, agreement.<sup>52</sup> That is, the buyer is given the option to accept the offer made by the seller.<sup>53</sup> Similarly we will see how optionality is essential in the *parallel model*. Furthermore, the need for optionality is reinforced by the fact that the CISG is a legal instrument where the trader plays a vital role.<sup>54</sup>

The *parallel model* would provide for an optional scenario. This is a common-sense approach. Traders with no intention of trading beyond the UK's borders, who, therefore, will only ever work within the Sale of Goods Act of 1979, will not be obliged to shift needlessly to a new legal regime, the CISG. On the other hand, it endows traders, who wish to expand beyond the UK's borders, the freedom to choose a legal regime which would reduce business costs and simplify transactions.

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on&hl=en&gl=cy&pid=bl&srcid=ADGEESg30U-BJ5YZPtByiH4a30ggJojePzm1IBLncScmLoGafzLu5Rio1DImA88XqRL2KOYhoYcXXY6sy eaqOhBYG9ZJCyfow9jDfnSNbmE6OhtX-TvKVp6ail3xYHFsoGxJQX2o0MrL&sig=AHIEtbRpcW6XXv5X9bkz2V6l3M7stmotNQ (accessed 7 March 2012).

<sup>49</sup> R J Hunter and R E Shapiro, 'A Primer on Important Legal Aspects of the International Business Environment' (2008) 2 JMIB

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> EWAN MCKENDRICK, *CONTRACT LAW: TEXT, CASES, AND MATERIALS* 4 (6th ed., 2014).

<sup>53</sup> *Id.*

<sup>54</sup> John Felemegas, *The United Nations Convention on Contracts for the International Sale of Goods: Article 7 and Uniform Interpretation*, PACE L. SCH. INST. INT'L COM. L. <http://www.cisg.law.pace.edu/cisg/biblio/felemegas.html> (last updated Nov. 5, 2002).

The outbreak of the economic crisis in 2008,<sup>55</sup> as in most economies around the globe, had a negative impact on the British economy.<sup>56</sup> Thus, in July 2010, the Green Paper: *Financing a Private Sector Recovery* was presented to the Parliament by the UK Secretary of State for Business, Innovation and Skills concerning the status of the British economy.<sup>57</sup> In this paper, both the Chancellor of the Exchequer, George Osborne, and the Secretary of State for Business, Innovation and Skills, Vince Cable, highlighted the call for revitalisation directed by augmenting business investment and a sustained growth in the private sector.<sup>58</sup> In this way the business community and the British economy would seize on the opportunities offered by a recuperating global economy.<sup>59</sup>

As the needs of the UK business community evolve, this should be mirrored in the choices made by the traders. The UK Parliament ought to recognise that the development of international trade around the globe has inspired the need for widespread harmonisation of the legal instruments that make international trade possible, such as the CISG enabling traders from different States, beliefs and cultures to carry out business under equal and comprehensible terms.<sup>60</sup> Opting into the CISG, by choosing to employ its set of rules, would diminish the uncertainties and potential unnecessary expenditures related with conducting trade under unfamiliar rules.<sup>61</sup> In other words, following the negative impact of the crisis on the British economy, traders should realise that at the moment the most suitable harmonization mechanism to be applied in the UK to meet the requirements of the nation and the economy is the CISG.<sup>62</sup> A legal officer at the UNCITRAL Secretariat, Professor Castellani addressed the subject matter:

As small and medium sized enterprises . . . have limited access to expert legal advice when drafting their contracts and little influence on the choice of the law applicable to the contract, they would take advantage correspondingly from the application of the CISG. Small and medium sized enterprises constitute the backbone of a modern and balanced economy. They support economic diversification and may therefore significantly contribute to achieving sustainable growth. In conclusion, they may play an

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<sup>55</sup> The effects of the international economic crisis appeared in the middle of 2007 and continued into 2008. Around the globe, stock markets have collapsed and as a result enormous financial institutions have fallen, and even wealthy states' governments have been impacted.

<sup>56</sup> In full: Hank Paulson's speech in London, *Financial Times* (Nov. 12, 2008) available at

<http://www.ft.com/cms/s/2/c2abf432-798f-11dd-bb93-000077b07658.html>.

<sup>57</sup> See generally DEPARTMENT FOR BUSINESS INNOVATION AND SKILLS, FINANCING A PRIVATE SECTOR RECOVERY, 2010, Cm. 7923 (UK) [hereinafter the 2010 Green Paper].

<sup>58</sup> *Id.* at 3.

<sup>59</sup> *Id.*

<sup>60</sup> See Williams, *supra* note 28.

<sup>61</sup> ROY GOODE, THE HAMLYN LECTURES: COMMERCIAL LAW IN THE NEXT MILLENNIUM 32-46 (Sweet & Maxwell eds., 1998).

<sup>62</sup> *Id.*

important role in addressing those structural problems... The CISG may be instrumental in making this role effective.<sup>63</sup>

There are several essential rights and freedoms, such as the freedom to move and live where you wish, freedom to choose a partner and create a family, freedom of press and freedom to work and trade.<sup>64</sup> However, it is vital to all such freedoms and rights that one should be able to make up one's mind without being dictated what choices to make.<sup>65</sup> One would say that a government is an enormous monopoly that establishes the way organisations and people act to a large extent and using monopolistic force of a legal system does not promote the advancement of freedom.

In contrast, the optionality offered by the parallel model rejects such legal constructions. The objective of the parallel model is that once it is there, optionality will continue not because it is being imposed but because it is appreciated. The importance of this is that traders would not be forced to use one legal regime or the other; they would have the freedom to accept or reject the CISG accordingly. Furthermore, it must be stated that optionality, which the parallel model promotes, embraces freedom of contract.<sup>66</sup>

#### IV. LEGAL PLURALISM

Not only would the parallel model encourage freedom of contract, but in addition to this, legal pluralism would ask us to apply a model that would go beyond legal singularity. Dualism, in the case of the parallel model, stands for a pluralism of a sort. In any case, the international legal system mirrors two conflicting sets of forces; one set moving towards interconnection and unity and the other one toward fragmentation.<sup>67</sup> Nevertheless, as these two sets of forces intermingle, a new form of international system comes forward. Paradoxically, this new type of international system is neither entirely unitary nor absolutely fragmented, but may be described as pluralist.<sup>68</sup> A pluralist legal system recognises a spectrum of equal yet different legal normative options by international tribunals, institutions and national governments, but does so within the

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<sup>63</sup> Luca G. Castellani, *Promoting the Adoption of the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, 13 VINDOBONA J. INT'L COM. L. & ARB. 241, 246 (2009).

<sup>64</sup> Universal Declaration of Human Rights <<http://www.un.org/en/universal-declaration-human-rights/>.

<sup>65</sup> *Measuring Freedom*, OPTIONALITY MAG., <http://www.optionality.net/mag/feb96a.html> [<https://web.archive.org/web/20110822095918/http://www.optionality.net/mag/feb96a.html>] (last visited Aug. 22, 2011).

<sup>66</sup> See The 2010 Green Paper, *supra* note 57.

<sup>67</sup> William W. Burke-White, *International Legal Pluralism*, 25 MICH. J. INT'L L. 963, 977 (2004).

<sup>68</sup> *Id.*

framework of a worldwide system.<sup>69</sup> An eminent scholar, Anthony Appiah, described the pluralist legal system in terms of a system that celebrates “difference [but] remains committed to the existence of universal standards.”<sup>70</sup>

In its modern structure, international legal pluralism offers several benefits. It accepts the value of variety in the options and the approaches and traditions of international actors, such as traders, who are presented with the opportunity of optionality to choose their preferred procedure for their commercial dealings.<sup>71</sup> Therefore, this system operates on the pragmatism that the ultimate harmonisation cannot exist, as each State has different political, cultural, social and legal behaviour, but it functions within what David Held characterises as “a framework of universal law.”<sup>72</sup> In other words, the legal pluralism notion of the international system demonstrates, and perhaps flourishes on, the diversity of the system.<sup>73</sup> According to legal pluralism, an extensive spectrum of courts will employ, develop and construe the corpus of international law.<sup>74</sup> Countries may encounter different sets of duties that are construed differently by a variety of tribunals that may sometimes clash.<sup>75</sup> More importantly, international and national procedures will cooperate and influence each other, leading to new fused rules and methods.<sup>76</sup>

Despite the numerous benefits of pluralism, this notion of the international legal system is not a solution for all threats presented by fragmentation.<sup>77</sup> The complexity of conflicting duties remains, and additional attempts at legal development will be required to cure them.<sup>78</sup> However, this pluralist visualisation provided by the parallel model does offer an optional and possibly influential means of conceptualising the potential progress of international law.<sup>79</sup> The parallel model embraces legitimate divergence of States, leading to a more legitimate and effective UK legal system as it regards private international law.<sup>80</sup>

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<sup>69</sup> *Id.*

<sup>70</sup> *Id.* at 978 (quoting K. Anthony Appiah, *The American University in an Age of Globalization*, Lecture at the Princeton-Oxford Conference on Globalization at Oxford University (June 15, 2002)).

<sup>71</sup> Burke-White, *supra* note 67, at 978.

<sup>72</sup> *Id.* at 978 (quoting David Held, *Law of States, Law of Peoples: Three Models of Sovereignty*, 8 *LEGAL THEORY* 1 38 (2002)).

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* at 979.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

## V. FREEDOM OF CONTRACT AND EFFICIENCY OF THE PARALLEL MODEL

The EU Commission and several international institutions have set freedom of contract as an essential point of reference for the potential progress of European and international contract law.<sup>81</sup> Additionally, a starting point in party autonomy or freedom of contract is illustrated in both EU and international private law,<sup>82</sup> as well as in private international law provisions.<sup>83</sup> Which, in some instances, prohibits an abuse of the freedom of contract,<sup>84</sup> whereas in others where they encourage its application so as to protect weaker parties.<sup>85</sup>

Nevertheless, as these paradigms make clear in international law, freedom of contract is no more than a starting point, given the array of current political and social factors which call for it as a requirement.<sup>86</sup> It is the author's conviction that in contemporary international law there lies under the flag of freedom of contract a significant duality of vision.<sup>87</sup> The first perspective reflects freedom of contract as an economic belief in which markets of all types are to be rooted.<sup>88</sup> From this point of view, the law's task in supporting or even establishing freedom of contract lays in guaranteeing that commercial and legal institutions are formed in such a way as to support an open and free market.<sup>89</sup> More precisely, the task of contract law is primarily to support and smooth the process of market business dealings.<sup>90</sup> The second perspective reflects freedom of contract as

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<sup>81</sup> EC Commission, *First Annual Progress Report on European Contract Law and the Acquis Review*, EC Com No 456, ¶ 2.6.3 (2005).

<sup>82</sup> Regulation (EC) No. 593/2008 of 17 June 2008, art. 2, 2008 (regulating the law applicable to contractual obligations ('Rome I') (the 'Rome I Regulation')).

<sup>83</sup> Convention on Contracts for the International Sale of Goods, Apr. 11, 1980. UNICITRAL, available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html) (accessed Apr. 2018).

<sup>84</sup> Council Directive (EC) 2000/35, arts. 1 & 2(1) of the 29 June 2000 (EC) (combating late payments in commercial transactions). Recital 19 of this directive states "This Directive should prohibit abuse of freedom of contract to the disadvantage of the creditor." The directive applies to "commercial transactions", defined as "transactions between undertakings or between undertakings and public authorities which lead to the delivery of goods or the provision of services for remuneration."

<sup>85</sup> The residual need to protect the parties' "contractual autonomy" can be seen in the fact that Council Directive (EC) 93/13 on unfair terms in consumer contracts does not apply to terms which have been individually negotiated nor to those which reflect the 'main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language.'" arts. 3, 4(2), of Apr. 5, 1993 (EEC). *Cf.*, H E Brandner & P Ulmer, *The Community Directive on Unfair Terms in Consumer Contracts: Some Critical Remarks on the Proposal Submitted by the EC Commission* (1991) 28 CMLR 64

<sup>86</sup> Simon Whittaker, *The Optional Instrument of European Contract Law and Freedom of Contract*,

7(3) EUR. REV. CONT. L. 371, 388 (2011).

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

an ethical notion.<sup>91</sup> In this point of view, the justification for contractual obligations lays in the option of the individual's party to the contract, this vision of freedom of contract is broadly known as "party autonomy" or as "contractual autonomy."<sup>92</sup> Moreover, it is rather obvious that this perspective of freedom of contract emerged from the philosophies of Kant and Rousseau.<sup>93</sup> Kant held that every individual has both an essential right to freedom and a duty to enter into a civil condition ruled by a social contract in order to realize and preserve that freedom.<sup>94</sup> Similarly Rousseau addresses freedom more than any other issue of political philosophy.<sup>95</sup> For that reason, as the parallel model promotes optionality, it adopts the second perspective of freedom of the contract, the one that enables traders to employ the legal regime which is more suitable to their transaction. Considering that the parallel model promotes individual autonomy, this does not mean that it does not agree with the first vision of freedom of contract which promotes ease of market transactions.

The CISG firmly promotes the freedom of contract notion; hence, parties wishing to avoid its application are free to do so.<sup>96</sup> The possibility of excluding some of its provisions is also available.<sup>97</sup> However, traders find it more convenient to employ a familiar legal instrument and would, therefore, opt out of the CISG. Nonetheless, simply writing into a contract that the Sale of Goods Act of 1979 will apply does not suffice, thus this article proposes the incorporation of the CISG into domestic law.

Pursuant to the proposed parallel model, the CISG would be part of UK domestic law and, in instances where a trader would wish to apply the Sale of Goods Act of 1979 and opt out of the CISG; traders would be required to say so expressly. In New Zealand, for instance, the option of opting in and out of the CISG seems to be disregarded reasonably frequently.<sup>98</sup> However, if the parallel model is employed that may prove to be advantageous for the UK traders. For instance, a UK-based importer might make an agreement to buy goods from Canada and the contract may just state that the law of British Columbia will apply. If this would be the case, most UK-based importers and the practitioners advising them would

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<sup>91</sup> *Id.*

<sup>92</sup> Fleur Johns, *Performing Party Autonomy*, 71(3) L. & CONTEMP. PROBS. 243, 249 (Summer 2008).

<sup>93</sup> Whittaker, *supra* note 86.

<sup>94</sup> Kevin E. Dodson, "Kant's Theory of the Social Contract", (Feb. 2014) (doctoral dissertation, University of Massachusetts) (available at [http://scholarworks.umass.edu/dissertations\\_1/2074](http://scholarworks.umass.edu/dissertations_1/2074)).

<sup>95</sup> Matthew Simpson, *Rousseau's Theory of Freedom*, 21 Reference and Res. News; Portland preface (2006) (available at <https://ndpr.nd.edu/news/rousseau-s-theory-of-freedom/>).

<sup>96</sup> United Nations Convention on Contracts for International Sale of Goods, Apr. 11, 1980, U.N. Doc. A/Conf. 97/18, art. 6 (1980) [hereinafter CISG].

<sup>97</sup> *Id.* art. 12.

<sup>98</sup> Kent France, *International Sale of Goods*, WYNN WILLIAMS LAW. 2 (Mar. 2012), <https://www.wynnwilliams.co.nz/getattachment/20847382-d5e6-430d-8089-10c95fd54ece/.aspx>.

be in the dark about the details of British Colombian law. If no specific reference excluding the CISG was made, then, because the UK (hypothetically speaking) and Canada would both be signatory parties to the CISG, then the CISG would be likely to apply. In principle then, the CISG would automatically apply to both the UK trader and the Canadian trader.

In addition, another benefit of being able to opt out of part or the entirety of the CISG is that it can also be applied in other trading arrangements.<sup>99</sup> The CISG is an international trading instrument especially designed to offer flexibility,<sup>100</sup> and that is why flexibility was used as the bedrock for the drafting of the parallel model.<sup>101</sup> For instance, the CISG offers its own rules about when risk regarding the goods passes from the purchaser to the seller.<sup>102</sup> If other common trading arrangements, such as the rules established by the International Chamber of Commerce for the interpretation of trade terms, Incoterms, are employed, then the particular Incoterm applied can substitute the specific rules in the CISG concerning the passing of risk.<sup>103</sup>

The parallel model supports the notion that “[e]very man is the master of the contract he may choose to make: and it is of the highest importance that every contract should be construed according to the intention of the contracting parties.”<sup>104</sup> Handling freedom of contract, however, can prove to be very tricky as the subject carries a heavy ideological charge. Freedom of contract may be seen as an option between heavy-handed government control and individual liberty.

The principle of freedom of contract concerns options available to the buyer and seller, such as whom they conduct business transactions with and what they wish to contract for and on what conditions. It emerges from the classical model of contract where the bottom-up approach is of the greatest significance,<sup>105</sup> where government intervention is kept to the minimum. Economists such as Adam Smith<sup>106</sup> and Michael Atiyah<sup>107</sup> were

<sup>99</sup> *Id.* at 3.

<sup>100</sup> UNCITRAL, *Introduction to the Digest of Case Law on the United Nations Sales Convention, Note by the Secretariat*, ¶¶ 3, 6, U.N. Doc. A/CN.9/562 (June 9, 2004).

<sup>101</sup> Yet the CISG has not been designed to cater for all contingencies in the commodities market.

<sup>102</sup> See generally CISG, *supra* note 96, arts. 66-70.

<sup>103</sup> UNCITRAL, *Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Contracts for the International Sale of Goods*, ¶ 31, U.N. Doc. V.89-53886 (1989).

<sup>104</sup> *Clarke v Watson* (1865) 144 Eng. Rep. 450, 452 (N.S.).

<sup>105</sup> Richard A. Epstein, *Contracts Small and Contract Large: Contract Law Through the Lens of Laissez-Faire*, in *THE FALL AND RISE OF FREEDOM OF CONTRACT* 25, 26 (F. H. Buckley ed., 1999).

<sup>106</sup> See ADAM SMITH, *THE ESSENTIAL ADAM SMITH* 151 (Robert L. Heilbroner ed., 1986); see also K. B. SMELLIE, *A HUNDRED YEARS OF ENGLISH GOVERNMENT* 8 (2d ed. 1950).

<sup>107</sup> See generally Graham Smith, Book Note, *On P.S. Atiyah's The Rise and Fall of Freedom of Contract*, 1 J. LIBERTARIAN ALLIANCE (SPECIAL ISSUE) 2 (1980), <http://www.la-articles.org.uk/FL-1-4-7.pdf>.

central to this classical model.<sup>108</sup> Their fall came about when consumer welfarism, reliance and pragmatism replaced the bargaining model and the *laissez faire* approach.<sup>109</sup>

The concept of freedom of contract has come under a critical gaze, as statutory legislation has been introduced in the UK which has implications for such freedom of options.<sup>110</sup> There are several examples of legislative interference with the freedom of contract and a wide range of legislation was passed that helped reform the law of contract, two of them are the Sale of Goods Act of 1979 and the Unfair Contract Terms Act of 1977.<sup>111</sup> Freedom of contract highlights the need for certainty, predictability, and stability.

Nonetheless, when building a model, such as the parallel model proposed herein, it is vital to also test its practicability; otherwise the model would only function properly in theory. Economists believe that applying ultimate freedom of contract would eventually result in market failure.<sup>112</sup> The main reason being that freedom of contract without any sort of regulation or restraint would only function properly in a perfectly efficient market.<sup>113</sup> Such a perfectly efficient market can only exist when, for example, the seller and the buyer gain the exact same benefits from a business transaction.<sup>114</sup> Hence, freedom of contract may be maintained to a great extent in the parallel model by giving the trader a leading role that would be somewhat regulated only during the consultation and the enactment of the CISG Act, where the government would have the responsibility as the decision maker. As Jean-Jacques Rousseau said, “Man is born free, and everywhere he is in chains.”<sup>115</sup> Obviously, Jean-Jacques Rousseau was referring to a more literal interpretation of his statement, perhaps he wanted to say that everywhere we go, there are rules to follow, there are laws to obey and absolute freedom does not exist.

## VI. LEGAL TRANSPLANTATION THEORIES

The parallel model research is not only concentrated on the sheer examination of case law and statutes of other signatory CISG States, but the legal transplantation process is also required to be taken into

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<sup>108</sup> By classical model, the author means the model of minimum legal interference on part of the government.

<sup>109</sup> Smith, *supra* note 106, at 2.

<sup>110</sup> Thomas Wilhelmsson, *Various Approaches to Unfair Terms and Their Background Philosophies*, 14 JURIDICA INT'L 53 (2008).

<sup>111</sup> *Id.*

<sup>112</sup> HUGH COLLINS, *THE LAW OF CONTRACT* 25-26 (4<sup>th</sup> ed. 2003).

<sup>113</sup> See generally Andrew W. Lo, *Efficient Markets Hypothesis*, in *THE NEW PALGRAVE DICTIONARY OF ECONOMICS* (Palgrave Macmillan, ed., 3<sup>rd</sup> ed. 2018).

<sup>114</sup> ROBERT L. HAGIN, *THE DOW JONES-IRWIN GUIDE TO MODERN PORTFOLIO THEORY* 11-13 (1979).

<sup>115</sup> JEAN-JACQUES ROUSSEAU, *THE SOCIAL CONTRACT* 14 (G.D.H. Cole trans., 2008).

consideration.<sup>116</sup> Consequently, in this sub-section of the chapter a number of legal transplants theorists will be analysed that justify the importance of the legal transplantation process. It is worth mentioning that globalisation is often identified as the core reason for the development of legal transplants in the world economy.<sup>117</sup> Global Trade has influenced what legal practitioners and scholars need and wish to know about foreign law, more specifically how they transport, obtain and process information, and how decisions and contracts are made.<sup>118</sup> Therefore, taking into account the enormous amount of borrowing<sup>119</sup> and copying in the international legal field, comparative research necessitates a more comprehensive approach that also involves the study of legal transplants.

Transforming an international law into a domestic legal system is not as simple in practise as it is in theory. The process by which the new set of rules would be incorporated into a country's legal system is analogous to that of transplanting an organ from a healthy human body to a sick human body. In turn these rules are called legal transplants; however, as a human body may reject such a transplant, the incorporation of a set of international rules into a domestic legal system may likewise fail.<sup>120</sup> According to Legrand, when a statute is transplanted from one state to the next, it has to be translated, which changes the meaning.<sup>121</sup> Legrand believes that when a rule is being incorporated into a legal system it becomes different and that people will interpret it differently as well, that is why he firmly considers legal transplants impossible.<sup>122</sup>

On the other end of the spectrum we find Watson, who believes that legal transplants are possible and he illustrates this through paradigms.<sup>123</sup> Such paradigms are the French *code civil*, the feudal laws from the medieval period, or the reception of the Roman law.<sup>124</sup> According to Watson, these are examples of a body of rules being incorporated into a legal system, and a legal transplant thereby being created.<sup>125</sup>

It is rather obvious that Legrand's and Watson's perspectives regarding legal transplants conflict. The former considers the legal

<sup>116</sup> See generally Irma Johanna Mosquera Valderrama, *Legal Transplants and Comparative Law*, INT'L L. J. 261 (2004).

<sup>117</sup> *Id.* at 264.

<sup>118</sup> David J. Gerber, *Globalization and Legal Knowledge: Implications for Comparative Law*, 75 TUL. L. REV. 949, 950 (2001).

<sup>119</sup> Alan Watson, *Legal Transplants and European Private Law*, ELECTRONIC J. COMP. L. (Dec. 2000), <http://www.ejcl.org/ejcl/44/44-2.html>.

<sup>120</sup> See Christie Brants, *Legal Culture and Legal Transplants: Netherlands National Report*, 1 INT'L ACAD. COMP. L. 1, 100 (2011).

<sup>121</sup> Pierre Legrand, *The Impossibility of Legal Transplants*, 4 MAASTRICHT J. EUR. COMP. L. 111, 117 (1997).

<sup>122</sup> *Id.*

<sup>123</sup> See Watson, *supra* note 119.

<sup>124</sup> *Id.*

<sup>125</sup> See *id.*

transplants impossible,<sup>126</sup> whereas the latter deems the incorporation of foreign rules into a state's legal system possible.<sup>127</sup> To complicate matters even more, there is a third scholar who has observed the difficulty of legal transplants, Gunther Teubner.<sup>128</sup> Teubner's opinion regarding legal transplants differs from both Legrand's and Watson's in that he prefers to portray a set of foreign rules as an 'irritant' rather than a transplant.<sup>129</sup> According to Teubner, the effect of transferring a legal notion from one mechanism to another cannot be predicted as structural pairing will change.<sup>130</sup>

One might say that Teubner made use of the term "[l]egal irritations" so as to avoid, as he characterises it, 'the false dichotomy' of interaction or repulsion, which is the consequence of legal transplant allegory.<sup>131</sup> Moreover, Teubner's term is constructive in signifying that when a set of rules is transferred into a different legal system it does not automatically substitute existing legal customs and meanings. To the contrary, it generates a new set of unpredictable options and effects.<sup>132</sup> Nevertheless, legal irritations, as an allegory, is restricted by certain conceptual deficiencies.<sup>133</sup> It mirrors the procedures that take place as soon as a set of rules is being transferred into a legal system, however it fails to signify when and why foreign laws are chosen for law transformation.<sup>134</sup> David Nelken goes a step further in commenting that the allegories 'legal irritations' and 'legal transplants' have some similarities, as they both "direct our gaze mainly to the regulatory problems of trying to use law to change other legal and social orders."<sup>135</sup>

To sum up, these three legal analysts, Legrand, Teubner and Watson, have all made significant contributions to the legal transplant issue dispute. While I do not entirely agree with any of the three commentators, certain features of all three theories are persuasive. Nevertheless, the parallel model shares some of the characteristics of Watson; that transplants are possible and that the accomplishment of a legal transplant relies mainly on the recipient state's need for the foreign legal rule.<sup>136</sup> As already

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<sup>126</sup> Legrand, *supra* note 121, at 120.

