Will Patents Be the Next Wave in Investor-State Arbitration?

By Sherman Kahn

It is not controversial that intellectual property can be a protected investment under both bilateral and multilateral investment treaties. For example, the 2012 U.S. Model Bilateral Investment Treaty defines investment as follows:

> "investment" means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:
>
> . . .
>
> (f) intellectual property rights;
>
> . . ."[1]

While the formulations differ, other U.S. Bilateral Investment Treaties ("BITs") similarly include IP rights as protectable investments.[2] Likewise, U.S. bilateral and multilateral free trade agreements protect investment in intellectual property.[3] Protection of international property in bilateral and multilateral investment protection treaties is not limited to the United States; rather it is widespread.[4]

Certainly, then, an aggrieved international investor would have rights under such international agreements to bring an arbitration should a host state take an action depriving the investor of patent rights qualifying as an investment under the applicable treaty. Nonetheless, patent related investment arbitration has not, to date, been common; rather investment arbitration has been more concentrated in heavy industries such as oil and gas, mining and infrastructure projects.[5]

A few intellectual property issues have recently emerged in investor-state arbitration. This article discusses some of these developments.

A. Tobacco Trademarks

In recent years, trademark rights have provided the putative basis for a variety of investor-state arbitrations brought by the tobacco industry to combat labeling restrictions imposed by states on tobacco products. Perhaps the most prominent of these arbitrations is one brought by a Hong Kong subsidiary of Philip Morris against Australia under the Australia-Hong Kong BIT challenging Australia's imposition of plain packaging requirements on cigarettes.[6] In its Notice of Arbitration, Philip Morris Asia Limited ("Philip Morris") claims that it owns a covered investment through shares in Philip Morris's Australian subsidiary which, in turn, holds rights in intellectual property.[7] Philip Morris alleges in its notice of arbitration that Australia's plain packaging statute deprives Philip Morris of its trademarks rights and goodwill in violation of the BIT's provisions on expropriation, fair and equitable treatment, unreasonable impairment of the investment and full protection and security.[8] Philip Morris also alleges that the plain packaging legislation violates the treaty's umbrella clause—*i.e.*, that each party shall observe any obligation it may have entered with regard to investments of investors of the other contracting party—by allegedly failing to adhere to obligations under the Agreement on Trade Related Aspects of Intellectual Property Rights ("TRIPS"), the Agreement on Technical Barriers to Trade ("TBT") and the Paris Convention for the Protection of Intellectual Property ("Paris Convention").[9] The arbitration is ongoing, with the most recent event, a hearing on bifurcation of the tribunal's decision on jurisdiction in February 2014.[10]

The Philip Morris Australia arbitration appears to be part of a concerted effort by the tobacco industry to utilize international investment and IP harmonization treaties as a tool to combat anti-tobacco legislation around the world.[11] Philip Morris has brought a similar arbitration challenging plain packaging legislation in Uruguay; an ICSID tribunal confirmed jurisdiction over this challenge in July of 2013.[12] *The New York Times* reports that threats from tobacco companies of treaty arbitration have caused countries around the world to back off of strict tobacco restrictions.[13]

It remains to be seen whether the tobacco industry is successful in this use of investment protection treaties against anti-smoking legislation. It also remains to be seen whether, should the tobacco industry be successful, such success would lead to limitations on investment protection, particularly where intellectual property rights conflict with health and safety concerns.

B. Compulsory Patent Licenses

Article 30 of the TRIPS agreement authorizes governments to make exceptions to the patent holder's right to exploit patented technology (*i.e.*, compulsory licenses) provided that the exception to the patent holder's right to exclude does not unreasonably conflict with the normal exploitation of the patent and does not unreasonably prejudice the legitimate interests of the patent holder.[14] Article 31 of the TRIPS agreement provides for the conditions under which a government can impose a compulsory license including, among other requirements, that the proposed licensee have tried and failed to negotiate a

license on reasonable commercial terms and that the patent holder is paid adequate remuneration in the circumstances of each case, taking into account the economic value of the authorization.[15] However, the TRIPS agreement leaves the decision regarding the commercial terms to the government issuing the license.[16]

The compulsory license provisions of the TRIPS agreement enable governments to promote public policy goals, for example, enhancing affordable availability of anti-retroviral drugs for the treatment of HIV.[17] Some countries have used the compulsory licensing regime as a way to force pharmaceutical companies to the bargaining table to lower prices on a broad range of medications.[18]

Dispute resolution under the TRIPS agreement is limited to state-to-state arbitration.[19] Some commentators have suggested, though, that treaty arbitration under BITs can provide a direct right of action for companies unhappy with compulsory license decisions under the TRIPS Agreement.[20] Nonetheless, to date no BIT-based arbitrations have emerged based on TRIPS compulsory licenses. It is possible that, as reported with respect to the tobacco industry, the pharmaceutical industry has used the possibility of investment arbitration as a negotiating tool to influence compensation under proposed compulsory licenses. It is also possible that the right case has not yet arrived. It remains to be seen whether TRIPS compulsory-related licenses will become a subject of investor-state arbitration.

C. Challenges to Patent Invalidity Findings

Outside the context of the compulsory license, there is now one instance in which a patent holder has brought an investment arbitration claiming interference by a government with patent rights. Eli Lilly and Company, a United States pharmaceutical company, has initiated an arbitration under NAFTA against Canada challenging a legal doctrine Canada has developed to circumscribe the scope of patentable subject matter.[21] Eli Lilly's arbitration demand challenges decisions of Canada's courts invalidating two Canadian patents owned by Eli Lilly covering a drug called Zyprexa, used for the treatment of schizophrenia and other psychotic disorders, and a second drug called Strattera used in the treatment of ADHD.[22] The Canadian courts invalidated each of the two patents on the ground that the patents did not satisfy the "utility" requirement of Canada's patent act.[23]

The general requirements for patentability around the world are that an invention be new, useful and non-obvious. The TRIPS agreement is consistent with this general set of requirements, stating that, subject to limited exceptions, patents shall be available "for any inventions whether products or processes, in all fields of technology, provided that they are new, involve an inventive step and are capable of industrial application."[24] A footnote to the previously quoted description states that for purposes of the section "inventive step" may be deemed synonymous with non-obvious and "capable of industrial application" may be deemed synonymous with "useful."[25]

Generally the utility requirement is very broadly interpreted and any invention that is industrially useful can be patented if it meets the novelty and non-obviousness requirements. In its arbitration demand, Eli Lilly refers to Canada's Manual of Patent Office Practice in effect as of 1994, which describes Canada's utility requirement broadly as "[if] an invention is totally useless, the purposes and objects of the grant would fail and such grant would consequently be void on the grounds of false suggestion, failure of consideration and having tendency to hinder progress."[26]

"Some commentators have suggested, though, that treaty arbitration under BITs can provide a direct right of action for companies unhappy with compulsory license decisions under the TRIPS Agreement."

Canada's courts, however, subsequent to its accession to NAFTA further interpreted Canada's utility requirement to require that, if a patent predicts a particular utility, the patent application must demonstrate or soundly predict the utility promised by the patent at the time of the patent application; *i.e.,* provide a sound factual basis for the predicted utility.[27] The Canadian Courts used this doctrine, referred to as the "promise doctrine" to invalidate the two patents at issue in the Eli Lilly arbitration.[28]

Eli Lilly argues in its arbitration demand that Canada's application of the promise doctrine to invalidate its patents on