<sup>127</sup> See Watson, *supra* note 119.

<sup>128</sup> See generally Gunther Teubner, *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences*, 61 M. L. REV. 11 (1998).

<sup>129</sup> *Id.* at 12.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> JAMES L. NOLAN, JR., LEGAL ACCENTS, LEGAL BORROWING: THE INTERNATIONAL PROBLEM-SOLVING COURT MOVEMENT 39 (2009).

<sup>134</sup> *Id.* at 39-40.

<sup>135</sup> David Nelken, *Beyond the Metaphor of Legal Transplants? Consequences of Autopoietic Theory for the Study of Cross-Cultural Legal Adaptation*, in LAW'S NEW BOUNDARIES: THE CONSEQUENCES OF LEGAL AUTOPOIESIS, 276 (Jiří Pribáň and David Nelken eds., 2001).

<sup>136</sup> See Watson, *supra* note 119.

mentioned, the 2010 *Green Paper: Financing a Private Sector Recovery* stressed the importance of Small and Medium-Sized Enterprises development to the British economy recovery.<sup>137</sup> These Small and Medium-Sized Enterprises, however, cannot afford to have expert legal advice when drafting their contracts.<sup>138</sup> Thus, it now may be the appropriate time for transplanting the CISG into the UK legal order as the UK needs a foreign rule such as the CISG to play a role in addressing structural issues.<sup>139</sup> As the CISG is less cost and time consuming<sup>140</sup> these enterprises would have more time and money to spend in making their companies more efficient and competitive, thus generating a healthier economy.

When transplanting a foreign legal instrument into a country's legal system, it is crucial to examine the approach other states have adopted so as to transplant the new set of rules.<sup>141</sup> Therefore, besides studying legal transplant theorists, another way to check if legal transplantation is possible is to see how other States have transplanted the CISG into their legal systems.<sup>142</sup> This would help to determine whether it has worked elsewhere and whether it can work in the UK legal order.

## VII. CONCLUSION

In synopsis, the name of the parallel model emerged from the notion of parallelism. More specifically, the model follows Euclidean parallelism, where two lines never intersect.<sup>143</sup> This implies that the CISG and the Sale of Goods Act of 1979 will be used concurrently, but would never have to interfere with one another, unless traders would use elements of both instruments at the same time based on the doctrine of freedom of contract. Pursuant to Euclidean parallelism, two parallel sales law regimes would exist, one related to domestic sales and one related to international sales and they would not 'intersect' in their respective fields of application. The CISG would become domestic law, albeit in the international trade law element thereof, which would lay down the rights and obligations for parties involved in international commercial transactions. Thus, UK traders would be given the opportunity to choose between the CISG and the Sale of Goods Act of 1979 based on which one would be more advantageous.

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<sup>137</sup> The 2010 Green Paper, *supra* note 57, at 3.

<sup>138</sup> *An Optional Common European Sales Law: Advantages and Problems, Advice to the UK Government*, SCOT. L. COMM'N 2 (Nov. 10, 2011), [https://www.scotlaw.com.gov.uk/index.php/download\\_file/view/931/468/](https://www.scotlaw.com.gov.uk/index.php/download_file/view/931/468/).

<sup>139</sup> *See id.* at 28-29.

<sup>140</sup> Katrina Winsor, *The Applicability of the CISG to Govern Sales of Commodity Type Goods*, 14 VINDOBONA J. INT'L COM. L. & ARB. 83, 97 (2010).

<sup>141</sup> Edward J. Eberle, *The Method and Role of Comparative Law*, 8 WASH. U. GLOBAL STUD. L. REV. 451, 452 (2009).

<sup>142</sup> *See id.*

<sup>143</sup> *Euclid, supra* note 15; *Euclid's Fifth Postulate, supra* note 16.

Furthermore, the parallel model is also based on the concept of parallel universes. Parallel universes, or parallel worlds, or alternate universes, all have the same meaning and they are all words employed by scientists to describe not just our universe but a range of others that may exist out there.<sup>144</sup> In the same way the developments in theoretical physics have led in the consideration of the existence of parallel universes, in legal terms a set of rules that exists in parallel to another statute may also be considered as a parallel universe.<sup>145</sup>

The parallel model gives optionality a powerful role to play as it recognises and strengthens the significance of optionality in the business transaction world. One might say that optionality is the fundamental in contract law; a buyer is given the option to accept the offer to buy made by the seller; and by doing so a contract is being formed.<sup>146</sup> Moreover, the necessity for optionality is reinforced by the fact that the CISG is a legal instrument where the trader plays a central role.<sup>147</sup> Thus, UK traders will achieve improved business dealings if they are presented with the option of selecting the legal regime that is more suitable and beneficial for their transactions. More importantly, optionality in a two-option parallel system may act as a safety net, if one legal instrument were to fail, then the second one would continue to function.

Legal traditions vary significantly from nation to nation in terms of managing the several main legal variables which may include “tradition, precedent, usage, custom, or religious precept.”<sup>148</sup> This is why the parallel model offers an optional scenario. Traders who are not planning on trading outside the UK borders and who will therefore only ever work within one system, the Sale of Goods Act 1979, will not be obliged to shift needlessly to a new legal regime under the CISG. However, more importantly, it offers traders who wish to develop beyond the UK borders the freedom to select a legal instrument which would decrease costs for business and increase simplification.<sup>149</sup> The trader is offered the right of option, to choose between the Sale of Goods Act 1979 and the CISG. In other words, the trader will be provided with the option of choosing the instrument which is more beneficial for the particular transaction.

In a democratic world a number of rights and freedoms exist and it is fundamental to all such freedoms and rights that one should be given the option of choice without being dictated by availability.<sup>150</sup> It is often the

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<sup>144</sup> Greene, *supra* note 14, at 4.

<sup>145</sup> Jones, *supra* note 23; Tate, *supra* note 23.

<sup>146</sup> Mckendrick, *supra* note 52, at 22.

<sup>147</sup> Felemegas, *supra* note 54.

<sup>148</sup> JOHN D. DANIELS, ET AL., INTERNATIONAL BUSINESS: ENVIRONMENTS & OPERATIONS 122 (16th ed. 2018).

<sup>149</sup> Lisa Spagnolo, *The Last Outpost: Automatic CISG Opt Outs, Misapplications and the Costs of Ignoring the Vienna Sales Convention For Australian Lawyers*, 10 MELBOURNE J. INT'L L. 1, 9 (2009).

<sup>150</sup> *Measuring Freedom*, *supra* note 65.

case that governments display an enormous monopoly that establishes the way organisations and people act to a large extent.<sup>151</sup> Hence, the advancement of freedom is hindered when choice is imposed by availability. On the contrary, optionality offered by the parallel model rejects such legal constructions.<sup>152</sup> One of the parallel model's objectives is that, once it is applied, optionality will carry on not because it is being imposed but because it is being appreciated and enhanced.<sup>153</sup> More specifically, optionality falls under the freedom of contract principle.<sup>154</sup>

Freedom of contract is very significant to the CISG and through the parallel model parties wishing to exclude its application are free to do so.<sup>155</sup> The parallel model endows traders with the ability to opt-out some of its provisions.<sup>156</sup> Nonetheless, it should be mentioned that the first reaction of some UK importers and exporters will probably be to seek to opt out of the CISG as they would be unfamiliar with it. According to the parallel model, the CISG would be part of UK domestic law and, on occasions where a trader would want to apply the Sale of Goods Act of 1979 and opt out of the Convention, traders would be required to say so expressly. If the parallel model is employed, that may prove to be beneficial for the UK traders and for UK commerce as a whole.

Despite the fact that Australia, Canada, New Zealand and Germany have acted as sources of comparative inspiration, the parallel model mainly draws on elements from the New Zealand and German approaches to implementation. Australia and Canada acted only as sources of inspiration on the ground that they pose a certain difficulty.<sup>157</sup> Both states are federal countries in which the ultimate authority for the sale of goods law is in the constituent units.<sup>158</sup> Based on this reality, it is rather apparent that the UK cannot adopt and adjust the Australian and Canadian approaches as to how to ratify the CISG, since ratification in both of these states required a unique approach. The parallel model adopts and adjusts the New Zealand and German approaches, as they are simpler and more suitable for the UK legal order.

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<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> See the 2010 Green Paper, *supra* note 57, at. 5.

<sup>155</sup> CISG, *supra* note 96, art. 6.

<sup>156</sup> *Id.* at art. 12.

<sup>157</sup> See Eric Bergsten, *Methodological Problems in the Drafting of the CISG*, in CISG METHODOLOGY 5, 16-17 (André Janssen et al. eds., 2009).

<sup>158</sup> *Id.* at 16 (“[S]tates in the case of Australia and provinces in the case of Canada.”).

Although Germany is a civil law State, which has a tendency to apply the respective literature<sup>159</sup> where necessary, it is an important point of reference for the parallel model. The method it used to ratify the CISG is worth considering and adapting for use by the UK.<sup>160</sup> The immense amount of CISG cases reported in Germany,<sup>161</sup> combined with the large amounts of German scholarly writing approving of the CISG, shows that the application of the CISG in parallel to the German Civil Code (“BGB”) has proved for the most part prosperous.<sup>162</sup>

Moreover, drawing elements from the Australian and Canadian approach would only be unrealistic, as it would cause confusion and further reluctance on behalf of the UK to ratify the CISG.<sup>163</sup> In addition, this would be in contrary to one of this article’s objectives, which is to offer a simple and realistic model of transforming the CISG into the UK legal order.

Additionally, one might say that one of the major reasons why New Zealand and other common law countries have not fully embraced the CISG is the UK’s reluctance to ratify it.<sup>164</sup> The UK’s unenthusiastic response to the CISG has most probably deprived other common law countries of valuable case material that could act as precedent or at least offer direction and assistance.<sup>165</sup>

The reluctance on the part of the legal profession in New Zealand to embrace the CISG ought not to hinder the final incorporation of the CISG into the UK legal order. Incorporating international instruments such as the CISG is not something which should necessarily be judged on its popularity in specific jurisdictions after such instruments have been implemented therein.

<sup>159</sup> See Stefano Troiano, *The CISG’s Impact on EU Legislation*, in THE CISG AND ITS IMPACT ON NATIONAL LEGAL SYSTEMS 345, 350 (Franco Ferrari ed., 2008) (citing Peter Schlechtriem, *10 Jahre CISG – Der Einfluß des UN-Kaufrechts auf die Entwicklung des deutschen und des internationalen Schuldrechts*, 1 INTERNATIONALES HANDELSRECHT 12 (2001); Jochen Glöckner, *Die Umsetzung der Verbrauchsgüterkaufrichtlinie in Deutschland und ihre Konkretisierung durch die Rechtsprechung*, 62 JURISTENZEITUNG 652, 654 (2007); Rolf Herber, *The German Experience*, in The 1980 Uniform Sales Law: Old Issues Revisited in the Light of Recent Experiences 59 (Franco Ferrari ed., 2003).

<sup>160</sup> See Justus Meyer, *UN-Kaufrecht in Der Deutschen Anwaltspraxis*, 69 RABEL J. COMP. & INT’L PRIV. L. 457, 458 (2005); Martin F. Koehler and Guo Yujun, *The Acceptance of the Unified Sales Law (CISG) in Different Legal Systems*, 20 PACE INT’L L. REV. 45, 45 (2008).

<sup>161</sup> Based on a database created on January 25, 2016, Germany had total 534 CISG cases reported. *CISG Database: Country Case Schedule*, PACE L. SCH. INST. INT’L COM. L., <http://www.cisg.law.pace.edu/cisg/text/casedit.html> (last updated Jan. 25, 2016).

<sup>162</sup> Ulrich Magnus, *Country Reports: Germany*, in THE CISG AND ITS IMPACT ON NATIONAL LEGAL SYSTEMS, *supra* note 154, at 143, 146.

<sup>163</sup> Bergsten, *supra* note 157, at 17.

<sup>164</sup> Though there has been some support for accession. See Henning Lutz, *The CISG and Common Law Courts: Is There Really a Problem?*, 35 VICTORIA U. WELLINGTON L. REV. 711, 726, n.77 (2004).

<sup>165</sup> Monica Kilian, *CISG and the Problem with Common Law Jurisdictions*, 10 J. TRANSNAT’L L. & POL’Y, 217, 233 (2001).

Furthermore, the parallel model recognizes that the implementation process of an international law into a national legal system is not as simple practically as it is theoretically. In the same way an organ is being transplanted from a healthy human body to a sick human body, a new set of rules would have to be incorporated into a country's legal system.<sup>166</sup> That is the reason why these rules are called legal transplants; nevertheless, as a human body may reject such a transplant as incompatible, so too may a domestic legal system reject such international rules as wholly foreign and incompatible.<sup>167</sup>

In this article three major legal transplants' theorists were considered; Legrand, Watson and Teubner.<sup>168</sup> According to Legrand's theory, when a statute is being transplanted from one state to the next, it has to be translated, which naturally alters the meaning.<sup>169</sup> Legrand theorizes that when a rule is being transposed into a legal system, it becomes different and that people will understand it differently as well, that is why he steadfastly believes that legal transplants are impossible.<sup>170</sup> Watson, on the other hand, considers that legal transplants are indeed possible and he exemplifies his opinion through paradigms.<sup>171</sup> Teubner's opinion regarding legal transplants varies from both Legrand's and Watson's; he in fact chooses to portray a set of foreign rules as an 'irritant' rather than a transplant.<sup>172</sup> Pursuant to Teubner, the outcome of transferring a legal notion from one mechanism into another cannot be predicted, as the structural pairing will be altered.<sup>173</sup> Despite the fact that all three legal transplants theorists have made fundamental contributions to the translatability argument, the author agrees with certain characteristics of all three theories. To be more precise, the parallel model shares the same viewpoint with Watson, in that transplants are possible and that the success of a legal transplant relies mainly on the recipient State's need for the foreign legal rule.<sup>174</sup>

Finally, the author is aware that the parallel model will be criticised on two major grounds; its similarity to the current UK approach towards the CISG and the fact that the absolute freedom of contract may prove to be problematic. The parallel model's proposal might make someone question whether there is a significant reason to transform the CISG through this model as the UK current approach towards the CISG

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<sup>166</sup> See Brants, *supra* note 120, at 110.

<sup>167</sup> See *id.*

<sup>168</sup> See *infra* Section 6.

<sup>169</sup> Legrand, *supra* note 121, at 117.

<sup>170</sup> *Id.*

<sup>171</sup> Watson, *supra* note 119.

<sup>172</sup> See generally Teubner, *supra* note 128.

<sup>173</sup> *Id.* at 12.

<sup>174</sup> Antoni Vaquer, *Verwirkung versus Laches: A Tale of Two Legal Transplants*, 21 TUL. EUR. & CIV. L. F. 53, 72 (2006) (citing ALAN WATSON, LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW 57, 88 (2d ed. 1993)).

appears to be very similar. Nevertheless, if one examines in depth the parallel model's proposal, the conclusion would be that simply letting the traders to opt in the CISG whenever they wish is very different from passing legislation on the matter.

The first rationale why the parallel model would be more advantageous for the UK than the current approach is that there is a comparison to the New Zealand and German CISG experiences. Germany had been quite effective in the international application of the UN Convention, since for a considerable time German courts played a chief role in the resolution of cases vis-à-vis the CISG.<sup>175</sup> In 2000 one third of the six hundred CLOUT reported cases were of German derivation.<sup>176</sup> Therefore, it should not come as a surprise that several other jurisdiction courts have mentioned and embraced German CISG judgments when employing the UN Convention.<sup>177</sup> Moreover, an important reason for embracing New Zealand's approach to a considerable extent is that New Zealand deems the application of international law for the development of the common law, in a way akin to the approach taken in the UK.<sup>178</sup> As an example, the introduction of the international law of human rights has played a very significant role in the New Zealand domestic legal system, following the ratification of the Bill of Rights Act in 1990.<sup>179</sup> That particular Act offered an influential statutory model for the UK Human Rights Act 1998.<sup>180</sup> It is obvious that New Zealand, as a common law State, has in the past played a noteworthy role as a model for the UK (and vice-versa). In this way the UK may adopt and adjust New Zealand's actions, as to how to put into operation the CISG, which is quite similar to this thesis' parallel model.<sup>181</sup>

This comparison will serve in predicting and controlling the outcome of the UK incorporating the CISG. The collecting of facts and information gained through comparative law can act as a crucial bridge to a foreign legal instrument.<sup>182</sup> In this case the knowledge gathered from the New Zealand and German experience can be applied to the UK CISG

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<sup>175</sup> See *CISG Database: Country Case Schedule*, *supra* note 161 (showing total 534 CISG cases reported in Germany as of January 25, 2016).

<sup>176</sup> Magnus, *supra* note 162, at 143.

<sup>177</sup> *Id.* (citing *Med. Mktg. Int'l, Inc. v. Internazionale Medico Scientifica*, No. CIV. A. 99-0380, 1999 WL 311945 (E.D. La. May 17, 1999) (stating that, under the CISG, a finder of fact has a duty to regard the "international character" of the convention and to promote uniformity in its application)).

<sup>178</sup> Michael Kirby, *The Common Law and International Law - A Dynamic Contemporary Dialogue*, 30 LEGAL STUD. 30, 33 (2010) (citing *Ministry of Transp. v. Noort* [1992] 3 NZLR 260 (CA); *Police v. Curran* [1992] 3 NZLR 260, 286 (CA); *Tavita v. Minister of Immigration* [1994] 2 NZLR 257 (CA)).

<sup>179</sup> *Id.*

<sup>180</sup> *Id.* at 31-33.

<sup>181</sup> See generally *Sale of Goods (United Nations Convention) Act 1994* (N.Z.).

<sup>182</sup> Eberle, *supra* note 141, at 456.

ratification, helping illuminate different angles that may lead to a deeper comprehension of the CISG.<sup>183</sup>

It is also noteworthy to take into account that legislative recognition of the CISG by the UK would lead to a widespread acceptance of the Convention by the UK traders. It is rather obvious that the Parliament's negative stance towards the CISG has deprived traders from applying it to their transactions.<sup>184</sup> Consequently, passing legislation on the matter would in due course lead to the creation of more case law and to a more concrete legal certainty regarding the CISG.

The parallel model might be criticised on the ground that it gives prominence to the freedom of contract as this notion has come under a critical gaze in the UK.<sup>185</sup> Certain statutory legislation has been launched which might act as an obstacle on such freedom of options.<sup>186</sup> There are a number of paradigms of legislative intervention interfering with the freedom of contract and a broad range of legislation was passed that helped modifying the laws of contract, including the Sale of Goods Act of 1979 and the Unfair Contract Terms Act of 1977.<sup>187</sup> Moreover, the majority of economists believe that following the ultimate freedom of contract approach would in the long run result in market failure.<sup>188</sup> The main reason for the market failure being that freedom of contract without any sort of control or limitation would only operate properly in a perfectly efficient market.<sup>189</sup> However, following the enactment of the CISG through the parallel model, the trader would play the leading role. Therefore, a balance between minimum government intervention and freedom of contract would exist.

Freedom of contract may be maintained to a great degree in the parallel model by granting the trader a principal part that would be, to some extent, regulated only during the consultation and enactment of the CISG Act, where the government would have the duty of the decision maker. In addition, freedom of contract is a very practical principle; as it is the unavoidable complement of a free business structure.<sup>190</sup> Consequently, the parallel model clearly operates in the premises of *laissez faire* and individuality.<sup>191</sup>

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<sup>183</sup> John C. Reitz, *How to Do Comparative Law*, 46 AM. J. COMP. L. 617, 621 (1998).

<sup>184</sup> See Sally Moss, *Why the United Kingdom Has Not Ratified the CISG*, 25 J. L. COM. 483, 483-85 (2005).

<sup>185</sup> See generally Wilhelmsson, *supra* note 110.

<sup>186</sup> *Id.* at 52.

<sup>187</sup> *Id.* at 53.

<sup>188</sup> COLLINS, *supra* note 112, at 25-26.

<sup>189</sup> HAGIN, *supra* note 114, at 11-13.

<sup>190</sup> Friedrich Kessler, *Contracts of Adhesion - Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 630 (1943).

<sup>191</sup> See Adam Smith, *Free Trade International Theory*, ECON. THEORIES (July 2, 2008), <http://www.economictheories.org/2008/07/adam-smith-free-trade-international.html>.

# PATENT PROTECTION REGULATION AND THE RIGHT TO HEALTH: RIPE FOR DISCUSSION IN RENEGOTIATING KORUS-FTA

Aerin Kim\*

## I. INTRODUCTION

It is uncontested that pharmaceutical companies provide enormous public benefits through innovative technologies and drugs.<sup>1</sup> Pharmaceutical companies protect their products, developed through extensive research and development (R&D), through patents.<sup>2</sup> However, patent protection may be utilized to advance the wealth of inventors and pharmaceutical companies while ignoring the consumers' need for affordable and accessible patented medicines.<sup>3</sup> Some consequences consumers bear include denial of innovative medical discoveries, a requirement to pay more to acquire available drugs, and usage of drugs of a less reliable company.<sup>4</sup> In the field of health, however, generic drugs<sup>5</sup> are essential to treating a wide variety of diseases.<sup>6</sup> Despite the ongoing concerns of intellectual property rights restricting access to price-lowering generic drugs,<sup>7</sup> the United States government has been imposing aggressive patent protection regulations.<sup>8</sup>

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<sup>1</sup> Amanda Fachler, *The Need for Reform in Pharmaceutical Protection: The Inapplicability of the Patent System to the Pharmaceutical Industry and the Recommendation of a Shift towards Regulatory Exclusivities*, 24 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 1059, 1060-61 (2014).

<sup>2</sup> INT'L TRADE ADMIN., U.S. DEP'T OF COMMERCE, 2016 TOP MARKETS REPORT PHARMACEUTICALS – OVERVIEW AND KEY FINDINGS 1 (2016).

<sup>3</sup> Amir H. Khoury, *The Public Health of the Conventional International Patent Regime and the Ethics of Ethics: Access to Patented Medicines*, 26 CARDOZO ARTS & ENT. L.J. 25, 48-49 (2008).

<sup>4</sup> Fachler, *supra* note 1, at 1062.

<sup>5</sup> Generic drugs are medications “created to be the same as an existing approved brand-name drug in dosage form, safety, strength, route of administration, quality, and performance characteristics.” They cost less than the brand-name medicines because generic drugs don’t require animal and clinical studies that brand-name medicines needed to show safety and effectiveness. *Generic Drug Facts*, U.S. FOOD & DRUG ADMIN., (Oct. 6, 2017), <https://www.fda.gov/Drugs/ResourcesForYou/Consumers/BuyingUsingMedicineSafely/GeneriCDrugs/ucm167991.htm> (last updated June 4, 2018).

<sup>6</sup> *Spotlight on: Trans-Pacific Partnership Agreement*, MÉDECINS SANS FRONTIÈRES (MSF) ACCESS CAMPAIGN, <https://msfaccess.org/spotlight-trans-pacific-partnership-agreement> (last updated June 2018).

<sup>7</sup> “Doctors Without Borders/Médecins Sans Frontières (MSF) expressed serious concern about the inclusion of dangerous provisions that would dismantle public health safeguards enshrined in international law and restrict access to price-lowering generic medicines for millions of people . . . governments have long recognized the need to balance public health interests with intellectual property demands when negotiating trade agreements.” *Id.*

<sup>8</sup> *Id.*

Aggressive patent protection regulations lead to extended patent monopolies and delayed generic competition, which then is followed by higher prices of lifesaving medicines.<sup>9</sup> Thus, whether intended or not, the government may be favoring the private interest of pharmaceutical companies over the public health interests through patent protection regulations.<sup>10</sup>

This issue has once again come to light as the Trump Administration's "Drug Pricing and Innovation Working Group" (Group) discussed an executive order on the cost of pharmaceuticals in June of 2017.<sup>11</sup> During the meeting, the Group proposed "extending the patent life of drugs in foreign markets to 'provide for protection and enforcement of intellectual property rights.'"<sup>12</sup> Doing so would ensure "that American consumers do not unfairly subsidize research and development for people throughout the globe."<sup>13</sup> However, extending the patent life of drugs causes disparities in access to such drugs in countries around the globe.<sup>14</sup> Further, such policy may impact the United States as well.<sup>15</sup> As such, the United States' attempt to control drug prices could end up hurting the interests of its own.

The Group's discussion of a patent extension was not something unexpected. The U.S. government has long been promoting stronger patent protection for drugs in foreign markets.<sup>16</sup> Most recently, the United States pushed to revise the relevant provisions in the Korea-US Free Trade Agreement (KORUS-FTA).<sup>17</sup> During a special session of the Joint KORUS-

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> Emily Kopp, *Exclusive: White House Task Force Echoes Pharma Proposals*, KAISER HEALTH NEWS (June 16, 2017), <http://khn.org/news/exclusive-white-house-task-force-echoes-pharma-proposals/>.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> "From 2010 to 2016, the US FDA approved 56 novel cancer drugs, an astonishing wave of innovation, ... Of these, zero are included in the WHO list of essential medicines because they are too expensive for countries with limited resources ... A recent study by EY Poland of 30 important cancer drugs found that only two of the 30 were routinely available for reimbursement in Poland and the Czech Republic, while 30 of 30 were routinely reimbursed in the Netherlands, and 28 of 30 were reimbursed in Switzerland. In the UK, just half were routinely reimbursed." James Love, *Trump's Executive Order on Drug Prices Might Be More in Favour of Drug Companies*, THE WIRE (June 22, 2017), <https://thewire.in/external-affairs/trump-drug-prices-pharma-companies>.

<sup>15</sup> Some of the arguments raised in response to the Group's discussion are: (1) promoting strong monopolies in foreign markets also lead to strong monopolies in the U.S. market; (2) foreign nations will likely propose other trade policies in return of an aggressive patent protection enforcement policy; and (3) U.S. patients will not be able to travel abroad to get an affordable treatment as the prices will be high around the globe. *Id.*

<sup>16</sup> Ruth Lopert & Deborah Gleeson, *The High Price of Free Trade: U.S. Trade Agreements and Access to Medicines*, 41 J.L. MED. & ETHICS 199, 199 (2013).

<sup>17</sup> Gye-wan Cho, *Pharmaceutical prices, intellectual property rights emerge as key issues in KORUS FTA discussions*, THE HANKYOREH (Aug. 24, 2017), [http://english.hani.co.kr/arti/english\\_edition/e\\_business/808169.html](http://english.hani.co.kr/arti/english_edition/e_business/808169.html).

FTA Committee on August 22, 2017, the U.S. Trade Representative, Robert Lighthizer, sought to “strategically promote American interests in various categories,” including American pharmaceutical prices and intellectual property rights.<sup>18</sup> Lighthizer argued that the American pharmaceutical companies cannot make maximum profit from patented drugs under the current KORUS-FTA regulations.<sup>19</sup>

This Comment will discuss how the United States government’s regulation on drug-price control through patent protection could harm public health, the economy, and the development of innovative drugs. Part I of this Comment will provide background information on various types of agreements the United States have utilized for trade regulations and will specifically review KORUS-FTA. Part II of this Comment will explore how aggressive patent protection could benefit the American pharmaceutical companies at the cost of public health interests. Finally, Part III of this Comment will review previously proposed solutions to balance the private and public interests and conclude with a revised solution that would encourage the development of innovative drugs while discouraging drug monopolies. Part III will conclude with a brief analysis of the amended KORUS-FTA and a discussion on why the United States must choose negotiation over the withdrawal of the Agreement.

## II. BACKGROUND

The World Trade Organization (WTO) provides a forum for member nations to negotiate, sets out trade rules around the world, and assists in settling disputes.<sup>20</sup> Member nations under WTO Agreement cannot discriminate between trading partners.<sup>21</sup> One exception to the previous statement is when nations set up a free trade agreement (FTA) that applies only to the goods traded between each other.<sup>22</sup> FTAs allow countries to impose certain tax obligations regarding trade in goods and services.<sup>23</sup> Pharmaceuticals, however, are different from other trading goods as countries do not impose extensive tax obligations.<sup>24</sup> Statistics have shown that “FTAs don’t result in a major reduction of import taxes for the

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<sup>18</sup> *Id.*

<sup>19</sup> “Korean pharmaceuticals that fall under the national health insurance plan are effectively cheaper than their American counterparts, which naturally increases the demand for domestic drugs and thereby prevents American pharmaceutical companies from fully profiting from patent drugs under the current trade agreement.” *Id.*

<sup>20</sup> *What is the World Trade Organization?* WTO, [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact1\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact1_e.htm) (last visited Oct. 11, 2018).

<sup>21</sup> ALLEN B. GREEN, INTERNATIONAL GOVERNMENT CONTRACT LAW § 2:34 (2017).

<sup>22</sup> *Id.*

<sup>23</sup> *U.S. Free Trade Agreements*, EXPORT.GOV, <https://2016.export.gov/fta/> (last updated Jan. 24, 2017).

<sup>24</sup> Kellie Gryga, *How FTAs Affect the Pharmaceutical Industry: A Discussion About TRIPS*, THOMSON REUTERS (Apr. 7, 2017), <https://tax.thomsonreuters.com/blog/onesource/how-ftas-affect-the-pharmaceutical-industry-a-discussion-about-trips/>.

pharmaceutical industry.”<sup>25</sup> How FTAs impact pharmaceutical industry is through intellectual property (IP) regulation.<sup>26</sup> Two main ways to enforce IP regulations are: by provisions embedded in bilateral or multilateral FTAs or through the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).<sup>27</sup> The following subsection will provide overviews of how IP rights are regulated through FTAs and TRIPS. Further, FTA at issue in this Comment, KORUS-FTA, will be reviewed, focusing on its provisions for pharmaceutical products and IP rights.

#### A. *Intellectual Property Regulations through TRIPS*

WTO covers three broad areas of trade – goods, services, and intellectual property.<sup>28</sup> The TRIPS Agreement governs IP rights of the WTO Member-countries.<sup>29</sup> Ever since 1995 when the TRIPS Agreement began its enforcement, it has impacted the pharmaceutical sector and access to medicines.<sup>30</sup>

Before the TRIPS Agreement, over 40 countries in the world did not grant patent protection for pharmaceutical products.<sup>31</sup> Even in those countries that granted patent protection, the duration of such protection was significantly shorter compared to the protection duration under the TRIPS Agreement.<sup>32</sup> The lack of regulation became problematic as IP grew its importance in trade.<sup>33</sup> Without patent protection, inventors could not prevent others from using their patented inventions.<sup>34</sup> Inventors were discouraged from creating more ideas as they were not getting paid or credited for their products.<sup>35</sup> For instance, an inventor from the United States did not have any right over a patented drug in overseas, so an inventor from another country could freely create copies of that patented

<sup>25</sup> “According to statistics from the World Health Organization (WHO), ... ninety percent of nations apply less than 10 percent tariff rates on medicines and that pharmaceutical tariffs generate less than 0.1 percent of Gross Domestic Product (GDP) in 92 percent of countries for which data is available.” *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Overview: a navigational guide*, WTO,

[https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm1\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm1_e.htm) (last visited Oct. 1, 2018).

<sup>29</sup> *Intellectual property: Protection and Enforcement*, WTO,

[https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/agrm7\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm7_e.htm) (last visited Oct. 2, 2018).

<sup>30</sup> *WTO and the TRIPS Agreement*, WHO,

[http://www.who.int/medicines/areas/policy/wto\\_trips/en/](http://www.who.int/medicines/areas/policy/wto_trips/en/) (last visited Oct. 1, 2018).

<sup>31</sup> *Id.*; see also WHO, *Access to Medicines, Intellectual Property Protection: Impact on Public Health*, 19 WHO DRUG INFO. 236, 238 (2005) (available at <http://www.who.int/entity/medicines/areas/policy/AccessstoMedicinesIPP.pdf?ua=1>).

<sup>32</sup> WHO, *Access to Medicines, Intellectual Property Protection: Impact on Public Health*, *supra* note 31, at 238.

<sup>33</sup> See *Intellectual property: Protection and Enforcement*, *supra* note 29.

<sup>34</sup> See *id.*

<sup>35</sup> *Cf. id.*

drug.<sup>36</sup> The need for internationally-agreed trade rules for IP rights became clear, “as a way to introduce more order and predictability, and to settle disputes more systematically.”<sup>37</sup> Thus, in 1995, the TRIPS Agreement came into effect to set out minimum standards of patent protection, to enforce domestic procedures and remedies of IP rights, and to settle disputes between WTO members concerning the TRIPS obligations.<sup>38</sup>

There are three key provisions of TRIPS that impact the pharmaceutical industry. First, WTO members are required to provide patent protection for a minimum term of 20 years from the filing date of a patent application for an invention.<sup>39</sup> Second, WTO members are required to “protect undisclosed test data, submitted to drug regulatory authorities for the purposes of obtaining marketing approval, against unfair commercial use.”<sup>40</sup> Lastly, the TRIPS Agreement provides “for transition periods, permitting developing countries additional time to bring national legislation and practices into conformity with TRIPS provision.”<sup>41</sup>

Through such provisions, the TRIPS Agreement sought to promote the adequate and effective protection of IP rights.<sup>42</sup> However, there were two different views on its purpose and consequence. Developed countries defended strong regulation of IP rights and promoted patent protections, whereas developing countries opposed such regulations and promoted free trade.<sup>43</sup> Developed countries argued that the TRIPS Agreement “would stimulate technology and foreign direct investment flows to developing countries, therefore promoting their participation in trade and economic development.”<sup>44</sup> The developing countries, however, viewed the TRIPS Agreement as “a list of demands of the wealthier nations especially aimed at them.”<sup>45</sup> Those countries argued that strong IP rights regulation would

<sup>36</sup> German Velasquez & Pascale Boulet, *Globalization and Access to Drugs: Perspectives on the WTO/TRIPS Agreement*, WHO, 1, 15, 19-20 (1999) (available at <http://www.who.int/entity/medicines/areas/policy/who-dap-98-9rev.pdf?ua=1>).

<sup>37</sup> *Intellectual property: Protection and Enforcement*, *supra* note 33.

<sup>38</sup> *Overview: the TRIPS Agreement*, WTO, [https://www.wto.org/english/tratop\\_e/trips\\_e/intel2\\_e.htm](https://www.wto.org/english/tratop_e/trips_e/intel2_e.htm) (last visited Sept. 30, 2018).

<sup>39</sup> WHO, *Access to Medicines, Intellectual Property Protection: Impact on Public Health*, *supra* note 32, at 238.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at 239.

<sup>42</sup> “Members, desiring to reduce distortions and impediments to international trade and taking into account the need to promote effective and adequate protection of intellectual property rights, and to ensure that measures and procedures to enforce intellectual property rights do not themselves become barriers to legitimate trade.” TRIPS: Agreement on Trade-Related Aspects of Intellectual Property Rights pmbl., Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, 1869 U.N.T.S. 299.

<sup>43</sup> Baskaran Balasingham, *Trade in Pharmaceuticals Under the TRIPS Agreement*, 11 U. C. DUBLIN L. REV. 1, 4-5 (2011).

<sup>44</sup> *Id.* at 5.

<sup>45</sup> Marco C. E. J. Bronckers, *The Impact of TRIPS: Intellectual Property Protection in Developing Countries*, 31 COMMON MARKET L. REV. 1245, 1246 (1994).

give them minimal benefit and hinder economic development as they had to pay developed countries for the use of their inventions.<sup>46</sup>

Putting economic concerns aside, both developing and developed countries saw the need to reform the TRIPS Agreement for serious public health issues.<sup>47</sup> Notably, developing countries could not access imported medicines for HIV and AIDS.<sup>48</sup> Thus, in 2001, the WTO members met in Doha, Qatar to redress the impact of the TRIPS Agreement on access to medicines and public health crisis in developing countries.<sup>49</sup> Through the Doha Declaration, the WTO members agreed on various measures to restate “the primacy of health over commercial interests.”<sup>50</sup> Despite the Declaration and developing countries’ continued efforts to resolve the access to medicine and public health crisis, developed countries, including the United States, began using bilateral and multilateral agreements and the “TRIPS-plus” provisions to enact even stronger IP rights regulations.<sup>51</sup>

### *B. The Free Trade Agreement and the TRIPS-Plus Provisions*

FTAs are agreements between two or more countries that establish certain obligations for the trade of goods and services and protect IP rights.<sup>52</sup> FTAs are considered one of the best approaches to trade liberalization.<sup>53</sup> FTAs “reduce barriers to U.S. exports, and protect U.S. interests and enhance the rule of law in the FTA partner country.”<sup>54</sup> The reduction of barriers and creation of a stable and transparent trading environment makes it easier and cheaper for U.S. companies to export their products and services.<sup>55</sup>

<sup>46</sup> *Id.* at 1247.

<sup>47</sup> See generally Andrew D. Mitchell & Tania Voon, *Patents and Public Health in the WTO, FTAs and beyond: Tension and Conflict in International Law*, 43 J. WORLD TRADE 571, 572 (2009).

<sup>48</sup> *Id.* at 571.

<sup>49</sup> *Spotlight on: TRIPS, TRIPS Plus, and Doha*, Médecins Sans Frontières (MSF) Access Campaign, <https://www.msfacecess.org/content/trips-trips-plus-and-doha> (last visited Oct. 2, 2018).

<sup>50</sup> “The Doha Declaration reaffirmed countries’ right to use TRIPS safeguards such as compulsory licences or parallel importation to overcome patent barriers to promote access to medicines, and guided countries in their use. One final significant achievement of Doha was to extend the deadline by which the least developed countries had to grant and enforce pharmaceutical patents, from 2006 to 2016. This deadline needs to be further extended or they will face the same difficulties that other developing countries already contend with in accessing medicines.” *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *U.S. Free Trade Agreements Overview*, What is an FTA Negotiated by the United States? INT’L TRADE ADMIN., <https://www.export.gov/article?id=U-S-Free-Trade-Agreements-Introduction> (last updated Mar. 14, 2018).

<sup>53</sup> See David A. Gantz, *Introduction to U.S. Free Trade Agreements*, 5 BRIT. J. AM. LEGAL STUD. 299, 300 (2016); see also *Free Trade Agreements*, INT’L TRADE ADMIN., <https://www.trade.gov/fta/> (last visited Oct. 2, 2018).

<sup>54</sup> *Free Trade Agreements*, *supra* note 53.

<sup>55</sup> *Id.*

Following the Doha Declaration, the United States began to enact provisions in FTAs to negotiate higher levels of IP protection with its FTA partners.<sup>56</sup> Such provisions are known as “TRIPS-plus” provisions.<sup>57</sup> These provisions require strengthening IP rights beyond the requirements of the TRIPS Agreement.<sup>58</sup> The United States, to protect its domestic interests, implements TRIPS-plus provisions in the following form: “(a) inclusion of new areas of IPRs [intellectual property rights]; or (b) implementation of more extensive levels or standards of IP protection than is required by TRIPS; or (c) elimination of an option or flexibility available under TRIPS.”<sup>59</sup> Since its first introduction, most FTAs signed and implemented by the United States<sup>60</sup> include the TRIPS-plus provisions.<sup>61</sup>

### C. KORUS-FTA and Its Provision on Intellectual Property Rights and Drugs

The United States-Korea Free Trade Agreement, KORUS-FTA, entered into force on March 15, 2012.<sup>62</sup> The purpose of KORUS-FTA was to strengthen and develop economic relations and to establish free trade through reduction of barriers in trading goods.<sup>63</sup> When KORUS-FTA was first introduced, it was publicized as “the United States’ most commercially significant free trade agreement in almost 20 years.”<sup>64</sup> One commentator stated, “KORUS set what at the time was the gold standard for 21st-century protections across a range of issues, including for intellectual property (IP) and competition.”<sup>65</sup>

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<sup>56</sup> Bryan Mercurio, *TRIPS-Plus Provisions in FTAs: Recent Trends*, in REGIONAL TRADE AGREEMENTS AND THE WTO LEGAL SYSTEM 219 (Lorand Bartels & Federico Ortino eds., 2006), available at <http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780199206995.001.0001/acprof-9780199206995-chapter-10>.

<sup>57</sup> *Spotlight on: TRIPS, TRIPS Plus, and Doha*, *supra* note 49.

<sup>58</sup> Mitchell & Voon, *supra* note 47, at 591.

<sup>59</sup> Mercurio, *supra* note 56, at 219.

<sup>60</sup> Currently, the United States has free trade agreements with the following twenty countries: Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, Singapore. *Free Trade Agreements*, U.S. TRADE REPRESENTATIVE, <https://ustr.gov/trade-agreements/free-trade-agreements#> (last visited Oct. 12, 2018).

<sup>61</sup> See generally Lopert & Gleeson, *supra* note 16.

<sup>62</sup> *Korea Overview*, Overview of the U.S.-Korea Free Trade Agreement, EXPORT.GOV, <https://www.export.gov/article?id=Korea-Overview> (last updated Mar. 22, 2018).

<sup>63</sup> *Korea Q&A*, Frequently Asked Questions About KORUS, EXPORT.GOV, <https://www.export.gov/article?id=Korea-Q-A> (last updated Mar. 22, 2018).

<sup>64</sup> *Fact Sheet: Benefits for the United States from the U.S.-Korea Trade Agreement*, U.S. TRADE REPRESENTATIVE, <https://ustr.gov/fact-sheet-benefits-united-states-us-korea-trade-agreement#> (last visited Oct. 12, 2018).

<sup>65</sup> Carla Hills, *US-South Korea trade deal must be held to its lofty standards*, THE HILL (Dec. 6, 2017, 12:40 PM) <http://thehill.com/opinion/finance/363531-us-south-korea-trade-deal-must-be-held-to-its-lofty-standards>.

KORUS-FTA sought to give the United States stronger protection and enforcement of IP rights in South Korea.<sup>66</sup> South Korea has “reduced tariffs, enhanced its regulatory transparency, and attracted further investment from multinationals” since KORUS-FTA.<sup>67</sup> To U.S. pharmaceuticals companies, South Korea became an attractive market, as its reliance on imported medicine increased under KORUS-FTA.<sup>68</sup> However, certain barriers impacted the export outlook for U.S. pharmaceutical companies.<sup>69</sup> As to the regulatory concerns, U.S. pharmaceutical companies argued that the South Korean government used subsidies, tax breaks, reimbursement policies, and intellectual property laws for its own domestic interest.<sup>70</sup>

As to the public health concerns, South Korea is expected to see an increase of aging population, due to a low fertility rate.<sup>71</sup> Such an increase in aging population “will sustain demand for pharmaceuticals given its high burdens of non-communicable diseases, such as heart disease, obesity, cancer and diabetes.”<sup>72</sup> Because South Korea has a relatively advanced domestic pharmaceutical industry dominated by large generics firms, such demand for pharmaceuticals may not necessarily mean increased demand for imported medicines.<sup>73</sup> With government policies encouraging the use of generic medicines,<sup>74</sup> the aging population is more likely to seek generic medicines rather than U.S. exported, expensive, medicines.

As to IP protection concerns, U.S. pharmaceutical companies have complained that South Korea’s efforts to weaken pharmaceutical patents has threatened U.S. companies’ ability to develop innovative medicines.<sup>75</sup> One commentator argued that South Korea has been failing to comply with its obligations under KORUS-FTA through various policies, such as exercising overly broad control over patient access to new medications and giving only a short amount of time to resolve a patent dispute.<sup>76</sup> With such policies, South Korea has failed in its promise for “fair, transparent,

<sup>66</sup> *Korea Overview*, *supra* note 62.

<sup>67</sup> INT’L TRADE ADMIN., U.S. DEP’T OF COMMERCE, 2016 TOP MARKETS REPORT PHARMACEUTICALS – COUNTRY CASE STUDY, SOUTH KOREA 3 (2016).

<sup>68</sup> *Id.* at 2.

<sup>69</sup> *See id.* at 3.

<sup>70</sup> “U.S. companies continue to raise concerns that, contrary to KORUS obligations, South Korean regulations relating to pricing and reimbursement of pharmaceutical products - such as continued price cuts on innovative drugs - do not appropriately recognize the value of innovation and lack transparency.” *Id.*

<sup>71</sup> The population over 65 is at 13.1 percent as of 2015, but is expected to increase to 15.8 percent by 2020. *Id.* at 2.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at 1.

<sup>74</sup> *Id.*

<sup>75</sup> James Edwards, *Calling out South Korean IP theft on fifth anniversary of trade deal*, WASHINGTON EXAMINER (Apr. 14, 2017, 12:01 AM), <http://www.washingtonexaminer.com/calling-out-south-korean-ip-theft-on-fifth-anniversary-of-trade-deal/article/2620270>.

<sup>76</sup> *Id.*; *see also* Hills, *supra* note 65.

predictable, and honest dealings.”<sup>77</sup> The commentator further argued that South Korea’s unfulfilled promise impacts not only U.S. pharmaceutical companies but also average Americans as it will eventually lead to job shortage.<sup>78</sup>

For the above reasons and other issues that the United States had observed since the enactment of the Agreement, the U.S. government and trade administrations sought reconsideration of the Agreement.<sup>79</sup> The new administration under President Trump criticized the Agreement for falling short of being mutually beneficial.<sup>80</sup> The Agreement was not acclaimed in South Korea either,<sup>81</sup> and the Korean government was not delighted to see the U.S. government trying to abolish the Agreement after long years of trying to enforce it.<sup>82</sup> After more than a year of continued efforts to come to an agreement,<sup>83</sup> the two countries will be signing an amended KORUS-FTA at the end of September 2018.<sup>84</sup>

### III. PATENT SYSTEM AND THE PHARMACEUTICAL INDUSTRY

Patents provide legal protection, ensuring that a pharmaceutical company is (1) compensated for its investments in R&D; and (2) made profitable by its competitive advantage in the form of exclusivity.<sup>85</sup> The process of getting patent approval may be costly and timely,<sup>86</sup> but it provides a company with billions of dollars to reinvest in developing other

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<sup>77</sup> Edwards, *supra* note 75.

<sup>78</sup> *Id.*

<sup>79</sup> Michelle Ye Hee Lee, *Trump wants to end ‘horrible’ South Korea-U.S. trade deal. Koreans disagree.*, WASH. POST (Sept. 14, 2017), [https://www.washingtonpost.com/world/trump-wants-to-end-horrible-south-korea-us-trade-deal-koreans-disagree/2017/09/13/fb528b3e-9627-11e7-a527-3573bd073e02\\_story.html?utm\\_term=.15f29256d3a2](https://www.washingtonpost.com/world/trump-wants-to-end-horrible-south-korea-us-trade-deal-koreans-disagree/2017/09/13/fb528b3e-9627-11e7-a527-3573bd073e02_story.html?utm_term=.15f29256d3a2); Shihoko Goto, *Attacking KORUS is Worse than Abandoning TPP*, THE DIPLOMAT (Sept. 29, 2017), <https://thediplomat.com/2017/09/attacking-korus-is-worse-than-abandoning-tpp>.

<sup>80</sup> Lee, *supra* note 79.

<sup>81</sup> Of the Koreans who were asked about their opinions on KORUS-FTA, 65% did not support the renegotiation of KORUS-FTA. Seung-woo Kang, *2 out of 3 Koreans disapprove of KORUS FTA renegotiation*, THE KOREA TIMES [https://www.koreatimes.co.kr/www/biz/2017/11/367\\_238541.html](https://www.koreatimes.co.kr/www/biz/2017/11/367_238541.html) (last visited Oct. 2, 2018).

<sup>82</sup> Lee, *supra* note 79.

<sup>83</sup> Stuart Anderson, *Evidence That U.S. Trade Policy Could Grow Worse*, FORBES (Aug. 17, 2018, 12:04 AM), <https://www.forbes.com/sites/stuartanderson/2018/08/17/evidence-that-u-s-trade-policy-could-grow-worse/#6711260d2730>.

<sup>84</sup> Suk-yeo Jung, *Revised KORUS FTA Expected to be Signed Late This Month*, BUSINESS KOREA (Sept. 7, 2018), <http://www.businesskorea.co.kr/news/articleView.html?idxno=24902>.

<sup>85</sup> Fachler, *supra* note 1, at 1066.

<sup>86</sup> *Id.* at 1064-1065 (explaining that the process of getting a patent grant followed by FDA approval can take up to fourteen years, and the average cost-per-drug for new-drug development may cost more than \$802 million).

new products.<sup>87</sup> Thus, patent protection is crucial for pharmaceutical companies to ensure that they have what is necessary to promote further innovation in disease prevention and treatment.

Further, there are ethical justifications for why strong patent protection is necessary. Patent protection helps inventors to produce socially valuable goods, pharmaceuticals, that would not otherwise exist.<sup>88</sup> First, inventors deserve to have property rights for creating new products through their labor.<sup>89</sup> IP rights acknowledge inventors for the hard work they put in.<sup>90</sup> Also, IP rights give inventors control over the production of their self-expression.<sup>91</sup> Lastly, the government must promote consumer interests and consider “social and communal goals beyond wealth maximization” of inventors.<sup>92</sup> By granting patents, inventors will be incentivized to disseminate innovation to others, which will lead to consumer welfare through widespread access to new information and ideas.<sup>93</sup>

Undoubtedly, there are reasons for why the U.S. government seeks to promote strong IP rights and patent protection regulations. However, despite the clear benefit, there have been many concerns over how rigorous regulations threaten public health and access to medicines.<sup>94</sup> Thus, this subsection will consider the aspects of international trade provisions that have led to such criticism. Further, other techniques private organizations and the U.S. government have used to extend patent protection will be analyzed. This subsection will conclude with how IP rights intersect with public health and access to medicines.

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<sup>87</sup> Chandra Mohan SB, et al., *Patents - An Important Tool for Pharmaceutical Industry*, 2 RES. & REV.: J. PHARMACEUTICS & NANOTECHNOLOGY 12, 13 (2014) (available at <https://www.rroj.com/open-access/patents-an-important-tool-for-pharmaceutical-industry-12-16.pdf>).

<sup>88</sup> Sarah M. Dickhut, *Ethical and Procedural Barriers to Accessing Critical Medicines in Least Developed Countries: A Look at TRIPS and the Doha Documents*, 20 J. GENDER RACE & JUST. 209, 212 (2017).

<sup>89</sup> *Id.* at 214.

<sup>90</sup> *Id.*

<sup>91</sup> “[I]nventive effort is more than an expression of an individual’s preferences or superficial traits; rather ... control over and manipulation of physical objects and intellectual ideas is essential for self-actualization.” *Id.*

<sup>92</sup> *Id.* at 215.

<sup>93</sup> *Id.* at 216.

<sup>94</sup> Rohit Malpani, *All Costs, No Benefits: How TRIPS-Plus Intellectual Property Rules in the US-Jordan FTA Affect Access to Medicines*, 102 OXFAM BRIEFING PAPER 19 (2007), <https://www.oxfam.org/sites/www.oxfam.org/files/all%20costs.%20no%20benefits.pdf>.

### A. *TRIPS-Plus Provisions*

Since their enforcement, the TRIPS-plus provisions have been considered to be “a disastrous impact on access to medicines”<sup>95</sup> and have raised grave concern for public health.<sup>96</sup> The TRIPS-plus provisions extend patent terms for at least 20 years and compensate patent holders for ‘unreasonable’ delays caused by the regulatory authority during patent approval and registration.<sup>97</sup> Such enforcement of extensive IP protection impacts developing countries as they are hindered from having access to affordable drugs.<sup>98</sup>

Another common feature of the provisions is data exclusivity.<sup>99</sup> Under the data exclusivity provisions, pharmaceutical companies are allowed to keep their drugs’ safety and efficacy information confidential for a certain period.<sup>100</sup> Because of such confidentiality, other manufacturers, including generic drug manufacturer, cannot market their drugs as being equivalent to the original product.<sup>101</sup> Thus, while the data exclusivity provisions may protect the interests of pharmaceutical companies, they nonetheless delay entry of generic pharmaceutical products onto the market, which then impact developing countries’ access to affordable medicines.<sup>102</sup>

As explained above, the TRIPS-plus provisions in FTAs do not resolve the access to medicine and public health crisis in developing countries. This is problematic especially since such provisions are frequently enforced as a part of FTAs between developed and developing countries.<sup>103</sup> Therefore, developing countries, as they had done with the Doha Declaration, had tried to resolve the issue by opposing the provisions.<sup>104</sup> However, not every developing country was successful in addressing their concerns and reaching an agreement, albeit temporary, with developed countries.<sup>105</sup> Thus, scholars have suggested various methods

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<sup>95</sup> *Spotlight on: TRIPS, TRIPS Plus, and Doha*, *supra* note 49.

<sup>96</sup> Mitchell & Voon, *supra* note 47, at 592.

<sup>97</sup> Mercurio, *supra* note 56, at 229.

<sup>98</sup> “Obviously, once the patent for a pharmaceutical product has expired in a given country, companies in that country may manufacture and export or import off-patent versions of the product without violating the patent holder’s rights or needing to rely on compulsory licensing or the principle of international exhaustion. Extending the patent term delays this means of access to affordable medicines, a particular concern for developing countries.” Mitchell & Voon, *supra* note 47, at 592.

<sup>99</sup> *Spotlight on: TRIPS, TRIPS Plus, and Doha*, *supra* note 49.

<sup>100</sup> *Id.*

<sup>101</sup> Mitchell & Voon, *supra* note 47, at 592.

<sup>102</sup> *Id.* at 592-93.

<sup>103</sup> *Spotlight on: TRIPS, TRIPS Plus, and Doha*, *supra* note 49.

<sup>104</sup> For example, Brazil has refused “to accommodate US interests in the name of perceived economic gain in other areas” and has successfully lowered “the cost of several antiretroviral drugs by threatening to issue a compulsory licence if the manufacturer does not lower the price.” Mercurio, *supra* note 56, at 236-37.

<sup>105</sup> *Id.* at 237.

developed and developing countries should consider in negotiating and amending the provisions of FTAs.<sup>106</sup>

### *B. Other Strategies to Ensure Patent Protection*

Opponents of strong IP protection argue that favoring the private interests of pharmaceutical companies would harm overall public health, especially of developing countries, as medication would inevitably become more expensive.<sup>107</sup> Proponents of strong IP laws, however, view that the protection would allow “companies to maximize profits to further additional research and development efforts and increase shareholder returns.”<sup>108</sup> Further, it ensures that “individual firms can monopolize the manufacturing of specific drugs, controlling prices without fear of being undercut by the emergence of cheaper alternatives or generics.”<sup>109</sup> For such reasons, the United States and other developed countries have promoted stronger IP protection. Inclusions of TRIPS-plus provisions in FTAs was one of the strategies to strengthen IP rights and patent protection.<sup>110</sup> Additional methods used to ensure that inventors are protected and compensated with R&D investment funding include evergreening and statutory exclusivity.

#### *1. Evergreening*

Patent system provides inventors with rights to prevent others from “making, using, selling, or offering to sell” the patented drug in the United States.<sup>111</sup> Such rights can be reserved for twenty years, with a possible extension of time.<sup>112</sup> During this twenty-year period, the initial price of an innovative drug is raised to compensate for the expected profit that will be lost when the patent expires.<sup>113</sup> Further, companies boost the prices of their drugs as rivals enter the market to match the price of that rival drug or to make up for the profits lost to the rival.<sup>114</sup> This eventually leads to drug price inflation.<sup>115</sup>

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<sup>106</sup> See e.g., *Id.*; Mitchell & Voon, *supra* note 47, at 601.

<sup>107</sup> Brittany Whobrey, *International Patent Law and Public Health: Analyzing Trips' Effect on Access to Pharmaceuticals in Developing Countries*, 45 BRANDEIS L.J. 623, 625 (2007).

<sup>108</sup> *Id.*

<sup>109</sup> *Id.* at 624-25.

<sup>110</sup> See *supra* Part I, Section B. The Free Trade Agreements and the TRIPS-Plus Provisions.

<sup>111</sup> Emily K. White, *Killing U.S. Slowly: Curing the Epidemic Rise of Cancer Drug Prices*, 72 FOOD & DRUG L.J. 189, 202 (2017).

<sup>112</sup> *Id.*

<sup>113</sup> Benjamin E. Brown, *Decreasing Prescription Drug Prices: Can Effective Policy Incentivize Cooperation between Previously Antithetic Sectors*, 14 IND. HEALTH L. REV. 162, 169 (2017).

<sup>114</sup> *Id.* at 170.

<sup>115</sup> *Id.*

Moreover, through a practice known as “evergreening,” pharmaceutical companies extend the length of patent protection.<sup>116</sup> Evergreening is a practice through which companies or inventors obtain multiple patents on the same underlying product simply by adding new improvements to the invention, such as new uses, formulations, and methods of delivery.<sup>117</sup> Pharmaceutical companies engage in this practice for the “lifecycle management” of their products.<sup>118</sup> However, this practice is often considered as patent abuse.<sup>119</sup> According to a critique, “[e]vergreening refers to different ways wherein patent owners take undue advantage of the law and associated regulatory processes to extend their IP monopoly particularly over highly lucrative blockbuster drugs by filing disguised/artful patents on an already patent-protected invention shortly before expiry of the patent term.”<sup>120</sup> Thus, evergreening has been considered as a regulatory barrier to generic medicines in entering a pharmaceutical market.<sup>121</sup>

## 2. *Statutory Exclusivities*

Another way to delay generic medicines’ market entry is through statutory exclusivities.<sup>122</sup> Pharmaceutical companies may receive protection through the Food and Drug Administration (FDA) regulatory system.<sup>123</sup> FDA created “abbreviated pathways for the approval of drug products” through the Biologics Price Competition and Innovation Act of 2009 (BPCIA).<sup>124</sup> One of the critical components of BPCIA is the twelve-year statutory exclusivity provision.<sup>125</sup> BPCIA provides twelve years of exclusivity for inventors to reward their risk and capital investment in developing innovative medicines.<sup>126</sup> During the twelve-year period of data exclusivity, companies creating generic medicines are prohibited from using the original inventor’s data.<sup>127</sup>

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<sup>116</sup> White, *supra* note 111, at 203-04.

<sup>117</sup> *Id.* at 204.

<sup>118</sup> Cynthia M. Ho, *Should All Drugs Be Patentable: A Comparative Perspective*, 17 VAND. J. ENT. & TECH. L. 295, 348 (2015).

<sup>119</sup> Yahong Li, *Intellectual Property and Public Health: Two Sides of the Same Coin*, 6 ASIAN J. WTO & INT’L HEALTH L & POL’Y 389, 397 (2011).

<sup>120</sup> *Id.*

<sup>121</sup> Stephen R. Tully, *Free Trade Agreements with the United States: 8 Lessons for Prospective Parties from Australia’s Experience*, 5 BRIT. J. AM. LEGAL STUD. 395, 409 (2016).

<sup>122</sup> White, *supra* note 111, at 204.

<sup>123</sup> *Id.* at 202.

<sup>124</sup> *Implementation of the Biologics Price Competition and Innovation Act of 2009*, FDA, <https://www.fda.gov/drugs/guidancecomplianceregulatoryinformation/ucm215089.htm> (last updated Feb. 12, 2016).

<sup>125</sup> Felix Shin, *Leaping from the Patent Cliff into the Global Drug Gap: Overcoming Exclusivity to Provide Affordable Biosimilars*, 37 LOY. L.A. INT’L & COMP. L. REV. 419, 426 (2016).

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

The rationale behind this statutory exclusivity provision is to protect the inventor's original product, to recover R&D costs, and to profit from the product, just like patent protection.<sup>128</sup> However, such purpose nonetheless conflicts with public health, especially access to medicines. The exclusivity provision under BPICA "is intended to run in parallel and in addition to any patents that may apply to such approved biological pharmaceutical products."<sup>129</sup> Generic brand companies could end up waiting for twenty-three to twenty-eight years after the original inventor's product is introduced.<sup>130</sup> Thus, statutory exclusivities delay generic market entry, contributing to increased drug costs and inaccessibility of affordable drugs.<sup>131</sup>

### C. Public Health and Access to Medicines

TRIPS-plus provisions in FTAs and other practices described above have given pharmaceutical companies great power in protecting drug patents around the world.<sup>132</sup> Such protection tends to reduce foreign countries' ability to access patented drugs.<sup>133</sup> Therefore, developing countries, especially in response to the HIV/AIDS crisis, have searched for options to promote the generic industry and to keep drug prices down.<sup>134</sup> However, their attempts to provide better health care through affordable medicines have been opposed by big pharmaceutical companies and governments supporting a strong patent regime.<sup>135</sup>

Patent protection enforcement has been argued to be focused only on the economic interest of the innovators and developed countries. For example, one study suggested that TRIPS patent rules dramatically raise prices of patented medicine for developing countries and inhibit access to the newest drugs.<sup>136</sup> Further, as described above, strict patent protection enforcement often disallows the use of generic, affordable versions of patented medicines.<sup>137</sup> Having no access to the low-cost generic drugs is problematic for developing countries.<sup>138</sup> Access to affordable essential

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<sup>128</sup> *Id.* at 430.

<sup>129</sup> *Id.* at 429.

<sup>130</sup> *Id.*

<sup>131</sup> White, *supra* note 111, at 204.

<sup>132</sup> Khoury, *supra* note 3, at 32.

<sup>133</sup> *Id.* at 32-33.

<sup>134</sup> Amit Gupta, *Patent Rights on Pharmaceutical Products and Affordable Drugs: Can TRIPS Provide a Solution*, 2 BUFF. INTELL. PROP. L.J. 127, 128 (2004).

<sup>135</sup> Examples include: the pharmaceutical industry and the U.S. and the European Union opposing South Africa's efforts to provide cheap drugs; and the U.S. filing a complaint with the WTO in response to Brazil's patent legislation allowing local manufacturing of generic drugs. *Id.* at 128-29.

<sup>136</sup> Khoury, *supra* note 3, at 42.

<sup>137</sup> *Id.*

<sup>138</sup> "This problem is particularly potent for individuals in LDCs who need access to critical medicines (such as drugs for tuberculosis, HIV/AIDS, malaria, etc.) but cannot pay the competitive market price of those drugs." Dickhut, *supra* note 88, at 216.

medicines, also known as ‘right to health’<sup>139</sup> is a “fundamental part of human rights and of the understanding of life in dignity.”<sup>140</sup> As one of the essential human rights, most countries have acknowledged the need to consider this right when implementing their health care policies.<sup>141</sup> As such, the United Nations (UN) has published a list of obligations and responsibilities governments and private sectors must bear in regards to the right to health.<sup>142</sup>

Governments have three core minimum obligations: (1) the obligation to respect; (2) the obligation to protect; and (3) the obligation to fulfill.<sup>143</sup> Governments must not interfere directly or indirectly with the right to health, by denying or limiting access to health care services.<sup>144</sup> Governments must protect against third parties interfering with the right to health.<sup>145</sup> Their duties include: adopting “legislation or other measures to ensure that private actors conform with human rights standards when providing health care or other services;” controlling the marketing of medicines by private sectors; and ensuring “that privatization does not constitute a threat to the availability, accessibility, acceptability and quality” of goods.<sup>146</sup> Further, governments must adopt the necessary legislative, administrative, budgetary, judicial, and other measures to fully realize the right to health.<sup>147</sup> Lastly and most importantly, government parties must oblige to all of the above duties as to the right to health in other countries.<sup>148</sup>

UN further assigns other actors in society, including private companies, with responsibilities on the promotion and protection of human rights.<sup>149</sup> While acknowledging that pharmaceutical companies contribute positively to the enjoyment of the right to health, UN also acknowledges the possibility that those companies can harm the accessibility and affordability of health care.<sup>150</sup> Thus, companies have responsibilities for human rights, but UN did not assign specific responsibilities to private sectors.<sup>151</sup> It

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<sup>139</sup> “Article 25(1) of Universal Declaration of Human Rights (UDHR) affirms that “[e]veryone has the right to a standard of living adequate for the health of himself and of his family, including food, clothing, housing and medical care and necessary social services.” Drafters of the International Covenant on Economic, Social and Cultural Rights (ICESCR) phrased the right to health as the ‘the right of everyone to the enjoyment of the highest attainable standard of physical and mental health.’” Balasingham, *supra* note 43, at 16.

<sup>140</sup> *The Right to Health*, OFFICE OF THE U.N. HIGH COMM’R FOR HUMAN RTS & WHO 1, <http://www.ohchr.org/Documents/Publications/Factsheet31.pdf>.

<sup>141</sup> Balasingham, *supra* note 43, at 16.

<sup>142</sup> See generally *The Right to Health*, *supra* note 140.

<sup>143</sup> *Id.* at 25.

<sup>144</sup> *Id.*

<sup>145</sup> *Id.* at 26.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.* at 27.

<sup>148</sup> *Id.* at 26.

<sup>149</sup> *Id.* at 28.

<sup>150</sup> *Id.* at 30.

<sup>151</sup> *Id.*

follows that while governments must ultimately be accountable for any violations of human rights, private sectors should exercise due diligence “to become aware of, prevent and address adverse human rights impacts.”<sup>152</sup>

Therefore, while governments and pharmaceutical companies must ensure that inventors are incentivized and properly funded with R&D costs, they must also make sure that fundamental human rights are not violated. Such responsibilities further extend to the right of health in other countries as well.

#### IV. PREVIOUSLY SUGGESTED SOLUTIONS AND PROPOSED SOLUTION

As stated above, the patent law must provide incentives to inventors to continue innovation, but at the same time, it must not ignore public interests.<sup>153</sup> When implementing and enforcing regulations on IP protection, participating countries must consider incentives to the pharmaceutical industry to encourage R&D of new drugs.<sup>154</sup> The consideration, however, must not stop there but go beyond the interests of the patent holder and address public interests that could be overlooked.<sup>155</sup> Therefore, identifying the balance between the societal interests and the incentive to the innovators is imperative.<sup>156</sup> Such a balance is so imperative because medicines directly impact the lives of people.<sup>157</sup> Thus, inventors and patent holders have social responsibilities to be ethical and need to balance their private property rights with the public interest.<sup>158</sup> The following section will review several solutions that scholars have previously suggested and conclude with a proposed solution.

##### A. *Previously Suggested Solutions*

###### 1. *Statutory Exclusivities*

Commentators suggest that participating countries of FTAs negotiate differential pricing<sup>159</sup> structures “based on a formula that considers per capita income, government resources, and the severity of the

<sup>152</sup> Dickhut, *supra* note 88, at 219.

<sup>153</sup> Gupta, *supra* note 134, at 151.

<sup>154</sup> *Id.*

<sup>155</sup> *Id.* at 152.

<sup>156</sup> Balasingham, *supra* note 43, at 4.

<sup>157</sup> Khoury, *supra* note 3, at 45.

<sup>158</sup> Khoury, *supra* note 3, at 45–46 (citing Angela R. Riley, *Indigenous Peoples and the Promise of Globalization: An Essay on Rights and Responsibilities*, 14 KAN. J.L. & PUB. POL'Y 155, 163 (2004)).

<sup>159</sup> Kayode Ibrahim Adam & Adaji Elejo Aishatu, *The Implications of Intellectual Property Rights on Access to Medicine in Africa: Nigerian Patent Act in Perspective*, 7 YONSEI L.J. 53, 86 (2016) (This framework is also known as “tiered pricing” or “price discrimination.”).

need for immediate access to medication.”<sup>160</sup> This framework, while already in practice, favors wealthy states.<sup>161</sup> The government should compensate any loss from differential pricing through subsidies.<sup>162</sup> In support of differential pricing framework, another commentator states that it would make “medicine easily accessible as the drug would be available at lower cost in developing countries, and the pharmaceutical would still have enough in capital return in developed countries to sustain competition and R&D.”<sup>163</sup> Differential pricing framework, however, is best applied to FTAs between developed and developing countries.<sup>164</sup> For instance, China, a lower-middle income country, does not have the privilege to enjoy this framework.<sup>165</sup>

## 2. *Publicly Funded Research*

It had been suggested that publicly funded research can better balance between inventors’ private interests and public interests of the right to health.<sup>166</sup> Publicly funded researches are prevalent in the United States and other wealthy countries, for example, through public university laboratories.<sup>167</sup> Further, seventy-one percent of drugs introduced between 1965 and 1992 were publicly funded.<sup>168</sup> Publicly funded research, however, is deemed too idealistic because this framework would depend “on pharmaceutical companies’ willingness to relinquish the ability to control their profits through market exploitation.”<sup>169</sup>

## 3. *Compulsory Licensing Provisions*

Compulsory licensing, a component built into the TRIPS Agreement,<sup>170</sup> allows another company to produce a patented medicine without the original patent owner’s consent.<sup>171</sup> In most situations, a government grants compulsory licenses when there are public health crises, such as those relating to HIV/AIDS, tuberculosis, malaria, and other epidemics.<sup>172</sup> Compulsory licensing has been considered as one of the

<sup>160</sup> Jamie Crook, *Balancing Intellectual Property Protection with the Human Right to Health*, 23 BERKELEY J. INT’L L. 524, 547 (2005).

<sup>161</sup> *Id.* For example, “[t]wo leading anti-retrovirals, acyclovir and nevirapine, cost twice as much in Kenya and 35% more in Tanzania than in Norway.”

<sup>162</sup> *Id.* (while arguing that the losses will be very slight).

<sup>163</sup> Adam & Aishatu, *supra* note 159, at 70.

<sup>164</sup> *Id.*

<sup>165</sup> Li, *supra* note 119, at 405.

<sup>166</sup> Crook, *supra* note 160, at 548.

<sup>167</sup> *Id.*

<sup>168</sup> Li, *supra* note 119, at 393, n.7.

<sup>169</sup> Crook, *supra* note 160, at 548.

<sup>170</sup> Scott Lucyk, *Patents, Politics and Public Health: Access to Essential Medicines under the TRIPS Agreement*, 38 OTTAWA L. REV. 191, 193 (2006).

<sup>171</sup> Whobrey, *supra* note 107, at 632.

<sup>172</sup> Li, *supra* note 119, at 409 (citing Ministerial Conference, Doha Declaration on the TRIPS Agreement and Public Health, ¶ 5(c), WTO Doc. WT/MIN(01)/DEC/W/2 (Nov. 14, 2001)).

solutions to the monopoly right granted by patents.<sup>173</sup> In fact, one commentator states that compulsory licensing is very “important both for improving access to essential medicines as well as facilitating the development of innovative capacities and R&D, especially in developing countries.”<sup>174</sup> Compulsory licensing can address multiple issues, including “high prices of medicines,... emergency health situations, [and] a failure by pharmaceutical patent holders to sufficiently supply the market with needed medicines.”<sup>175</sup>

However, there are certain concerns that compulsory licensing is not ideal for developing countries. First, generic manufacturers must have investment funds necessary to produce the drugs.<sup>176</sup> Because most developing countries have an insufficient manufacturing capacity and too small markets, it is doubtful that they would have a robust competition that would attract generic manufacturers.<sup>177</sup> Other concerns include the original patent specification not providing sufficient information to copy the drug, not having chemists who can copy the drug, and a possibility that the copied drug will not be sold at a much lower price than the original drug.<sup>178</sup> Therefore, “compulsory licenses alone do not present an answer to the issue of access to medicine in developing countries.”<sup>179</sup>

#### 4. *Price Caps and Subsidizations*

One commentator suggests that price caps and subsidizations would successfully balance private and public interests.<sup>180</sup> Neglected diseases are “those diseases primarily affecting those living in poverty, especially in rural areas, in low-income countries.”<sup>181</sup> Drugs for neglected diseases have low-profit potential.<sup>182</sup> An example of a low-profit potential disease is one that occurs only in the least developed countries and has no cure or effective treatment.<sup>183</sup> Given that there are significantly fewer incentives to invest in R&D for such a disease, the commentator suggests that the government intervene by funding through subsidization.<sup>184</sup> In the case of a high-profit potential disease like HIV/AIDS, however, pharmaceutical companies charge high prices as it has large market potential.<sup>185</sup> The commentator argues that the government should place

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<sup>173</sup> Lucyk, *supra* note 170, at 208.

<sup>174</sup> Adam & Aishatu, *supra* note 159, at 72.

<sup>175</sup> *Id.*

<sup>176</sup> Lucyk, *supra* note 170, at 208-09.

<sup>177</sup> *Id.* at 209.

<sup>178</sup> Adam & Aishatu, *supra* note 159, at 72.

<sup>179</sup> *Id.* at 73.

<sup>180</sup> Dickhut, *supra* note 88, at 235.

<sup>181</sup> *Id.* at 231 (quoting *The Right to Health*, *supra* note 140, at 16).

<sup>182</sup> *Id.*

<sup>183</sup> *Id.* at 231-32.

<sup>184</sup> *Id.* at 232.

<sup>185</sup> *Id.*

price caps on drugs for high-profit potential diseases.<sup>186</sup> The commentator states that these two steps – price caps on high-profit potential drugs and subsidizations for low-profit potential drugs – would “make critical medicines more affordable, and stimulate research when there is not otherwise an economic incentive.”<sup>187</sup>

### B. A Proposed Solution

The pivotal issue is balancing the interests of pharmaceutical companies and the public’s right to health. While most of the discussion focused on FTAs between developed and developing countries, the focus in this Comment is on the agreement between two developed countries. KORUS-FTA rightfully requires reconsideration and renegotiation since South Korea was a developing country when the agreements entered into force.<sup>188</sup> However, since then, it “has demonstrated incredible economic growth and global integration to become a high-tech industrialized economy.”<sup>189</sup> As of 2016, South Korea ranked thirty-two on the list of countries with the highest gross domestic product (GDP) which measures the total value of goods and services produced within a nation.<sup>190</sup> Further, in 2016, South Korea was among the top ten countries that filed the largest number of international patent applications under the Patent Cooperation Treaty (PCT),<sup>191</sup> and in 2015, South Korea filed 8.2 percent of the patent applications filed worldwide.<sup>192</sup>

As discussed above, balancing the two interests through a single technique is difficult. Thus, a framework that integrates some of the previously suggested solutions is necessary. First, compulsory licensing provisions must still be included in FTAs. Such provisions are necessary in case of a public health crisis. For example, in 2015, South Korea was

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<sup>186</sup> *Id.*

<sup>187</sup> *Id.* at 235.

<sup>188</sup> See Dae Hee Lee, *KORUS FTA and Intellectual Property Protection in Korea*, 5 ASIAN BUS. LAW. 11, 32 (2010).

<sup>189</sup> Charles Arthur, *Developing countries can learn from South Korea’s research and development experience*, UNIDO, available at <https://www.unido.org/news/developing-countries-can-learn-south-koreas-research-and-development-experience>.

<sup>190</sup> Jonathan Gregson, *The World’s Richest and Poorest Countries*, GLOBAL FINANCE (Feb. 13, 2017), <https://www.gfmag.com/global-data/economic-data/worlds-richest-and-poorest-countries>.

<sup>191</sup> *Infographic: Who filed the most PCT patent applications in 2016?* WORLD INTELLECTUAL PROPERTY ORGANIZATION, available at [http://www.wipo.int/export/sites/www/ipstats/en/docs/infographic\\_pct\\_2016.pdf](http://www.wipo.int/export/sites/www/ipstats/en/docs/infographic_pct_2016.pdf).

<sup>192</sup> In 2015, total 2,887,300 patent applications were filed worldwide, and South Korea filed 238,045 patent applications in that year. See *Total Applications Indicator*, WIPO IP STATISTICS DATA CENTER (last updated Feb. 2017), <https://www3.wipo.int/ipstats/keysearch.htm?keyId=201>; Statistical Country Profiles – Republic of Korea, WIPO IP STATISTICS DATA CENTER (last updated May 2017), [http://www.wipo.int/ipstats/en/statistics/country\\_profile/profile.jsp?code=KR](http://www.wipo.int/ipstats/en/statistics/country_profile/profile.jsp?code=KR).

threatened by a MERS (Middle East respiratory syndrome) outbreak.<sup>193</sup> Since 2012, there have been only 1,599 confirmed cases of infection with MERS,<sup>194</sup> approximately eighty percent of which occurred in Saudi Arabia.<sup>195</sup> Therefore, the unprecedented outbreak quickly became a serious public health crisis in South Korea, especially considering that thirty-five percent of reported patients with MERS died and there were no vaccine or specific treatment is currently available for treating MERS.<sup>196</sup> In a similar situation where a country experiences an unexpected disease outbreak and the only available corresponding medicines are imported and expensive, compulsive licensing provisions would be necessary.

Further, instead of differential pricing, a government must enforce price caps and subsidizations. However, unlike the suggested categorization of neglected drugs and high- or low-profit potential drugs, the parties to FTAs should analyze the supply and demand of pharmaceuticals and decide 1) which types of drugs require further R&D; 2) what the top-selling drugs in the participating countries are; and 3) what type of diseases would require patients' continued access to medicines. While the process may be time-consuming and costly, pharmaceuticals have a direct impact on a person's life, and IP rights have the potential to interfere with one of the fundamental rights of a person – the right to health. Thus, such a process is necessary to ensure that private interests are balanced with public interests.

First, drugs that require further R&D may be those that correspond to the leading causes of death. Continued R&D is necessary to prevent, treat, or mitigate the diseases that lead to death. For example, in 2015, the top ten causes of death worldwide included ischemic heart disease, stroke, chronic obstructive pulmonary disease, and tuberculosis.<sup>197</sup> Government subsidization, whether through tax subsidies or publicly-funded research, must support R&D of those drugs. Pharmaceutical companies, inventors, or public university laboratories may file for government funding or tax deductions on R&D of drugs that qualify under this category. In doing so, they should inform the government as to why R&D of a specific drug would fit under the category. Public interests are properly addressed as government subsidization would bring the costs of drugs down.

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<sup>193</sup> Elise Hu, *South Korea's MERS Crisis Exposes Public Distrust Of Leaders*, NPR (June 5, 2015 3:35 AM), <https://www.npr.org/sections/goatsandsoda/2015/06/05/412118009/south-koreas-mers-crisis-exposes-public-distrust-of-leaders>.

<sup>194</sup> Middle East respiratory syndrome coronavirus (MERS-CoV) – Republic of Korea, WHO (Oct. 25, 2015), <http://www.who.int/csr/don/25-october-2015-mers-korea/en/>.

<sup>195</sup> Middle East respiratory syndrome coronavirus (MERS-CoV) – Fact Sheet, WHO (last updated May 2017), <http://www.who.int/mediacentre/factsheets/mers-cov/en/>.

<sup>196</sup> *Id.*

<sup>197</sup> *The top 10 causes of death*, WHO (last updated Jan. 2017), <http://www.who.int/mediacentre/factsheets/fs310/en/> (The top ten causes, in descending order, are: ischemic heart disease, stroke, lower respiratory infections, chronic obstructive pulmonary disease, lung cancer, diabetes, dementias, diarrhoeal diseases, tuberculosis, and road injuries).

Next, top-selling drugs should be left untouched in terms of R&D costs and selling costs to ensure that pharmaceutical companies derive the investment funds from those drugs. Further, the government must make sure that pharmaceutical companies do not abuse patent protection on those drugs and that the companies exercise due diligence to the public's right to health. For example, top pharmaceutical products by worldwide sales in 2016 included Humira, Harvoni, and Enbrel.<sup>198</sup> In 2016, advisers to FDA recommended approval of the near generic versions of the best-selling drugs Humira and Enbrel.<sup>199</sup> However, the makers of Humira and Enbrel are using patent laws to delay generic competition.<sup>200</sup> What the makers are doing is certainly not illegal. However, there are questions as to the consumers' "lost opportunity to reduce health care costs."<sup>201</sup> Thus, governments, ultimately accountable for the right to health, must protect the public from the pharmaceutical companies' decisions that would jeopardize access to medicines.

Lastly, price caps are necessary on drugs for diseases that would require patients' continued access to medicines. Drugs related to aging population or diabetes are some of the examples. In most situations, drugs in this category are not used as a treatment, but to prevent further development of a disease or to mitigate the symptoms. While such drugs are of the same importance as treatment drugs, these drugs would require that the patients have continued access to the medication, preferably at affordable costs. Thus, pharmaceutical companies already have secured a high demand from the consumers. Price caps would likely address the public interest concern in this case by ensuring affordable prices.

### C. *Why Renegotiation Rather than Withdrawal*

In January 2017, President Trump formally withdrew the United States from the Trans-Pacific Partnership (TPP), a 12-nation deal to slash tariffs and foster trade in hopes to boost economic growth and to build a closer relationship on economic policies and regulation.<sup>202</sup> Shortly after, the Trump administration began the North American Free Trade Agreement

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<sup>198</sup> *Top 15 pharmaceutical products by sales worldwide in 2016 (in million U.S. dollars)*, STATISTA (Mar. 2017), <https://www.statista.com/statistics/258022/top-10-pharmaceutical-products-by-global-sales-2011/>.

<sup>199</sup> Andrew Pollack, *Makers of Humira and Enbrel Using New Drug Patents to Delay Generic Versions*, THE NEW YORK TIMES (Jul. 15, 2016), <https://www.nytimes.com/2016/07/16/business/makers-of-humira-and-enbrel-using-new-drug-patents-to-delay-generic-versions.html>.

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

<sup>202</sup> Eric Bradner, *Trump's TPP withdrawal: 5 things to know*, CNN (Jan. 23, 2017, 2:52 PM), <http://www.cnn.com/2017/01/23/politics/trump-tpp-things-to-know/index.html>; *TPP: What is it and why does it matter?*, BBC (Jan. 23, 2017), <http://www.bbc.com/news/business-32498715>.

(NAFTA) renegotiation process.<sup>203</sup> Not surprisingly, considering the trend, President Trump had also suggested withdrawing t from KORUS-FTA.<sup>204</sup> President Trump has tried to take firm control of the trade rules and to help American working families<sup>205</sup> by attacking different agreements, pushing for renegotiations, or threatening withdrawals. While some critics acclaimed such moves, some expressed concerns for what it means for globalization and for the United States.<sup>206</sup>

Withdrawal from KORUS-FTA “would have far greater consequences from an economic perspective than pulling out of the TPP.”<sup>207</sup> Large companies are concerned that President Trump is “undercutting their ability to sell to the vast majority of the world’s consumers.”<sup>208</sup> U.S. exports, including cars, medicines, machinery sectors, and agricultural goods, have risen after KORUS-FTA.<sup>209</sup> President Trump’s withdrawal decision would “forfeit the opportunity to promote American exports, reduce trade barriers, open new markets, and protect American invention and innovation.”<sup>210</sup> One report found that the withdrawal would “impose a dead loss on the U.S. economy of \$411 million annually and \$2.1 billion over five years.”<sup>211</sup> Pharmaceutical companies would lose patent protections they had received for years if the United States withdrew from the agreements.<sup>212</sup> Furthermore, withdrawing from the agreement would lead South Korea to charge a high tariff against U.S. imports, which would make U.S. companies challenging to find buyers.<sup>213</sup>

Withdrawal from the agreement would hurt the relationship between the two nations. After the withdrawal from TPP, Taiwan had no “concrete, compelling objective to work toward in its economic relationship with the United States.”<sup>214</sup> Likewise, if the United States withdraws from the agreement, South Korea would have no reason to work out its economic relations with the States. What concerns more than the economic

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<sup>203</sup> Phil Levy, *Trump Pushes NAFTA Talks Onto Treacherous New Timeline*, FORBES (Oct. 1, 2017, 7:00 PM), <https://www.forbes.com/sites/phillevy/2017/10/01/trump-pushes-nafta-talks-onto-treacherous-new-timeline>.

<sup>204</sup> Damian Paletta, *Trump preparing withdrawal from South Korea trade deal, a move opposed by top aides*, THE WASHINGTON POST (Sept. 2, 2017), <https://www.washingtonpost.com/news/wonk/wp/2017/09/02/trump-plans-withdrawal-from-south-korea-trade-deal/>.

<sup>205</sup> Bradner, *supra* note 202.

<sup>206</sup> Bradner, *supra* note 202.

<sup>207</sup> Goto, *supra* note 79.

<sup>208</sup> Bradner, *supra* note 202.

<sup>209</sup> Goto, *supra* note 79.

<sup>210</sup> Bradner, *supra* note 202.

<sup>211</sup> Anderson, *supra* note 83.

<sup>212</sup> Bradner, *supra* note 202.

<sup>213</sup> Paletta, *supra* note 204.

<sup>214</sup> AmCham Taipei Editorial, *The Evolving Trade-agreement Scene*, TAIWAN BUSINESS TOPICS (Dec. 19, 2017), <https://topics.amcham.com.tw/2017/12/evolving-trade-agreement-scene/>.

relationship is the trust between the United States and South Korea as allies against North Korea.<sup>215</sup>

Ever since North Korea's withdrawal from the Nuclear Non-Proliferation Treaty (NPT),<sup>216</sup> South Korea and the rest of the world have faced North Korea's nuclear missiles threats. The tensions grew especially during the past couple years, as North Korea conducted numerous missile tests and provoked the world by saying that it has missiles that can "reach anywhere in the world" and that it plans to attack "the heart of the U.S."<sup>217</sup> As President Trump showed intent to withdraw from KORUS-FTA in 2017 when the threat was reaching its climax, commentators agreed that withdrawal during such a global crisis would create a trust deficit between the two countries.<sup>218</sup> In addition, South Korea's current president is "not as pro-America" as previous presidents,<sup>219</sup> and would react aggressively to the withdrawal. KORUS-FTA, which provided stronger economic and security ties between the two countries,<sup>220</sup> thus was deemed necessary as the countries faced North Korea's threats.

Considering the economic consequences and relationship issues, President Trump was advised against withdrawing from the Agreement.<sup>221</sup> Renegotiation of the Agreement was considered vital to both countries, for the economy and their relationship. Both countries needed to "understand[] the other's position and ... find an agreed solution addressing legitimate U.S. concerns."<sup>222</sup> South Korea wanted "a united front against North Korea and healthy bilateral trade."<sup>223</sup> As such, the two countries have agreed to revise KORUS-FTA, renegotiating the elements of the Agreements including its provisions on pharmaceuticals.<sup>224</sup>

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<sup>215</sup> Robert Delaney, *Donald Trump the 'greatest source of instability' in Asia, says Australia's former PM Kevin Rudd*, SOUTH CHINA MORNING POST (Dec. 14, 2017, 8:44 PM), <http://www.scmp.com/news/asia/diplomacy/article/2124285/donald-trump-greatest-source-instability-asia-says-australias-ex>.

<sup>216</sup> *North Korea Nuclear Timeline Fast Facts*, CNN (Apr. 3, 2018, 12:56 PM), <https://www.cnn.com/2013/10/29/world/asia/north-korea-nuclear-timeline---fast-facts/index.html>.

<sup>217</sup> *Id.*

<sup>218</sup> See generally *Id.*; Goto, *supra* note 79; Chris Carothers, *Trump Is Undercutting America's Allies and Strengthening China's Hand*, THE DIPLOMAT (Aug. 17, 2017), <https://thediplomat.com/2017/08/trump-is-undercutting-americas-allies-and-strengthening-chinas-hand/>.

<sup>219</sup> Paletta, *supra* note 204.

<sup>220</sup> Hills, *supra* note 65.

<sup>221</sup> See Jin-Kyu Kang, *Talks to partially revise FTA will start in U.S.*, KOREA JOONGANG DAILY (Dec. 29, 2017), <http://koreajoongangdaily.joins.com/news/article/article.aspx?aid=3042639>.

<sup>222</sup> Hills, *supra* note 65.

<sup>223</sup> Carothers, *supra* note 218.

<sup>224</sup> Niv Elis, *Revamped US-South Korea trade deal tackles pharma, currency issues*, THE HILL (Mar. 27, 2018, 9:00 PM), <http://thehill.com/homenews/administration/380576-revamped-us-south-korea-trade-deal-tackles-pharma-currency-issues>.

While it was the worst time for the United States to pull back from the Agreement just several months ago, now is a good time to push for renegotiation that would protect its interests. Although the Trump-Kim's Singapore summit discussed "the complete denuclearization of the Korean peninsula,"<sup>225</sup> South Korea still needs the United States as an ally. As United States is considering a second summit with North Korea, the president of South Korea urged both leaders to move forward with denuclearization.<sup>226</sup> The denuclearization could bring lasting peace to the Korean Peninsula,<sup>227</sup> reduce military tensions and formally end the Korean war, as well as economic revival.<sup>228</sup> However, such changes cannot occur until the United States and the UN declare that North Korea has worked sufficiently towards denuclearization.<sup>229</sup> Accordingly, South Korea must continue to be in good terms with the United States.<sup>230</sup>

Therefore, the U.S. government now has the opportunity to strengthen its relations and implement provisions that would help resolve various issues seen over the last five years. Especially considering how South Koreans' perception of President Trump is continuing to improve after the summit,<sup>231</sup> South Korean government and the public may be open to the renegotiation of KORUS-FTA more than ever. The revised KORUS-FTA to be signed on September 2018, however, has said to make only minor changes to its provisions.<sup>232</sup> While the exact texts of the amended provisions are not available, the commentators expect the Agreement to include drugs from the U.S. companies in South Korean health program's premium reimbursement plan.<sup>233</sup> Whether the revised KORUS-FTA includes such an amendment, how the amendment affects the pricing of the American drugs, and the impact on the public's health remain to be seen.

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<sup>225</sup> Uri Friedman, *South Korea's Ambassador Has a Message for All the North Korea Skeptics*, THE ATLANTIC (July 6, 2018), <https://www.theatlantic.com/international/archive/2018/07/ambassador-cho-south-north-korea/564359/>.

<sup>226</sup> Choe Sang-Hun, *South Korean Leader Urges 'Bold Decisions' on North's Denuclearization*, N.Y. TIMES (Sept. 11, 2018), <https://www.nytimes.com/2018/09/11/world/asia/trump-kim-jong-un-summit.html>.

<sup>227</sup> *Id.*

<sup>228</sup> *The South clings to hope that North Korea is scrapping its nukes*, THE ECONOMIST (Sep. 13, 2018), <https://www.economist.com/asia/2018/09/15/the-south-clings-to-hope-that-north-korea-is-scrapping-its-nukes>.

<sup>229</sup> *Id.*

<sup>230</sup> *Id.*

<sup>231</sup> *U.S.-North Korea Summit and South Koreans' Perceptions of Neighboring Countries*, THE ASAN INSTITUTE FOR POLICY STUDIES (July 6, 2018), <http://en.asaninst.org/contents/u-s-north-korea-summit-and-south-koreans-perceptions-of-neighboring-countries>.

<sup>232</sup> Simon Lester & Inu Manak, *A Preliminary Assessment of the Amended KORUS FTA*, CATO INSTITUTE (Apr. 25, 2018, 10:43 AM), <https://www.cato.org/blog/preliminary-assessment-amended-korus-fta>.

<sup>233</sup> *Id.*; Elis, *supra* note 224.

## V. CONCLUSION

As this Comment argues, the United States government's attempt to control drug prices through aggressive patent protection may harm public health. It would discourage R&D of new drugs and encourage pharmaceutical industry monopolies. The U.S. government must propose regulations that would encourage the R&D of new medicines and promote public's right to health. This Comment suggests the U.S. government to provide compulsory licensing provisions in case of an unexpected health crisis, support drugs of leading causes of death through tax subsidization or publicly-funded research, strictly regulate so that pharmaceutical companies do not abuse patents of their top-selling drugs, and place price caps for the drugs that require consumers' continued access. As a result, pharmaceutical companies would be incentivized to focus on the R&D of innovative drugs rather than try to extend patent lives of the drugs already on the market. This proposed solution must be considered for KORUS-FTA renegotiation, rather than withdrawing from the agreement, as the withdrawal would hurt the economy and the relationship between the United States and South Korea.

## FATCA: WHO FORGOT TO ATTACH THE CARROT TO THE STICK?

*Richard White\**

### I. INTRODUCTION

*Setting:* Piazza Magione, Palermo, Italy. It is a hot summer day in the Piazza. 79 degrees in the shade. A young mother of two, with dual United States and Italian citizenship, is walking with her children in tow, when her youngest son, a boy of four, starts asking persistently for a gelato to cool down . . .

“Mom! Mom!” he yells petulantly, “I want an Ice Cream!! Mom!”

The mother begins to protest, “I’ll get you one when we get h . . .”

“You promised!” the boy interjects sadly.

Realizing it is a lost cause and recalling that she really had promised earlier, the mother looks around for one of the many cafés or gelato shops that dot the Piazza.

“Alright,” she says, dragging her children by the hands toward a small brightly colored café with a sign reading “Gelato” in one of the windows. “I’ll get you a gelato,” the mother says in exasperation.

“Ciao!” says the young woman behind the counter as the family approaches. Then, looking at her potential customers again, the woman switches to surprisingly good English and asks, “what can I get for you?”

“One small gelato, si prega” says the mother.

As the woman scoops a generous portion of creamy gelato into a small cone and hands it across the counter to the son, the mother begins rifling through her purse for some money. She can’t find any so pulls out her debt card instead.

“Three Euro,” says the woman, and the mother produces her debt card with a slightly embarrassed shrug at using it for such a small amount.

The young woman smiles and swipes her card.

“It’s saying declined,” the woman states with a questioning look in her eyes. “Do you have another form of payment?”

“That can’t be right!” says the mother. “Try it again.”

As the woman swipes her card for a second time, the mother tries to think of why her card would be declined . . . *It was working earlier . . . maybe it is something to do with her new bank?* she thinks. It had been a nightmare to find one that would take her after the U.S. government passed the Foreign Account Tax Compliance Act, and foreign institutions had a much heavier work load to keep their US customers, and the fees she had had to

pay, the fees . . . *But this bank had seemed willing to do the extra paperwork, she thinks . . .*

A polite “Mam?” from the young woman snaps the mother back to reality. “It’s still coming up declined, I tried it three times.”

Now panic starts to set in, and the mother begins to frantically look through her purse and pocket book, patting her side pockets. Then she remembers the change she had from the farmers market! She pulls a few crumpled bills out of her pocket and shoves them across the counter to the startled young woman, grabs her children’s hands again and rushes out of the café, not even waiting to see if she owed more money or had change due.

On the way home, the mother calls up her new bank frantically and a young teller answers the phone. He informs her that he is sorry, but her account has been frozen until the bank can verify and approve the stack of U.S. tax documents the mother had signed the day before. Somewhat relieved that her money is there at least, the mother heads home.

Fortunately, she stashed a few hundred euros away after the scare with her old bank. Two weeks later, after hours on the phone with her bank and despite the most spend thrifting she had done in her entire life, that few of hundred had dwindled to just five euros. The groceries were almost gone and she had no idea how she was going to fix dinner for her children that night. Out of desperation the mother calls the bank one more time. The same young teller answers. “I’m sorry miss, but we are still awaiting verification on your tax documents . . .”<sup>1</sup>

This story is a dramatization based on real events, but the effects of the Foreign Account Tax Compliance Act (“FATCA”) are not dramatized. The FATCA is the farthest reaching U.S. tax bill to date, requiring Foreign Financial Institutions (“FFIs”) outside the jurisdiction of the U.S. to report on U.S. accounts held by their institution.<sup>2</sup> The cost of implementing the FATCA is born to a large extent by these FFIs, making it expensive for

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\* Antonin Scalia Law School at George Mason University, J.D. Candidate, May 2019. For my father, Theodore White, a consummate scholar. Wish you were here.

<sup>1</sup> This story is loosely (and I stress the word loosely) based on the *testimonial of a new Mexican voter* from the Democrats abroad 2014 FATCA Research Project. *See generally Stories of FATCA Affecting Everyday Americans Every Day*, DEMOCRATS ABROAD 4-5 (Oct. 2014), <https://www.finance.senate.gov/download/att-5-democrats-abroad-2014-fatca-research-stories&download=1>.

<sup>2</sup> Ann C. Kossachev, *Worldwide Taxation and FATCA: A Constitutional Conundrum or the Final Piece of the Tax Evasion Puzzle?* 25 GEO. MASON U. C.R. L.J. 217, 224 (2015).

them to do business with U.S. citizens.<sup>3</sup> According to a Democrats Abroad Survey, as of 2014, one in every five Americans living abroad were affected by the closure of an account in a foreign bank due to the FATCA;<sup>4</sup> 22% of U.S. applicants were denied when they attempted to open new investment accounts in foreign institutions;<sup>5</sup> 12.9% were forced to split their joint accounts with their partners into separate accounts;<sup>6</sup> 5.6% were denied an employment position due to the FATCA;<sup>7</sup> and a record number of U.S. citizens denounced their citizenship due to complications arising from the FATCA.<sup>8</sup> The suggested solutions are as complex and varied as the requirements of the FATCA itself, but it is clear that something must be done.

Part two of this comment examines the world before the FATCA, the unique tax structure of the United States, and the evolution of anti-money laundering laws, up to the passage of the FATCA in 2010. Part three looks at how the FATCA functions, the different types of intergovernmental agreements that have become the backbone of the Act, and how the Act interacts with other statutes. Part four then inspects the legal problems that the FATCA has encountered both domestically and abroad and concludes that it is likely here to stay. Part five begins with an examination of the practical problems that face the Act, including new loopholes that have been exploited, and ends with a cost benefit analysis that demonstrates the inefficiency of the FATCA. Part six then looks to proposed solutions, including a switch to a territorial approach to taxation, repeal of the Act, and increases in penalties for leaving the U.S. tax base. Finally, part seven concludes that the best approach is an aggregate of methods. Reducing the burden of the individual reporting requirements, lowering the corporate tax rate, making voluntary disclosures less expensive, awarding a percentage of the penalties recovered to the FFIs and generally making it cheaper to become compliant, while maintaining the threat of force through the FATCA for the true tax dodgers.

## II. BACKGROUND: PRE FATCA

The citizen-based tax system enforced by the FATCA is the latest and farthest-reaching attempt to close the tax gap created by a citizen-based

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<sup>3</sup> 26 U.S.C. § 1471(b) and (c) provides the FFIs responsibility under the FATCA. FFIs must research and compile a list of all accounts held by their institution where a U.S. citizen is either the primary account holder or a beneficiary. They must also report how much money is in each such account, the Tax Identification Number of the account holder, the institution's identification number, and a host of other information, including the gross income earned by the account and transfers of funds.

<sup>4</sup> *Stories of FATCA Affecting Everyday Americans Every Day*, *supra* note 1, at 4.

<sup>5</sup> *Id.* at 7.

<sup>6</sup> *Id.* at 9.

<sup>7</sup> *Id.* at 12.

<sup>8</sup> *Id.* at 20.

tax structure.<sup>9</sup> The Revenue Act of 1913 allowed Congress to tax U.S. Citizens *wherever they could be found*.<sup>10</sup> Although contemporaries of the Act questioned Congress' constitutional authority to enact such far reaching extraterritorial regulation<sup>11</sup>, the tax imposed was relatively low and the realities of early 20<sup>th</sup> century life made it unlikely that U.S. authorities would *find* many citizens living abroad in the first place. Nevertheless, even at the time of passage, the Act did affect some expatriates living close to home.<sup>12</sup> In 1924, the Supreme Court examined the constitutionality of citizen-based taxation squarely for the first time in *Cook v. Tait*.<sup>13</sup> In *Cook*, the Court lent judicial approval to the Act, holding that a dual U.S. and Mexican citizen still owed taxes to the United States, even though the money being taxed was earned in Mexico.<sup>14</sup>

Since *Cook*, Congress has entered treaties and passed measures, like the Bank Secrecy Act, to collect taxes owed to the IRS from foreign source income.<sup>15</sup> However, before the FATCA, those measures were domestic in operation, except bills passed pursuant to international law and intergovernmental agreements.<sup>16</sup> The FATCA is Congress's first attempt to pass binding legislation on foreign citizens absent a governmental agreement with the sovereigns of the citizens impacted by the far-reaching legislation.

#### A. A Citizen Based Model: The Unique Tax Structure of the U.S.

Federal income tax is a relatively new institution in the United States. Two significant wars, one in the 19<sup>th</sup>, and one in the 20<sup>th</sup> century, led to drastic increases in governmental need for money, which radically changed the means Congress used to acquire that money, including implementation of federal income tax. During the Civil War, Congress implemented the first federal income tax to make up for revenue shortfalls caused by the war.<sup>17</sup> However, in *Pollock v. Farmers' Loan & Tr. Co.*, the

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<sup>9</sup> The United States first implemented lasting citizen-based taxation with Revenue Act of 1913, passed following the adoption of the 16<sup>th</sup> Amendment, which allowed for income tax generally. See *infra* Section II.A. The FATCA was passed by the 111th United States Congress in 2010 and requires foreign governments and institutions outside of U.S. jurisdiction to report of U.S. accounts held by those institutions. See generally Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71.

<sup>10</sup> Revenue Act of 1913, ch. 16, 38 Stat. 114, 166 (1913).

<sup>11</sup> See generally *Cook v. Tait*, 267 U.S. 47 (1924).

<sup>12</sup> See generally *id.*

<sup>13</sup> *Id.* at 54, 56.

<sup>14</sup> *Id.*

<sup>15</sup> Peter E. Meltzer, *Keeping Drug Money from Reaching the Wash Cycle: A Guide to the Bank Secrecy Act*, 108 BANKING L.J. 230, 230-231 (1991).

<sup>16</sup> Lisa De Simone, et al., *Transparency and Tax Evasion: Evidence from the Foreign Account Tax Compliance Act (FATCA)*, STAN. U. GRADUATE SCH. BUS. RES. PAPER 17-62, 8 (June 2018), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3037426](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3037426).

<sup>17</sup> Revenue Act of 1861, ch. 45, § 49, 12 Stat. 292, 309, repealed by Revenue Act of 1862, ch. 119, § 89, 12 Stat. 432, 473.

Supreme Court intervened and concluded that federal income tax was unconstitutional because it violated the constitutional prohibition on direct taxation.<sup>18</sup> The holding in *Pollock* stood until the buildup to World War I, when again in need of money, Congress proposed the 16<sup>th</sup> Amendment, which was later adopted and negated the holding in *Pollock*.<sup>19</sup> However, it was not until 1913 that the United States adopted a citizenship-based model for taxation, and not until 1924, in *Cook v. Tait*, that the issue was examined by the Supreme Court and resolved in favor of the government.<sup>20</sup> Although the decision was resolved in favor of the government, the issues of fairness and the problem of double taxation highlighted in the opinion were later resolved using a foreign tax credit that could deduct U.S. taxes owed equal to taxes due on the amount of money earned abroad.<sup>21</sup>

### 1. *Legality of the Model*

Before the Civil War, there was no such thing as “income tax” in the U.S. However, to raise revenue for the Civil War, Congress passed the Revenue Act of 1861, which established a flat 3% tax on income over \$800.<sup>22</sup> The 1861 Act specifically exempted income earned in foreign countries, only taxing nonresidents on income earned in the U.S.<sup>23</sup> However, with the Revenue Act of 1864, Congress extended the framework of the 1861 model to include a tax on non-resident citizens.<sup>24</sup> The Act of 1864 expired in 1872 and no federal income tax was passed until Congress passed the Revenue Act of 1894.<sup>25</sup>

The following year, in 1895, The Supreme Court received its first opportunity to examine citizen-based taxation and income tax generally in *Pollock v. Farmers' Loan and Trust*.<sup>26</sup> The majority concluded that many of the types of income covered by the statute, such as those from rent, interest,

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<sup>18</sup> *Pollock v. Farmers' Loan & Tr. Co.*, 157 U.S. 429, 607-08 (1895).

<sup>19</sup> Kossachev, *supra* note 2, at 220.

<sup>20</sup> *Id.* at 220-21.

<sup>21</sup> Philip R. West & Amanda P. Varma, *The Past and Future of the Foreign Tax Credit*, 38 INT'L TAX J. 47, 48 (2012).

<sup>22</sup> Revenue Act of 1861 § 49.

<sup>23</sup> *Shaffer v. Carter*, 252 U.S. 37, 53 (1920); *see also* Sheldon D. Pollack, *The First National Income Tax, 1861-1872*, 67 TAX LAW. 311, 320-21 (2014) (noting that no revenue was collected under the Revenue Act of 1861 because, as Treasury Secretary Chase stated, the tax would cost more to implement than it would earn).

<sup>24</sup> The Revenue Act of 1864 was a funding bill for the Civil War which, by its terms, would terminate in 1872, that extended the tax to “the gains, profits, or income of... any citizen of the United States residing abroad, whether derived from any kind of property, rents, interests, dividends, salaries, or from any profession, trade, employment, or vocation, carried on in the United States or elsewhere, or from any other source whatever.” Revenue Act of 1864, ch. 173, § 116, 13 Stat. 223, 281 (1864).

<sup>25</sup> This Act, also called the Wilson-Gorman Tariff Act for the bill's sponsor, reduced tariffs, but covered the gap by implementing an income tax. *See generally* Revenue Act of 1894, ch. 349, § 3173, 28 Stat. 509 (1894); *see also* Sheldon D. Pollack, *Origins of the Modern Income Tax, 1894-1913*, 66 TAX LAW. 295, 306 (2013).

<sup>26</sup> *See generally Pollock*, 157 U.S. 429.

or dividends, was a direct tax.<sup>27</sup> The Constitution generally reserved the power to levy direct taxes to the states, and so the statute was unconstitutional.<sup>28</sup> However, since the Court resolved the case on the principal of direct taxation, it never reached the constitutionality of a tax on income earned abroad.<sup>29</sup>

Partially in response to the Court's decision, Congress proposed the Sixteenth Amendment, which was ratified in February of 1913.<sup>30</sup> By October of that same year, the United States became the first country in the world to establish a legal, lasting, citizen-based taxation system.<sup>31</sup> The Revenue Act of 1913 applied a citizen-based tax on all income sources wherever they could be found.<sup>32</sup> Soon after the Supreme Court examined the 1913 Act's direct tax provisions and generally affirmed its constitutionality in *Brushbar v. Union Pacific*, however, again, the Court did not reach the issue of Congress's ability to tax non-U.S. based income.<sup>33</sup> Perhaps no serious suit was brought because the technological and geopolitical realities of life in 1913 made the Act's reach largely symbolic.<sup>34</sup>

It was not until 1924, in *Cook v. Tait*, that the Supreme Court examined the issue of citizen-based taxation absent direct tax implications.<sup>35</sup> *Cook* involved a dual U.S. and Mexican citizen, residing in Mexico, who challenged the constitutionality of a tax on his income earned in Mexico.<sup>36</sup> The Court concluded that citizenship came with benefits, and while the citizen had the rights to enjoy the benefits anywhere, the government had the right to tax a citizen wherever he was found, regardless of the source of

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<sup>27</sup> *Id.* at 604.

<sup>28</sup> Unless Congress follows the apportionment laid down in U.S. Const. art. 1, § 2, cl. 3, § 9, cl. 4. *Id.* at 607-08. The Court has since limited the definition of a direct tax to three categories, (1) capitation, (2) real property, and (3) personal property. Nat'l Fed'n of Indep. Bus. v. *Sebelius*, 567 U.S. 519, 571 (2012).

<sup>29</sup> See *Pollock*, 157 U.S. at 607-08 (holding that the part of the 1894 law related to "the rents profits, or income from real estate," was void because it constituted a direct tax not imposed consistent with state representation, as outlined in the Constitution).

<sup>30</sup> See U.S. CONST. amend. XVI ("The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.").

<sup>31</sup> Kossachev, *supra* note 2, at 220.

<sup>32</sup> The Tax Structure instituted by the Revenue Act was a progressive tax and applied a base tax of 1% for individuals earning more than \$3,000 per year and a 7% Tax for individuals earning more than \$500,000 per year. Revenue Act of 1913, § II at 166-67.

<sup>33</sup> In this case involving a request for injunctive relief of a corporation's compliance with the Revenue Act of 1913 by a shareholder, the bill was challenged on number of constitutional fronts and a narrow interpretation of the 16<sup>th</sup> amendment was urged. The Court opted for a broad interpretation and concluded that the Act was constitutional. Again, the Court did not reach application to non-U.S. based income. See *Brushbar v. Union Pac. R. Co.*, 240 U.S. 1, 20 (1916).

<sup>34</sup> Kossachev, *supra* note 2, at 220.

<sup>35</sup> *Id.* at 218, 220.

<sup>36</sup> See *id.* at 220-21.

his income.<sup>37</sup> Elaborating, the Court held that it was constitutional to tax people based on their citizenship, and that Congress' power to tax was not limited by the source of a citizen's income or the place of his residence.<sup>38</sup> *Cook* has been the final word on the legality of a citizen based tax system and is unlikely to be overturned.<sup>39</sup> Of course, the legislation was only binding on U.S. citizens and was subject to the same jurisdictional limitations that any other act of Congress would be.

## 2. *Global Reception of a Citizen-Based Model*

Today, the U.S. is one of only two nations to tax its citizens based on their citizenship alone.<sup>40</sup> Most nations tax income derived from foreign sources based on residency, if at all.<sup>41</sup> The only other nation to employ citizen-based taxation is Eritrea.<sup>42</sup> Eritrea uses what the United Nations ("UN") Security Council has described as "thug tactics" to enforce their tax structure.<sup>43</sup> These tactics include withholding citizen's passports and refusing readmission to the country for citizens until the tax is paid.<sup>44</sup> Eritrea also uses exorbitant expatriation fees to make it cheaper for citizens to remain in Eritrean rather than to expatriate.<sup>45</sup>

International response to Eritrea's model has been harsh. Eritrea received sanctions from the UN,<sup>46</sup> their envoy was expelled from Canada,<sup>47</sup> and similar measures are being considered by the European Parliament, Netherlands and Switzerland.<sup>48</sup> All of this is, in part, a reaction to Eritrea's harsh treatment of their citizens abroad. Interestingly, the U.S. uses similar

<sup>37</sup> *Id.* at 221, 232.

<sup>38</sup> *See id.*

<sup>39</sup> *Cf. id.* at 219, 227, 232.

<sup>40</sup> Editorial Board, *End the American Expat Tax*, BLOOMBERG (Apr. 24, 2015, 1:42 AM), <https://www.bloomberg.com/view/articles/2015-04-24/end-the-american-expat-tax>.

<sup>41</sup> *See id.*

<sup>42</sup> *Id.*

<sup>43</sup> *See* Meeting Coverage, Security Council, Security Council, by Vote of 13 in Favour, Adopts Resolution Reinforcing Sanctions Regime against Eritrea 'Calibrated' to Halt All Activities Destabilizing Region, U.N. Meeting Coverage SC/10471 (Dec. 5, 2011), <https://www.un.org/press/en/2011/sc10471.doc.htm> ("Demands Eritrea to cease all direct or indirect efforts to destabilize States, including through financial, military, intelligence and non-military assistance, such as the provision of training centres, camps and other similar facilities for armed groups, passports, living expenses, or travel facilitation").

<sup>44</sup> *See id.*

<sup>45</sup> *See id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Canada expels Eritrea envoy over expat fees claims*, BBC (May 29, 2013) <http://www.bbc.com/news/world-us-canada-22708711>.

<sup>48</sup> *See generally* Resolution on Eritrea, notably the cases of Abune Antonios and Dawit Isaak, EUR. PARL. DOC. P8\_TA(2017)0309 (2017); K. Smits, *New study confirms concerns over Eritrean diaspora tax in Europe*, EUR. EXTERNAL POL'Y ADVISORS (Sept. 20, 2017), <http://www.eepa.be/?p=1751>; "Diaspora tax" draws more criticism, Economy: Forecast, THE ECONOMIST (Aug. 31, 2016), <http://country.eiu.com/article.aspx?articleid=34564387&Country=Eritrea&topic=Economy&subtopic=Forecast&subsubtopic=External+sector&u=1&pid=1077057691&oid=1077057691&uid=1>.

tactics and more, as this comment will demonstrate, to extract taxes from non-compliant expatriates. However, international response to the U.S. has been more restrained, with little official resistance to U.S. citizen-based taxation. However, as time has gone on, it has become clear that implementing a citizenship-based tax is not the same as enforcing that tax structure.

### B. Bank Secrecy Act

In 1970, Congress took a different approach and sought to reduce the tax gap through criminal regulations.<sup>49</sup> That year, Congress passed the Currency and Foreign Transaction Reporting Act, (“TRA”) contained within the Bank Secrecy Act of 1970 (“BSA”).<sup>50</sup> This statute required financial institutions to keep records of cash purchases of negotiable instruments and to file reports if the amount held was more than \$10,000.<sup>51</sup> TRA has two major components related to individual taxation. First, it requires individuals to file a Treasury Form 90-22.1, which is also called a Foreign Bank and Account Report (“FBAR”) form, with the IRS.<sup>52</sup> FBAR requires that a person or institution with “interest in,” “authority over,” or primary status on a foreign account with an aggregate value of over \$10,000 at any point in the filing year, to file an FBAR form.<sup>53</sup> Second, the act requires a Report of International Transportation of Currency or Monetary Instruments, (“RITCMI”) and an accompanying Currency and Monetary Instruments Report (“CMIR”).<sup>54</sup> RITCMI requires people who transfer more than \$10,000 in “monetary instruments” into or out of the U.S. to fill out a CMIR.<sup>55</sup> Although the TRA brought in significant revenue, it was far from perfect, and in 2006 the IRS estimated a \$385 billion tax gap remained following the act.<sup>56</sup>

On the Senate floor, Senator Carl Levin, one of the FATCA’s co-sponsors, claimed that \$100 billion of the treasury departments lost annual tax revenue was due to fraudulent reporting of foreign accounts by citizens left to their own devices.<sup>57</sup> Congruently, a congressional report concluded that the gap was caused by the fact that the IRS could only regulate domestic financial institutions, and had no power over international

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<sup>49</sup> See Meltzer, *supra* note 15, at 230.

<sup>50</sup> *Id.* at 230-31, 230 n.2. The BSA is also called the “anti-money laundering” law (“AML”). *FinCEN’s Mandate From Congress*, FINCEN.GOV, <https://www.fincen.gov/resources/fincens-mandate-congress> (last visited Oct. 13, 2018).

<sup>51</sup> See Meltzer, *supra* note 15, at 231.

<sup>52</sup> 31 C.F.R. § 1010.350(a) (2016).

<sup>53</sup> *Id.*

<sup>54</sup> 31 U.S.C. § 5316(a) (2006).

<sup>55</sup> *Id.* “Monetary instruments” includes currency and travelers’ checks. 18 U.S.C. § 1956 (2006). CMIR focuses on physically transferred money. See 31 C.F.R. § 1010.340 (2011).

<sup>56</sup> James F. Kelly, *International Tax Regulation by United States Fiat: How FATCA Represents Unsound International Tax Policy*, 34 WIS. INT’L L.J. 981, 984, n.8 (2017).

<sup>57</sup> 156 CONG. REC. S1,745 (2010) (Statement of Sen. Levin).

financial institutions, who were encouraging and aiding U.S. citizens' efforts to evade taxes.<sup>58</sup> Switzerland and other countries passed strict bank secrecy laws that prohibited their financial institutions from sharing account holder information, making the countries havens for U.S. tax evasion.<sup>59</sup> The Swiss Bank secrecy laws made it difficult for the IRS to attain information on accounts where U.S. citizens were either unnamed beneficiaries or even, in some cases, primary account holders.<sup>60</sup>

*C. UBS AG of Switzerland: A Case Study of Enforcing Compliance Pre-FATCA*

One banking institution supported by Swiss laws that encouraged U.S. tax evasion was UBS AG of Switzerland ("UBS"). Fortunately for the IRS, Bradley Birkenfeld, a U.S. citizen who worked at UBS, discovered that the bank was actively aiding Americans in hiding their wealth from the IRS in violation of U.S. tax laws.<sup>61</sup> Mr. Birkenfeld resigned from the bank, and sought immunity under the IRS whistleblower statute. He also sought a percentage of the assets recovered in the event of successful litigation.<sup>62</sup> During the investigation, he revealed information on the tax evasion schemes UBS used to defraud the U.S.<sup>63</sup>

The IRS investigated Birkenfeld's claims and found sufficient evidence to file suit. They found that, among other illegal practices, UBS was actively encouraging tax evasion through agents who would cross into the United States to encourage wealthy U.S. citizens to deposit funds with UBS and avoid U.S. tax burdens.<sup>64</sup> This practice, termed "cross border business," granted U.S. courts jurisdiction over UBS.<sup>65</sup> After an exhaustive investigation, UBS accepted a deferred prosecution agreement from the Justice Department, under which they would provide information to the U.S. through the Swiss Government.<sup>66</sup> Under the agreement, UBS had to pay \$780 million in fines and other penalties, and stop providing services to U.S. citizens who held undeclared accounts.<sup>67</sup> More importantly, under the

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<sup>58</sup> 155 CONG. REC. S10,785 (daily ed. Oct. 27, 2009) (Statement of Sen. Baucus).

<sup>59</sup> 156 CONG. REC., *supra* note 57.

<sup>60</sup> Kelly, *supra* note 56, at 985.

<sup>61</sup> *Id.*

<sup>62</sup> Both attempts failed and Birkenfeld eventually pled guilty of conspiracy to defraud the US government. *Id.* at 986, 986 n.16.

<sup>63</sup> *See id.* at 986.

<sup>64</sup> *See* Petition to Enforce John Doe Summons at 2-3, *United States v. UBS AG*, No. 09-20423 (S.D. Fla. Feb. 19, 2009), 2009 WL 864716.

<sup>65</sup> The court had jurisdiction over UBS agents and the bank due to respondeat superior. *See id.* at 1-3.

<sup>66</sup> Kelly, *supra* note 56, at 986 (citing Press Release, Dep't of Justice, UBS Enters into Deferred Prosecution Agreement (Feb. 18, 2009), <http://www.justice.gov/opa/pr/ubs-enters-deferred-prosecution-agreement>).

<sup>67</sup> *Id.*

agreement, UBS revealed how they had been evading the IRS.<sup>68</sup> UBS also agreed to report all accounts that they still held.<sup>69</sup> It is important to note that the deferred prosecution agreement could only be completed with the help of the Swiss government who aided the IRS in pursuing its goals.

This example demonstrates two points. First, even before the FATCA, the United States had significant power to reach across its borders and effect its policies on foreign soil. Although significant cooperation with foreign governments, as well as jurisdiction over the case, was a predicate, the United States had sufficient influence to gain that cooperation and most tax evasion schemes were sufficiently connected to the U.S. to warrant jurisdiction.<sup>70</sup> The second point that the UBS example demonstrates, and the one seized on by Congress, is the evidence of the sheer amount of money that might be contained in tax havens across the world.<sup>71</sup> In 2010 Congress passed the FATCA to combat this second issue that the UBS case highlighted.

### III. STRUCTURE OF THE FATCA

The FATCA was passed in 2010 and enacted *unilateral* tax evasion measures to curb tax evasion through the use of offshore accounts.<sup>72</sup> FATCA accomplishes this end through two forms of reporting: (1) by U.S. taxpayers voluntarily disclosing their interests in foreign financial accounts

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<sup>68</sup> *Id.* Primarily, UBS agents showed Americans how to conceal their role in businesses and aided them in filing false paperwork with the IRS. *See generally* Deferred Prosecution Agreement at Ex. C, *United States v. UBS AG*, No. 09-60033-CR-COHN (S.D. Fla. Feb. 18, 2009).

<sup>69</sup> Deferred Prosecution Agreement, *supra* note 68, at 6. UBS further agreed to an “Exit Program,” under which they would fully comply by identifying U.S. account holders, and, once identified they would aid them in filling out full W-9 Forms. *Id.* at 4. They also agreed to institute internal controls compliant with a Qualified Intermediary Agreement. *Id.* at 5. They provided information on the U.S. accounts held by UBS in an account disclosure letter. *Id.* at 6. They would also cooperate with a “John Doe” summons for information on US account holders, which are authorized by IRC 7609 (c)(3) and 7609 (f) and allow the IRS to issue a summons based on liability to an unidentified person or group of people who are under investigation. *Id.* at 9. Finally, they would provide for an external auditor to ensure UBS was compliant moving forward. *Id.* at 13-14.

<sup>70</sup> Switzerland’s cooperation with the U.S. investigation illustrates how even an influential country famous for bank secrecy laws was willing to risk its citizens over offending the United States. Kelly, *supra* note 56, at 986. The example also illustrates how the “cross border business,” the means by which many foreign financial institutions illicitly attract new clients, could easily be used to extend jurisdiction to U.S. courts. *See generally* Deferred Prosecution Agreement, *supra* note 68.

<sup>71</sup> The deferred prosecution agreement admits liability for \$780 million in damages, plus FBAR penalties for non-compliant U.S. account holders. Deferred Prosecution Agreement, *supra* note 68, at 3; Press Release, Dep’t of Justice, UBS Client Pleads Guilty to Failing to Report Over \$1 Million in Swiss Bank Accounts (Apr. 12, 2010), <http://www.justice.gov/opa/pr/ubs-client-pleads-guilty-failing-report-over-1-million-swiss-bank-accounts>.

<sup>72</sup> *Crawford et al. v. U.S. Dep’t. of Treasury*, No. 3:15-cv-250, 2015 WL 5697552, at \*1 (S.D. Ohio Sept. 29, 2015).

and (2) by Foreign Financial Institutions (“FFIs”) forcibly disclosing U.S. accounts held by their institutions.<sup>73</sup> The first reporting requirement, codified as 26 U.S.C. § 6038D, requires individuals holding more than \$50,000 in “specified foreign financial assets” to report to the IRS.<sup>74</sup> This reporting requirement is nothing novel under U.S. law and similar stipulations were passed under the BSA. However, the second requirement, codified as 26 U.S.C. §1471 requires FFIs to report directly to the IRS.<sup>75</sup> This represents the first act where Congress unilaterally required non-U.S. citizens to report directly to the IRS or face penalties. All other similar measures have been bilateral in nature involving an agreement between U.S. and a foreign government.

#### A. *The Basics: How the FATCA Works*

The FATCA was somewhat duplicitously passed as a funding measure for House Bill 2847 which was entitled the Hiring Incentives to Restore Employment (“HIRE”) bill.<sup>76</sup> A big part of the FATCA, and a deviation from other tax reporting acts, is the requirement that foreign financial institutions (“FFIs”) report information on U.S. accounts directly to the IRS.<sup>77</sup> FFIs include hedge funds and foreign banks.<sup>78</sup> Section 1471(c)(1) defines the what must be reported including (A) the Taxpayer Identification Number (“TIN”) of each U.S. account holder, (B) the account number of each U.S. account, (C) the account balance or value, and (D) the gross receipts and gross withdrawals or payments to and from the account.<sup>79</sup> In case of conflict of laws, §1471(b)(1)(F) of the act provides that the FFI should attempt to attain a waiver of their domestic law so U.S. law can apply, or else close the U.S. account if a waiver cannot be attained.<sup>80</sup> Section 1471(b) also requires that FFIs file a report directly with the IRS absent another agreement.<sup>81</sup>

The Act is not limited to individuals who do business with the U.S. By covering something called pass-through payments, the FATCA theoretically extends the IRS’s reach to institutions that hold no U.S. accounts and do no business with the U.S.<sup>82</sup> A pass-through payment is a payment where an FFI who does business with the U.S. is used as an intermediary, attaining money from one source and transferring it to

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<sup>73</sup> *Id.*

<sup>74</sup> 26 U.S.C. § 6038D (2006).

<sup>75</sup> 26 U.S.C. § 1471 (2010).

<sup>76</sup> *See* Hiring Incentives to Restore Employment Act, H.R. 2847, 111th Cong. (2010).

<sup>77</sup> *See* 26 U.S.C. § 1471(c)(1).

<sup>78</sup> *FATCA Information for Foreign Financial Institutions and Entities*, I.R.S.,

<https://www.irs.gov/businesses/corporations/information-for-foreign-financial-institutions> (last updated Mar. 30, 2018).

<sup>79</sup> 26 U.S.C. § 1471(c)(1).

<sup>80</sup> *Id.* § 1471(b)(1)(F).

<sup>81</sup> *Id.* § 1471(b).

<sup>82</sup> *Crawford*, 2015 WL 5697552, at \*2.

another.<sup>83</sup> The other source can be either people who hold accounts with other FFIs, or other FFIs themselves that invest with the U.S.-affiliated FFI.<sup>84</sup> The regulation of pass-through payments is set out in §1471 (b)(1)(D) of the Act, which stipulates that to comply, FFIs must withhold a tax equal to 30% of pass-through payments to a “recalcitrant account holder or another [“FFI”] which does not meet the requirements.”<sup>85</sup> The first part of the section is what the FATCA was passed to effect: if a U.S. citizen does not comply and an FFI is handling their money, the FFI will withhold a 30% fee. The second part is more novel. It means, in effect, that FFIs who do not conduct business with the U.S. could none the less face penalties from other financial institutions for not filing a reporting form with the IRS.<sup>86</sup> In a way, Congress is passing on the responsibilities and costs of enforcing the act to FFIs and extending its reach to any institutions that a compliant FFI does business with. If the FFI affiliated with the U.S. market does not comply with the FATCA, they face a 30% withholding fee from all U.S. investments, including interest and dividends.

There is an escape valve, however. The fee can be avoided under 26 U.S.C. § 1471 (b)(1) if the FFI enters an agreement with the Secretary of Treasury (“Secretary”).<sup>87</sup> The Secretary has a large degree of discretion over every section of the statute. If the Secretary exempts an FFI under § 1471(b)(2), they are no longer required to make the report described in § 1471(c)(1), which is contingent on (b)(2).<sup>88</sup> This theoretically enables the Secretary to enter separate agreements with FFIs supplanting the requirements of the FATCA for whatever arrangement s/he deems appropriate. The Secretary’s authority is also derived from § 1474(f) which enables him or her to “prescribe such regulations or other guidance as may be necessary.”<sup>89</sup>

### *B. IGAs: How a Unilateral Bill Becomes Bilateral*

Due to fears of international conflict of laws, the Secretary of Treasury uses his or her authority to enter Intergovernmental Agreements (“IGAs”) with many countries, thereby making the Act *bilateral* for those countries who sign on. Absent these agreements, the U.S. might not have jurisdiction over FFIs, which could raise some constitutional issues.<sup>90</sup> The IGAs solve this problem by extending jurisdiction through the authority of the foreign sovereign.<sup>91</sup> The IGAs also add another layer to the pass-through

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<sup>83</sup> 26 U.S.C. § 1471(b)(1)(D).

<sup>84</sup> *Id.* § 1471(e).

<sup>85</sup> *Id.* § 1471(b)(1)(D)(i).

<sup>86</sup> *Crawford*, 2015 WL 5697552, at \*3.

<sup>87</sup> 26 U.S.C. § 1471(b)(1).

<sup>88</sup> *Crawford*, 2015 WL 5697552, at \*2.

<sup>89</sup> *Id.*

<sup>90</sup> *See Kelly*, *supra* note 56, at 990.

<sup>91</sup> *Id.*

requirement by forcing countries to enact local laws to make recalcitrant FFIs who might otherwise just avoid U.S. markets comply with FATCA.<sup>92</sup> Despite the costs, IGAs are on the rise. As of August 1, 2016, there were 63 IGAs in effect.<sup>93</sup> Today, that number is 113.<sup>94</sup> The IGAs typically include a Tax Information Exchange Agreement (“TIEA”) which means a sharing of information, rather than a unilateral demand from the treasury department.<sup>95</sup> These agreements take two basic forms, IGA Model 1 or 2.<sup>96</sup> The basic aim of both of these options is to ensure the FFIs in the country entering the agreement can legally share information on U.S. account holders in those countries.<sup>97</sup> Within these categories are various subcategories, which allows the agreements to be amended to allow for the exigencies of any given situation.<sup>98</sup> Interestingly, the IRS recognizes both explicit and implicit IGAs, or those that foreign governments sign and acknowledge, and those with nations who are simply complying with the FATCA’s demands.<sup>99</sup> The explicit IGAs are significantly more common however, and take two forms, models 1 and model 2 agreements.

### 1. IGA Model 1

Under model 1 agreements, foreign governments collect U.S. account holders’ information from their domestic financial institutions and send it to the IRS.<sup>100</sup> FFIs in countries that have adopted this model must register with the IRS, but they do not have to enter a Foreign Financial Institution Agreement (“FFIA”).<sup>101</sup> Instead, the FFIs report information on U.S. accounts to their local regulators, who in turn pass the information on to the IRS pursuant to the IGA.<sup>102</sup> Additionally, nations that enter model 1 agreements must modify their local laws setting forth regulations on what accounts are to be identified, and to ensure that FFIs conduct due diligence in reporting.<sup>103</sup> Article 2, § 2 of the model type I IGA sets forth the type of

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<sup>92</sup> Laurie Hatten Boyd, *Are Problems Looming for FATCA and the “Reciprocal” IGA?* THE TAX ADVISER (June 1, 2016), <https://www.thetaxadviser.com/issues/2016/jun/problems-looming-for-fatca-and-reciprocal-iga.html>.

<sup>93</sup> ERIKA K. LUNDER & CAROL A. PETTIT, CONG. RESEARCH SERV., R44616, FATCA REPORTING ON U.S. ACCOUNTS: RECENT LEGAL DEVELOPMENTS 5 (2016); *but see Crawford*, 2015 WL 5697552, at \*3 (“[T]he United States has concluded over 70 intergovernmental agreements (IGAs) with foreign governments...”).

<sup>94</sup> Foreign Account Tax Compliance Act (FATCA), U.S. DEP’T. OF TREASURY, <https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx> (last updated Apr. 11, 2018).

<sup>95</sup> *Crawford*, 2015 WL 5697552, at \*3.

<sup>96</sup> Kelly, *supra* note 56, at 991.

<sup>97</sup> *Id.*

<sup>98</sup> See Foreign Account Tax Compliance Act (FATCA), *supra* note 94 (listing the types of IGAs).

<sup>99</sup> Kelly, *supra* note 56, at 991; *see generally* I.R.S. Announcement 2014-38, 2014-51 I.R.B. 951 (Dec. 15, 2014).

<sup>100</sup> *Crawford*, 2015 WL 5697552, at \*3.

<sup>101</sup> Boyd, *supra* note 92.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

information that must be reported, and hence the types of local laws that must be implemented by the FATCA partner nation.<sup>104</sup> That information includes the name, address, and TIN of any U.S. account holder or controlling U.S. person,<sup>105</sup> the account number, the FFIs identification number, the account balance, the total gross amount and gross interest, and dividends and income for certain accounts.<sup>106</sup> (Basically, all of the factors required under the FATCA absent an IGA) Under this model, the partner nation bears the cost of implementing the laws and reporting requirements of the FATCA in their nation.<sup>107</sup>

## 2. IGA Model 2

Under the model 2 agreements, countries modify their laws and allow the IRS to receive reports directly from the FFIs in their nation.<sup>108</sup> Under this agreement FFIs are instructed by their government to follow the terms of the FFIA entered with the U.S.<sup>109</sup> The terms of the model 2 agreement are similar to those of the model 1 agreement, with the added requirement that the government instruct the FFI to register on the IRS FATCA website and comply with the terms of the FFIA.<sup>110</sup> Under this model, the cost of implementation is born to a larger degree by the FFIs. This is because the reporting and due diligence requirements are passed from the partner government to the FFIs in their country.<sup>111</sup>

## 3. Reciprocity under the IGAs

The reason many countries agree to enter an IGA with the Secretary in the first place is the reciprocity stipulation, which is an agreement that the IRS will exchange information on nonresident alien accounts (“NRA”) in exchange for the information on U.S. citizens abroad.<sup>112</sup> Under reciprocal agreements, the U.S. agrees to exchange the

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<sup>104</sup> Agreement between the Government of the United States of America and the Government of [FATCA Partner] to Improve International Tax Compliance and to Implement FATCA, U.S. DEP’T OF TREASURY 9-10 (Nov. 30, 2014), <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Reciprocal-Model-1A-Agreement-Preexisting-TIEA-or-DTC-11-30-14.pdf> [hereinafter Model 1A Agreement].

<sup>105</sup> *Id.* at 9.

<sup>106</sup> *Id.* at 9-10.

<sup>107</sup> Boyd, *supra* note 92.

<sup>108</sup> Crawford, 2015 WL 5697552, at \*3.

<sup>109</sup> Agreement between the Government of the United States of America and the Government of [FATCA Partner] for Cooperation to Facilitate the Implementation of FATCA, U.S. DEP’T OF TREASURY 6 (Nov. 30, 2014), <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-2-Agreement-Preexisting-TIEA-or-DTC-11-30-14.pdf> [hereinafter Model 2 Agreement].

<sup>110</sup> Compare *id.* with Model 1A Agreement, *supra* note 104.

<sup>111</sup> Model 2 Agreement, *supra* note 109, at 6.

<sup>112</sup> Boyd, *supra* note 92.

same information that partner nations give to the U.S.<sup>113</sup> In recognition of the difficulty and cost involved with identifying passive U.S. accounts, under the reciprocity agreements, the U.S. will pass legislation to increase transparency and reciprocal levels of automatic information exchange.<sup>114</sup> However, although several proposals for such exchanges have been proffered, Congress has not adopted any of the suggestions and so the IRS has yet to meet its reciprocal obligations.<sup>115</sup> This lack of action is given exigence by the fact that all the pre-2017 agreements, which are all but four,<sup>116</sup> contain a provision stipulating that the parties to the agreement will meet to amend the agreement “to reflect progress on the commitments set forth in Article 6” before December 31, 2016.<sup>117</sup>

### C. *How the FATCA Interacts with FBAR*

The FATCA interacts with a number of existing regulations to make them more effective, most notably FBAR. FBAR, or Treasury Form TD F 90-22.1, is a report of an individual’s foreign bank and financial accounts.<sup>118</sup> A duty to file an FBAR form arises if a “U.S. [p]erson” (1) has a direct financial interest in, an indirect financial interest in, signatory authority over, or some other type of authority over one or more financial accounts located in a foreign country and (2) the aggregate value of such account or accounts was greater than \$10,000.00 at any time during the calendar year at issue.<sup>119</sup> Failure to file can result in significant punitive damages for the government.<sup>120</sup> “In order to state a claim regarding a violation of FBAR reporting, the Government must plead facts supporting the reasonable inferences that”<sup>121</sup> (1) the person evading was a “U.S.

<sup>113</sup> For example, Model 1A Agreement, art. 3, § 3(b) provides that “[i]n the case of the United States, the information to be obtained and exchanged with respect to 2014 and subsequent years is all of the information identified in subparagraph 2(b) of Article 2 of this Agreement.” Model 1A Agreement, *supra* note 104, at 11. Further, art. 2, § 2(b) identifies (1) the name address and TIN of account holders (2) the account number (3) the identifying number of the Reporting U.S. FI, (4) the gross interest paid on depository Account, (5) the gross amount of dividends paid or credited to the account and (6) the gross amount of U.S. source dividends paid or credited to the account. *Id.* at 10.

<sup>114</sup> *Id.* at 16 (“Reciprocity. The Government of the United States acknowledges the need to achieve equivalent levels of reciprocal automatic information exchange with [FATCA Partner]. The Government of the United States is committed to further improve transparency and enhance the exchange relationship with [FATCA Partner] by pursuing the adoption of regulations and advocating and supporting relevant legislation to achieve such equivalent levels of reciprocal automatic information exchange.”).

<sup>115</sup> Boyd, *supra* note 92.

<sup>116</sup> See Foreign Account Tax Compliance Act (FATCA), *supra* note 94 (listing all of the IGAs in effect and the type of agreement entered into with each country).

<sup>117</sup> IGA MODEL 1 RECIPROCAL § 10(3) (I.R.S. 2010).

<sup>118</sup> Treasury Form TD F 90-22.1, 31 U.S.C. § 5314 (2012).

<sup>119</sup> 31 U.S.C. § 5314 (2012); see also 31 C.F.R. § 1010.350 (2012), Treasury Form TD F 90-22.1, 31 U.S.C. § 5314 (2012).

<sup>120</sup> 31 U.S.C. § 5321 (2012).

<sup>121</sup> *U.S. v. Pomerantz*, No. C16-0689JLR, 2017 WL 2483213, at \*5 (W.D. Wash. June 8, 2017).

[p]erson," who (2) had an interest in or authority over the subject foreign accounts, which (3) had an aggregate value of \$10,000.00 or more, and (4) that he willfully failed to file an FBAR Form for the accounts.<sup>122</sup> The "interest or authority" element may be met by showing that the taxpayer (1) had a direct financial interest in a foreign account, (2) had an indirect financial interest in a foreign account, or (3) served as a signatory or had other authority over a foreign account.<sup>123</sup>

FBAR violations are codified under the Ant-Money Laundering Act and contain punitive damages for violations. Sometimes these damages exceed the total amount held in the account. By requiring foreign financial institutions to disclose information on U.S. accounts, the FATCA makes it much more likely that FBAR violations will be detected. Combined with the reporting requirements of the FATCA, FBAR has increased the amount of people voluntarily complying with the IRS by imposing the threat of penalties.

#### *D. How the FATCA Interacts with the Offshore Voluntary Disclosure Program*

In 2004, the IRS began an Offshore Voluntary Disclosure Program ("OVDP") which is, in many ways, the inverse of FBAR. The OVDP has netted \$6.5 billion between 2004 and 2014.<sup>124</sup> The program unsurprisingly works through *voluntary disclosures*. People are given reduced penalties if they voluntarily come forward and bring their accounts into compliance. At the writing of this paper, 45,000 people have participated in the program and brought their accounts into IRS compliance.<sup>125</sup> The forgiving nature of the OVDP initially allowed amnesty even for willful violations in exchange for money owed, thereby making it an attractive option for noncompliant citizens.<sup>126</sup>

However, currently OVDPs only cover the civil side of noncompliance. Although voluntary disclosures reduce the chance that a person will be prosecuted under FBAR, as the IRS will not typically recommend criminal charges if a person voluntarily discloses their violation, a person who enters the program is not precluded from criminal prosecution.<sup>127</sup> The most recent iteration of the OVDP was implemented by

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<sup>122</sup> *Pomerantz*, 2017 WL 2483213, at \*5.

<sup>123</sup> 31 C.F.R. § 1010.350(e) (2012).

<sup>124</sup> *Crawford*, 2015 WL 5697552, at \*1.

<sup>125</sup> News Release, Internal Revenue Service, *IRS Makes Changes to Offshore Programs; Revisions Ease Burden and Help More Taxpayers Come into Compliance* (June 18, 2014) available at, <http://www.irs.gov/uac/Newsroom/IRS-Makes-Changes-to-Offshore-Programs;-Revisions-Ease-Burden-and-Help-More-Taxpayers-Come-into-Compliance>.

<sup>126</sup> *Crawford*, 2015 WL 5697552, at \*1.

<sup>127</sup> *Offshore Frequently Asked Questions and Answers 2014*, I.R.S., <https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised> (last visited January 2, 2018).

the IRS in 2014, and unlike previous versions of the bill, contains no time deadline. However, it can also be revoked or modified at any time without notification.<sup>128</sup> The new program also added a 50% penalty for citizens who comply only after the FFI where their accounts are held is placed under investigation.<sup>129</sup> The new version also eliminated many of the reduced penalties implemented by the 2012 model.<sup>130</sup> Despite the shortfalls of the new model, the FATCA still encourages non-compliant citizens to voluntarily comply under the OVDP, or face a greater risk of penalties from FBAR violations.<sup>131</sup>

#### IV. LEGAL PROBLEM ANALYSIS

Courts around the world have had an opportunity to observe and comment on the FATCA's use in their own country. U.S. courts have also had the opportunity to examine the constitutionality of the act. However, surprisingly, none of the decisions to date have reached the merits. Perhaps domestically, it is an issue of *Chevron* deference, or, as noted by courts in the 6th Circuit, it is a question of ripeness<sup>132</sup>. Internationally, it could be an issue of wishing to avoid confrontation with the political and economic clout of the U.S., or, as noted by the court considering the issue in Israel, it could be a that foreign courts view the "main show" as taking place in American courts.<sup>133</sup> Regardless, for the present at least, it appears as if courts are content to wait and see.

##### A. *Domestic Challenges: Crawford v. U.S. Dep't of Treasury; U.S. v. Pomerantz*

The main case on point, domestically, is *Crawford v. US Dep't of Treasury*. In *Crawford*, seven plaintiffs, including Senator Rand Paul, sued for a preliminary injunction against the FATCA's asset reporting requirements, claiming, among other things, that the act violated the 8th Amendment's excessive fines prohibition and the 4th Amendment's Search and Seizure provisions.<sup>134</sup> The plaintiffs claimed that the Act required dual reporting for U.S. citizens who did not reside in the U.S., and therefore unfairly distinguished between foreign and domestic citizens and disparately impacted the foreign citizens.<sup>135</sup> To support this contention, the plaintiffs noted that the IRS only requires a report on interest paid to the

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<sup>128</sup> *Offshore Frequently Asked Questions and Answers 2014*, *supra* note 111, at 1.0.

<sup>129</sup> *Offshore Frequently Asked Questions and Answers 2014*, *supra* note 111, at 7.2.

<sup>130</sup> *Offshore Frequently Asked Questions and Answers 2014*, *supra* note 111, at 1.1.

<sup>131</sup> *Crawford*, 2015 WL 5697552, at \*1-2.

<sup>132</sup> *Crawford*, 2015 WL 5697552, at \*14-15.

<sup>133</sup> Bryan Koenig, *Israeli Court Rejects Challenge of US Tax Data-Sharing Pact*, LAW 360 (September 14, 2016, 3:44 PM), <https://www.law360.com/articles/839893/israeli-court-rejects-challenge-of-us-tax-data-sharing-pact>.

<sup>134</sup> *Crawford*, 2015 WL 5697552, at \*14-16.

<sup>135</sup> *Id.*, at \*12.

accounts during the calendar year for domestic citizens, but, for a foreign account, the IRS requires a report of interest paid, any income gain or loss, deduction, or credit recognized on the account during the year, whether the account was opened or closed and the balance of the account.<sup>136</sup> Although the case was dismissed for lack of standing and ripeness, the court examined the merits and concluded in dicta that the reporting requirement is the same for U.S. citizens living in the U.S. and abroad.<sup>137</sup> In other words, the court concluded that if a U.S. citizen residing in the U.S. were to open an account in an FFI, they would be subject to the same reporting requirements as citizens currently residing abroad. The court also concluded that a disparate impact is not enough to warrant injunctive relief.<sup>138</sup> Although the court's ruling was not dispositive on the issues, the decision did examine the merits of the case and presented powerful arguments as to why it would be constitutional, especially considering the long history of judicial acquiescence to citizen-based taxation.<sup>139</sup>

*United States v. Pomerantz* presents an example of how FBAR could interact with the FATCA in practice. In *Pomerantz*, a dual U.S. and Canadian citizen was sued by the attorney general for \$1.1 million C.D.<sup>140</sup> Although the defendant in *Pomerantz* filed income tax returns with Canada and the IRS, he failed to file an FBAR form; therefore, pursuant to the IGA between the United States and Canada, the Canadian government disclosed his bank accounts to the IRS.<sup>141</sup> Rather than argue against the disclosure of information, the defendant instead argued that he did not meet the elements of an FBAR failure-to-file penalty.<sup>142</sup> To constitute a violation, the failure to file must be "willful," which means that the person in violation must *know* that they were supposed to file in the first place.<sup>143</sup> Willful ignorance is not an excuse, and the knowledge could be actual or constructive.<sup>144</sup> The court ruled in favor of the defendant on a 12(b)(6) motion to dismiss because the government did not prove the willful element.<sup>145</sup> Like *Crawford*, *Pomerantz* did not reach the merits of a challenge to the FATCA itself, but instead

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<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> *Id.* at \*13.

<sup>139</sup> See generally *Cook v. Tait*, 265 U.S. 47, 56 (1924) (holding that the government has to power to tax a US citizen's property wherever it is found).

<sup>140</sup> *U.S. v. Pomerantz*, No. C16-0689JLR, 2017 WL 2483213, at \*1 (W.D. Wash. June 8, 2017).

<sup>141</sup> Elizabeth Thompson, *U.S. government suing Canadian resident for \$1.1M over bank form*, CBC News (Mar. 16, 2017, 5:00 AM), <http://www.cbc.ca/news/politics/taxation-canada-u-s-irs-1.4025880>.

<sup>142</sup> *Pomerantz*, 2017 WL 2483213 at \*5.

<sup>143</sup> *Id.* at \*6.

<sup>144</sup> See *id.* at 14-15; *Offshore Voluntary Disclosure Program (OVDP) Frequently Asked Questions and Answers 2014*, IRS, <https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised> (under current law even non-willful FBAR violations are subject to a \$10,000 fine).

<sup>145</sup> *Pomerantz*, 2017 WL 2483213 at \*15.

acknowledged a narrow exception which will likely become smaller over time as the FATCA becomes more widespread. However, the excessive penalties sought also illustrate the interaction between FBAR and the FATCA and the potential for huge windfalls for the IRS.

*B. Foreign Challenges: Hillis v. A. G. of Canada; Republicans Overseas Israel v. Israel*

Due to the international nature of the reporting requirements of the FATCA, challenges to the bill are not limited to U.S. courts. In *Hillis v. Attorney General of Canada*, the plaintiffs did not challenge the FATCA directly as unconstitutional, but rather they challenged the act in relation to the Canadian constitution.<sup>146</sup> The suit was brought by two dual U.S. and Canadian citizens who claimed that the IGA with Canada violated both the Canadian Constitution and the Canada-US double taxation agreement (“DTA”).<sup>147</sup> Rather than addressing the merits of the case, the court held that the bill was “legally authorized in Canada by the provisions of the IGA Implementation Act.”<sup>148</sup> The court also concluded that the DTA was not violated, because reporting is not the same as taxing, and the reporting requirements of the FATCA therefore are permissible.<sup>149</sup>

In *Republicans Abroad in Israel v. Government of Israel*, the plaintiffs brought suit and won a preliminary injunction against the IGA with Israel and the Implementation of the FATCA there.<sup>150</sup> In granting the injunction, Judge Mazuz noted how there was not much of a right to privacy left and that the alternative to that right is crime.<sup>151</sup> However, the temporary injunction was dismissed, and the justices in the court above noted that it was “ancillary to the ‘main show’ U.S. legal challenge.”<sup>152</sup>

After examining the legal conflicts arising from the FATCA, it is probable that any successful legal challenge would take place in the United States, and given recent judicial trends, it is unlikely that the challenge will prevail. The FATCA is likely here to stay until or unless it is repealed. The reason for repeal or modification therefore would have to be due to some practical aspects of the act rather than legal challenges.

<sup>146</sup> *Canadian Court Dismisses FATCA Lawsuit*, SOVOS INTELLIGENT COMPLIANCE, <https://sovos.com/blog/canadian-court-dismisses-fatca-lawsuit/> (last accessed Sept. 15, 2017).

<sup>147</sup> *Id.*

<sup>148</sup> *Id.* (citing *Hillis v. Attorney General of Canada*, [2015] F.C. 1082 (Can. Ont.))

<sup>149</sup> *Id.*

<sup>150</sup> Bryan Koenig, *Israeli Court Rejects Challenge of US Tax Data-Sharing Pact*, LAW 360 (Sept. 14, 2016), <https://www.law360.com/articles/839893/israeli-court-rejects-challenge-of-us-tax-data-sharing-pact> (last accessed Sept. 15, 2017); see H.C.J 8886/15 *Republicans Abroad in Israel v. Government of Israel* (2015) (Isr.), <https://supremedecisions.court.gov.il/Home/Download?path=HebrewVerdicts\15\860\088\k12&fileName=15088860.K12&type=4> (Hebrew only).

<sup>151</sup> Koenig, *supra* note 150.

<sup>152</sup> *Id.*

## V. PRACTICAL PROBLEM ANALYSIS

Over the course of the seven years since its initial passage, the proposed aims of the FATCA have not been fully realized for many reasons. Three of the main reasons are crypto currencies, corporate inversion, and expatriation. First, in our world of ever-evolving technology, cyber currencies have become new tax havens for citizens wishing to avoid the U.S. tax burden.<sup>153</sup> Although they still constitute an emerging market, cyber currencies allow people to convert assets into data which can then be liquidated or traded for goods.<sup>154</sup> Second, corporations are giving up their U.S.-based citizenship in order avoid the associated heavy tax burden associated.<sup>155</sup> U.S.-based corporations are dissolving and reforming under new corporate charters granted by foreign nations, allowing them to avoid onerous U.S. taxes.<sup>156</sup> Finally, despite the growing barriers to doing so, individual citizens are giving up their U.S. citizenship at record rates.<sup>157</sup> Currently, most of the people expatriating are individuals who hold dual citizenship with little ties to the U.S., but as time and taxes progress, the trend is likely to spread to more U.S. citizens who wish to leave just to avoid taxes.<sup>158</sup> Whatever the reasons, the FATCA is not performing as forecast and the cost of enforcing the act outweighs the fiscal gains it produces for the United States.

A. *Crypto Currencies: The New Swiss Bank Account*

In 2009, Satoshi Nakamoto invented a form of cyber currency called “bitcoin.”<sup>159</sup> Since then, over 30 other types of similar currencies have been introduced.<sup>160</sup> What this means in a practical sense is, today, U.S. citizens can convert their assets into virtual currency and transfer it to an offshore account or store it on a personal memory drive.<sup>161</sup> The transactions are designedly “pseudo-anonymous” and permanent.<sup>162</sup> Their creators meant to develop a “virtual” economy free from government taxes and general interference.<sup>163</sup> Since cryptocurrency is just a digital record on an

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<sup>153</sup> Elizabeth M. Valeriane, *IRS, Will You Spare Some Change: Defining Virtual Currency for the FATCA*, 50 Val. U. L. Rev. 863, 893 (2015-2016).

<sup>154</sup> *Id.* at 863 n.2.

<sup>155</sup> See DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH SERV., R43568, *Corporate Expatriation, Inversions, and Mergers: Tax Issues*, 1-2 (2014).

<sup>156</sup> *Id.* at 3.

<sup>157</sup> Ari Shapiro, *Why more Americans Are Renouncing U.S. Citizenship*, NPR (Feb. 20, 2014, 3:42 AM), <http://www.npr.org/sections/parallels/2014/02/20/275937138/why-more-americans-are-renouncing-u-s-citizenship>.

<sup>158</sup> *See id.*

<sup>159</sup> Valeriane, *supra* note 153, at 868.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* at 865.

<sup>162</sup> *Id.* at 867.

<sup>163</sup> *Id.*

electronic account and it is not physically located anywhere, it is hard to trace. People can often escape detection by using it.<sup>164</sup>

The most common forms of cryptocurrency require account holders to secure public and private addresses.<sup>165</sup> They use the private address for sending cyber currency and the public address for receiving it.<sup>166</sup> Users can then secure the “virtual wallet” on a hard drive or external memory source and can easily access it at any time they want.<sup>167</sup> Depending on the format used, the currency can be either centralized, where it is stored on one server, like a bank, or decentralized, like bitcoin, which relies on users to manufacture and store it.<sup>168</sup> Similar to a stock, both types of currency can be sold and converted into actual currency.<sup>169</sup> One reason that it has not become widespread yet is that cyber currency is very unstable. Bitcoin, for example ranged in price from \$70 per unit to \$600 within a few months.<sup>170</sup> Despite its instability, cyber currency is gaining popularity and the FATCA currently does not incorporate Virtual Wallet providers into its definition of FFI's allowing them to escape IRS regulation for the present.<sup>171</sup>

### *B. Corporate Inversion: A Way Out for Large Corporations*

Another problem with the FATCA is that it does not take corporate inversion into account. Corporate inversion is the process by which large corporations change their citizenship to escape onerous U.S. taxes.<sup>172</sup> Corporations then reincorporate and become a subsidiary of a foreign corporation.<sup>173</sup> Although in many cases the corporation's principle place of business and corporate headquarters remains in the United States, they are no longer subject to U.S. jurisdiction and tax laws in the same manner they would be if they were incorporated in the U.S..<sup>174</sup> Although corporate inversion is not new and was first recorded in 1980, over half of all the conversions that have taken place have been within the last five years.<sup>175</sup> This shows an alarming trend towards corporations fleeing the oppressive tax structure of the U.S., which is among the highest in the world, and, more importantly, represents millions in lost revenue for the U.S. government.

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<sup>164</sup> *Id.* at 871 n.42.

<sup>165</sup> *Id.* at 870.

<sup>166</sup> *Id.*

<sup>167</sup> *Id.* at 873.

<sup>168</sup> *Id.* at 868-69.

<sup>169</sup> *Bitcoin under pressure*, THE ECONOMIST, (Nov. 30, 2013),

<https://www.economist.com/news/technology-quarterly/21590766-virtual-currency-it-mathematically-elegant-increasingly-popular-and-highly>.

<sup>170</sup> *Id.*

<sup>171</sup> Valeriane, *supra* note 153, at 865.

<sup>172</sup> MARPLES & GRAVELLE, *supra* note 155.

<sup>173</sup> *Id.*

<sup>174</sup> Michael B. Cohen, *Avoiding Double Taxation and Expatriation: A Comprehensive Solution to FATCA and Corporate Inversion*, 41 N.C. J. Int'l L. 595, 628-29 (2015-2016).

<sup>175</sup> *Id.* at 629.

### C. Corporate Inversion: A Way Out for Large Corporations

If a U.S. citizen is fed up and decides that they want to leave, they can pack up and do so. It is a free country after all, right? Not quite. Citizens cannot simply renounce citizenship, take their money, and run.<sup>176</sup> If a person is “covered” under the definition of 26 U.S.C. §877 (a)(2)(A-C), they are subject to a number of requirements before they can give up their citizenship.<sup>177</sup> Subsection (A) provides coverage if the average net income of the preceding five taxable years is more than \$124,000.<sup>178</sup> Subsection (B) extends the coverage to people with a net worth of \$2,000,000 or more.<sup>179</sup> Finally, Subsection (C) extends coverage to people who fail to certify or provide evidence that they do not qualify.<sup>180</sup> If one of these requirements are met, then all the person’s property in the U.S. is “deemed sold” the day before expatriation and the gains are counted as income for the year in question with taxes due.<sup>181</sup> “Property” includes (A) real property, (B) stocks or debt obligations, and (C) income or gain derived from controlled foreign corporation.<sup>182</sup> Additionally, the cost of simply completing the necessary paperwork increased from \$400 to over \$2,000 in 2014 alone.<sup>183</sup>

Despite these barriers, there is a noticeable upward trend in expatriation in the United States.<sup>184</sup> Thirteen years ago, the rate of expatriation in the U.S. was generally stable at a rate of about 500 people per year.<sup>185</sup> By 2013 it was nearly 3,000 and it was not a gradual change.<sup>186</sup> The sudden rise in rates of expatriation took place in 2008 when *UBS AG of Switzerland* case was decided and continued to climb due in large part to the FATCA.<sup>187</sup> By 2016, that number reached a record 5,411 citizens choosing to face the cost of expatriation rather than bear the cost of maintain their citizenship.<sup>188</sup> Whether the costs of the program are worth the trouble associated with the gains depends on large part on the gains realized under the FATCA.

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<sup>176</sup> See generally *Expatriation Tax*, IRS.GOV (last updated Mar. 30, 2018), <https://www.irs.gov/individuals/international-taxpayers/expatriation-tax>.

<sup>177</sup> See generally 26 U.S.C. § 877(a) (2012).

<sup>178</sup> 26 U.S.C. § 877(a)(2)(A) (2012).

<sup>179</sup> 26 U.S.C. § 877(a)(2)(B) (2012).

<sup>180</sup> 26 U.S.C. § 877(a)(2)(C) (2012).

<sup>181</sup> *Expatriation Tax*, IRS.GOV (last updated Mar. 30, 2018), <https://www.irs.gov/individuals/international-taxpayers/expatriation-tax>.

<sup>182</sup> 26 U.S.C. § 877(d)(1)(A-C) (2012).

<sup>183</sup> Lyman Stone, *In the Age of Global Citizenship, American Expatriates Increase*, THE FEDERALIST: WORLD AFFAIRS (May 4, 2015), <http://thefederalist.com/2015/05/04/in-an-age-of-global-citizenship-american-expatriates-increase/>.

<sup>184</sup> Shapiro, *supra* note 157.

<sup>185</sup> *Id.*

<sup>186</sup> *Id.*

<sup>187</sup> *Id.*

<sup>188</sup> Deidre McPhillips, *Record Number Renounce U.S. Citizenship in 2016*, U.S. NEWS (Feb. 9, 2017), <https://www.usnews.com/news/best-countries/articles/2017-02-09/record-number-renounce-us-citizenship-in-2016>.

#### D. Cost Revenue Analysis

It is difficult to get precise numbers on the FATCA's effectiveness due to the integrated nature of tax collection in the U.S. and the number of fluctuating factors that affect revenue. The Joint Committee on Taxation initially estimated that the FATCA would garner \$792 million per year, and netting \$8.7 billion over 10 years when it was expected the Act would bring most people into compliance.<sup>189</sup> A later estimate concluded that revenues would be \$250 million per year, or \$2.5 billion total.<sup>190</sup> One estimate places the actual recovery rates closer to 400 million per year with a prediction that they would decrease the longer FATCA is in place as more people come into compliance.<sup>191</sup> The IRS has claimed that the Act was a great success. Since 2009, the agency has claimed \$10 billion dollars in revenue from the FATCA.

However, this number is misleading because approximately \$8 billion of that revenue was generated by FBAR, which was passed under the BSA.<sup>192</sup> The difference is important because the FATCA is a Title 26 tax bill and there are limits to the amount that it generates.<sup>193</sup> FBAR conversely, is an anti-money laundering statute under the Bank Secrecy Act.<sup>194</sup> The stricter penalties allowable under the BSA stipulate that accounts can be subject to a fine of up to half the money in an account or a penalty, whichever is greater. Cumulative penalties as large as 150% of the value of the account have been approved for FBAR violations.<sup>195</sup> The FATCA certainly has led to a greater number of FBAR violations discovered, and those violations net big dollars for the U.S. government, but it is tough to correlate the punitive nature of FBAR violations with the tax-based nature of the FATCA. More to the point, the IRS also rolls in the taxes earned through OVDP, which was also passed before FATCA<sup>196</sup> into the revenue generated by the FATCA. The OVDP has netted over \$6 billion since its implementation and has significantly contributed to the money claimed by the IRS as revenue.

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<sup>189</sup> Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment to the Senate Amendment to the House Amendment to the Senate Amendment to H.R. 2847, the "Hiring Incentives to Restore Employment Act"*, JCX-6-10, available at <https://www.jct.gov/publications.html?func=showdown&id=3650>

<sup>190</sup> JANE G. GRAVELLE, CONGRESSIONAL RESEARCH SERVICE, *TAX HAVENS: INTERNATIONAL TAX AVOIDANCE AND EVASION*, 20 (2015).

<sup>191</sup> William Byrnes, *Is FATCA chasing a leprechaun and his pot of gold?* CAYMAN FINANCIAL REVIEW (Aug. 19, 2015), <http://www.caymanfinancialreview.com/2015/08/19/Is-FATCA-chasing-a-leprechaun-and-his-pot-of-gold-/>.

<sup>192</sup> Republican Overseas, Inc., *Senate Finance Committee Submissions*, Apr. 14, 2015, available at <http://fatca.eu.pn/docs/Republicans%20Overseas.html>.

<sup>193</sup> See 26 U.S.C. § 1471 (2010).

<sup>194</sup> 31 U.S.C. § 5314 (2012).

<sup>195</sup> Byrnes, *supra* note 192.

<sup>196</sup> *Id.*

The costs of the FATCA is likewise not easy to calculate, but it can be separated into four major categories: institutional, global, domestic, and individual.<sup>197</sup> First, the industries bear the brunt of the implementation cost for the FATCA. Implementing the FACTA costs a small institution an estimated \$25,000, the average institution between \$100,000 - \$500,000, and larger institutions \$1 million or more.<sup>198</sup> On a global scale, Forbes estimated the cost to be \$8 billion per year.<sup>199</sup> Depending on the estimate relied upon, this is approximately ten times the revenue raised by the FATCA.<sup>200</sup> The FATCA XML data website cost \$16.6 million to develop, and in 2013 the IRS requested an additional \$37.1 million in funding for the FATCA's IT development, and additional staff examiners and agents.<sup>201</sup>

Individual costs are likewise difficult to estimate. The court in Canada held that since the FATCA only required reporting, it did not violate the double taxation agreement.<sup>202</sup> However, the time required to file the form is its own cost. For example, the FATCA requires that a person who owns a passive foreign owned investment, such as a mutual fund, fill out a Form 8621.<sup>203</sup> The IRS estimates that a person with a single passive foreign owned investment would require 16 hours and 58 minutes to keep the requisite records, 11 hours and 24 minutes to learn about the law and the form, and 20 hours and 34 minutes to fill out the form and send it to the IRS.<sup>204</sup> Consider a person who diversified and has multiple passive investments, such a person would have to spend the same amount of time record keeping and filling out paperwork (16 hours and 58 minutes + 20 hours and 34 minutes equaling a total of 37 hours and 32 minutes) for each account. Multiply that number by the millions of such accounts in existence and you will get a number close to the estimates made using data from the

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<sup>197</sup> *Id.*

<sup>198</sup> Paul Cochrane, *FATCA – Region preparing for Uncle Sam: Forthcoming US Rules Loom Large Over Middle Eastern Banking Sector*, EXECUTIVE MAGAZINE (Apr. 30, 2014), <http://www.executive-magazine.com/business-finance/finance/fatca-answering-to-uncle-sam>.

<sup>199</sup> Robert W. Wood, *FATCA Carries Fat Price Tag*, FORBES (Nov. 30, 2011), <https://www.forbes.com/sites/robertwood/2011/11/30/fatca-carries-fat-price-tag/#22c0dc864ae9>.

<sup>200</sup> Mark Twain, *FATCA Global Implementation Costs Revealed*, THE ISAAC BROCK SOCIETY (Oct. 20, 2014), <http://isaacbrocksociety.ca/2014/10/20/fatca-global-implementation-costs-revealed-cross-post-guest-post/>.

<sup>201</sup> U.S. TREASURY INSPECTOR GENERAL FOR TAX ADMIN., REF. NO. 2013-20-118, FOREIGN ACCOUNT TAX COMPLIANCE ACT: IMPROVEMENTS ARE NEEDED TO STRENGTHEN SYSTEMS DEVELOPMENT CONTROLS FOR THE FOREIGN FINANCIAL INSTITUTION REGISTRATION SYSTEM 7,19 (2013); U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-484, REPORT TO THE COMMITTEE ON FINANCE, U.S. SENATE: FOREIGN ACCOUNT REPORTING REQUIREMENTS: IRS NEEDS TO FURTHER DEVELOP RISK, COMPLIANCE AND COST PLANS 14 (2012).

<sup>202</sup> *See generally Crawford*, 2015 WL 5697552, at \*11 ("If Model 1 partner countries comply with Article 2 as well as the "Time and Manner of Exchange of Information" agreed to in Article 3 and other rules, then their reporting FFIs 'shall be treated as complying...").

<sup>203</sup> INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, CAT. NO. 10784P, INSTRUCTIONS FOR FORM 8621 1 (2017) <https://www.irs.gov/pub/irs-pdf/i8621.pdf>.

<sup>204</sup> *Id.* at 14.

Bureau of Labor Statistics, which found that Americans spend an average of 4,446,476 hours filling out Form 8957 as required by the FATCA. The estimated cost for this time is \$165,764,625 per year.<sup>205</sup>

The cause for the remaining taxes that elude the IRS might be debatable, but the cost is far greater than the benefits if viewed from a strictly economic perspective. It is doubtful that 100% of the taxes levied by any government will ever be collected, especially in a country like the U.S., with a rich history of dumping tea and rebelling for taxes levied on whiskey. The question becomes how much spending is justified in pursuit of the remaining elusive tax revenue. To be sure, there are deterrence and ideological reasons to go after the people evading taxes, but again the question of justifiable expenditures is raised.

## VI. SOLUTION ANALYSIS

### A. *Repeal*

Repealing FATCA is probably the most popular solution.<sup>206</sup> There are strong arguments on this side. The Act costs more than it gains in revenue,<sup>207</sup> and it is a burden to the approximately nine million Americans living abroad in addition to the over 300 FFIs who have signed onto the FATCA.<sup>208</sup> Additionally, the revenue that the Act takes in is offset by the approximately \$53 million onetime costs and \$40 million to \$160 million annual cost to the IRS.<sup>209</sup> The act is performing nowhere near as effectively as it was supposed to and there is still a significant tax gap.<sup>210</sup> All of this and more make repealing FATCA a popular option.

The problem with this solution, to borrow the analogy, is that it is like closing the door after the horse is out of the barn. To begin with, there is a real problem of a tax gap to the tune of 15-20% pre-FATCA.<sup>211</sup> Additionally, the FATCA has already cost institutions and governments billions of dollars, repealing the Act would essentially waste those expenditures. Further, before the FATCA, the U.S. had approximately 20

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<sup>205</sup> Scott A. Hodge, *The Compliance Costs of IRS Regulations*, TAX FOUND. (June 15, 2016), <https://taxfoundation.org/compliance-costs-irs-regulations/>.

<sup>206</sup> Lisa Smith, *Repeal FATCA Protest Hits Washington Wall of Silence*, REPEALFATCA (July 20, 2017), <http://repealfatca.com/2017/07/20/repeal-fatca-protest-hits-washington-wall-silence/>.

<sup>207</sup> Byrnes, *supra* note 192.

<sup>208</sup> U.S. Dep't of State, Bureau of Consular Affairs, "CA By the Numbers" available at [https://web.archive.org/web/20160616233331/https://travel.state.gov/content/dam/travel/CA\\_By\\_the\\_Numbers.pdf](https://web.archive.org/web/20160616233331/https://travel.state.gov/content/dam/travel/CA_By_the_Numbers.pdf).

<sup>209</sup> Foreign Account Reporting Requirements.

<sup>210</sup> Kelly, *supra* note 56, at 984-85.

<sup>211</sup> I.R.S. News Release IR-2012-4 (Jan. 6, 2012).

tax information exchange agreements (TIEAs) with partner nations.<sup>212</sup> However, the FATCA overrode these agreements, so the TIEAs' current status is questionable.<sup>213</sup> Absent these agreements, which were inadequate to their task to begin with, there would be little insight into U.S. accounts held abroad.<sup>214</sup> To this end, if the Act were repealed, Congress would probably feel pressure to sign onto the Common Reporting Standard ("CRS") proposed by the Organization for Economic Co-operation and Development and already adopted by a growing number of nations.<sup>215</sup> The CRS is a bank transparency agreement that proposes similar reporting standards as the FATCA, only it is regulated internationally, not domestically.<sup>216</sup> Given the fact that the FATCA was enacted to fix a real problem, and that the U.S. would likely be left with a foreign-controlled agreement that reached the same ends, complete repeal seems unlikely, and a bad option.

### B. *Switch to a Territorial Approach*

Another popular suggestion is to make taxes based on residency, rather than citizenship. This would allow the U.S. to tax the persons and businesses residing within its territory without infringing on the territories of other sovereign nations.<sup>217</sup> This would also solve the corporate inversion problem, because companies will be taxed based on where they conduct business, regardless of where they are incorporated.<sup>218</sup> Additionally, this plan has the added incentive of removing a significant tax barrier to repatriating corporate profits.<sup>219</sup> If people and corporations are taxed based on where their profits are made, where they spend their profits would not make a difference. This could lead to more money spent domestically and thus increased tax revenue, which would offset the profits lost from money made internationally.

The problem with this approach is it does nothing to combat the real problem the FATCA was aimed at stopping: companies and persons hiding their assets in tax havens. Without the FATCA or similar piece of legislation, individuals and corporations could continue to hide assets, regardless of the assets origins, in offshore accounts completely outside of

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<sup>212</sup> Callyn H. Terveer, *Desperate Times Call for Desperate Measures: The Cost to Multinational Corporations of Implementing FATCA*, 15 HOUS. BUS. & TAX L.J. 300, 324 (2015).

<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> Randall M. Cathell, *Recent developments under FATCA, U.S. withholding tax, and global information reporting*, THE TAX ADVISER (Howard Wagner ed., Sept. 1, 2017), <https://www.thetaxadviser.com/issues/2017/sep/developments-fatca-withholding-global-information-reporting.html>.

<sup>216</sup> *Id.*

<sup>217</sup> Cohen, *supra* note 174, at 644.

<sup>218</sup> *Id.*

<sup>219</sup> Terveer, *supra* note 214, at 327.

the purview of the United States. Hiding money from the government is not unique to the two countries that tax based on citizenship. The fact that the reciprocal arrangement under the IGAs and the growing popularity of the CRS is illustrative of most governments' desire for greater banking transparency, regardless of the organization of their tax system.

*C. Increase Exit Costs and The Cost of Inversion, and Lower the Percentage Requirements Used to Determine a Corporation's Country of Incorporation*

Another solution would be to increase exit costs, or the cost of inversion, while simultaneously lowering the percentage requirements used to determine a corporation's country of origin. This solution is the inverse of the preceding two. President Obama proposed lowering the 80% former shareholder test to 50%.<sup>220</sup> As it stands now, if a corporation wants to invert, but 80% of the new shareholders are the same as the former U.S. shareholders, the company is still a U.S. company for tax purposes. Obama's suggestion would lower the requirement to 50%. In other words, if half of stockholders are the same following an inversion, then the corporation is still U.S. based for tax purposes.<sup>221</sup>

Another suggestion along the same lines is to add an "exit tax," which would function like the current tax on expatriation of citizens. Under this model, a corporation's remaining U.S. assets following an inversion would be taxed as if they were sold. This would deter inversion and provide more equitable taxes in the event that inversion occurred anyway.

The problem with these proposals is it is just more stick with no carrot. Companies and individuals who have seen the current taxation trend may be more willing to face the stiffer fines to avoid future high taxation.

*D. Aggregate Approach*

The best solution to resolving the problems created by the FATCA is an aggregate of methods with each solution tailored to aid an impact the FATCA has on different types of groups. The aggregate approach would involve (1) lowering the penalties associates with the OVDPs, (2) actually complying with the reciprocal agreements promised, (3) decreasing the corporate tax rate, and (4) awarding a percentage of the penalties recovered under FBAR to the FFI that discovers the violation. The aggregate approach

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<sup>220</sup> *US President releases Budget and tax proposals*, WASHINGTON COUNCIL ERNST & YOUNG (Mar. 7, 2014), <https://www.ey.com/gl/en/services/tax/international-tax/alert--us-president-releases-budget-and-tax-proposals>; See also OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2015 (2014).

<sup>221</sup>*Id.*

would benefit (1) individuals, (2) foreign governments, (3) corporations, and (4) FFIs respectively.

*1. Make it easier for non-compliant citizens to cooperate through the OVDP*

Before the FATCA was enacted, despite the holes in the enforcement, the United States received a remarkable degree of voluntary compliance under their unique tax structure. Further, when late payments were considered, this number was increased to 85.5%.<sup>222</sup> There are obviously exceptions, but the high voluntary compliance rate coupled with the success of the OVDP is illustrative of amount of people who are willing to come into compliance voluntarily. However, the OVP is currently compromised by the fact that citizens who voluntarily attempt to bring their accounts into compliance might still be subject to a criminal FBAR penalty, as well as the fact that many of the reduced penalties available under the 2012 model were revoked by the 2014 model. This part of the solution would involve eliminating the possibility of penalties if a person reports themselves, and a reduction in the overall fees to become compliant.

While it is true that many people could be forced into compliance by the FATCA, thereby rendering the OVDP obsolete, and the government could make more money through FBAR penalties than the reduced penalties of the OVDP, the burden and expenditures outweigh the costs of this forceful compliance as noted above. Additionally, citizens would be less likely to hide their funds in cryptocurrencies or other tax havens if there is an option to comply without facing penalties. The FATCA was enacted, despite the holes in the enforcement, the United States received a remarkable degree of voluntary compliance under their unique tax structure. Further, when late payments were considered, this number was increased to 85.5%. There are obviously exceptions, but the high voluntary compliance rate coupled with the success of the OVDP is illustrative of amount of people who are willing to come into compliance voluntarily. However, the OVP is currently compromised by the fact that citizens who voluntarily attempt to bring their accounts into compliance might still be subject to a criminal FBAR penalty, as well as the fact that many of the reduced penalties available under the 2012 model were revoked by the 2014 model. This part of the solution would involve eliminating the possibility of penalties if a person reports themselves, and a reduction in the overall fees to become compliant.

*2. Comply with the Reciprocal Portion of the Agreements.*

Reciprocal account sharing on the part of the U.S. with IGA partner nations will decrease the burden on those countries by adding a

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<sup>222</sup> I.R.S. News Release IR-2012-4 (Jan. 6, 2012); Kelly, *supra* note 56, at 984.

benefit to counterbalance expenditures and make the FATCA more equitable internationally. Currently, the main way that the FATCA ensures compliance is through the strength of the U.S. economy and the threat of withholding 30% of funds invested by FFIs in U.S. Markets. Although this is effective, it is not good for international relations. Additionally, countries that receive a benefit from an arrangement are more likely to comply with their end of the bargain. Similarly, there is likely a positive correlation between the amount of effort that partner nations are willing to put into searching out U.S. accounts and the benefit they receive from doing so.

### 3. *Lower the Corporate Tax Rate*

The US has the 3rd highest corporate tax rate in the world, behind only Chad and the UAE.<sup>223</sup> Decreasing, but not eliminating the corporate tax rate would incentivize more corporations to stay in the U.S. and reduce the inversion rate. The reason that many corporations invert is to save money by incorporating under a different nation. Reducing the tax burden on corporations to bring the rate level with competitor nations will encourage corporations to remain in the U.S. and pay their taxes with the IRS.

Reducing the corporate tax rate could result in higher taxes collected by the U.S. in line with the Laffer curve, a theory that prescribes the optimal level of taxation for revenue collection.<sup>224</sup> Although the success of Laffer's model depends on the strength of the supply side effect and is contested by many economists, the principal of deadweight loss through taxation is sound and has found its way into many economics textbooks. If the effects of a corporate tax cut were compounded by the fact that some corporations would not expatriate at a lower tax rate but would expatriate at current rates, it is clear that the IRS would gain more revenue from reducing the corporate tax rate to bring it in line with competing nations.

### 4. *Award a Percentage of the Penalty Recovered to the FFI that discovered the Violation*

Awarding a percentage of the penalty recovered to the FFI that discovered the violation would reward the institution that bears most of the cost in discovering the violation. This would incentivize FFIs to delve deeper into their records, and it would also defray the FFI's cost in maintaining U.S. accounts. Although this solution would reduce the amount of penalties collected through FBAR violations by the IRS, it would also increase the amount of violations that were found, thus increasing the revenue of the IRS ultimately gets and further reducing the tax gap.

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<sup>223</sup> Derek Tsang, *Does the U.S. have the highest corporate tax rate in the free world?*, POLITICO (Sept. 4, 2014), [www.politifact.com/punditfact/statements/2014/sep/09/eric-bolling/does-us-have-highest-corporate-tax-rate-free-world/](http://www.politifact.com/punditfact/statements/2014/sep/09/eric-bolling/does-us-have-highest-corporate-tax-rate-free-world/).

<sup>224</sup> See Seth Giertz, *The Elasticity of Taxable Income*, in TAX POLICY LESSONS FROM THE 2000S 101, 125, 128 (Alan D. Viard ed., 2009).

## VII. CONCLUSION

The United States needs the FATCA, or something similar, in order to force compliance from true tax dodges and to increase bank transparency, but modifying the Act as suggested would soften the blow of the proverbial stick and simultaneously hold out a carrot, thereby reducing the burden on foreign nations and encouraging bilateral cooperation while leaving the unilateral option on the table. The FATCA is in place, and while it could be argued that it should not have been passed in the first place, large sums of money have already been laid to implement the Act. Additionally, the FATCA interacts with many existing laws, such as the Anti-Money Laundering Act, or OVDPs, to increase their effectiveness. In many ways the FATCA is America's Luca Brasi. It might be embarrassing at weddings, but when the Tattaglias come around, you want to have it as an option.

Implementing the solutions discussed in the aggregate approach would reduce the burden of the FATCA on those that are hit the hardest by it and solve many of the spoken and unspoken associated problems associated. While the recommendation's focus addresses the larger institutional problems associated with the FATCA, the solution would also aid the more individual problems felt by U.S. citizens living abroad.

For example, what would the modifications suggested do for the mother in the beginning of this comment who had her accounts frozen? The answer is that she likely would not have been forced out of her first bank if the blow of the FATCA were softened in the recommended manner. First, the growing popularity of the CRS and other like agreements that impose a similar burden on FFIs reduce the impact of the FATCA. Although the burden to the FFI is the same, the fact that an alternative, like CRS, would impose similar reporting requirements even in the absence of the FATCA, and already imposes burdens on reporting on citizens of different nations, reduces the benefit of expelling U.S. account holders. Additionally, the possibility of gaining penalties from seeking out non-compliant account holders would incentivize the FFI to maintain U.S. accounts in the hope of gaining something in exchange for work they would likely be required to do regardless.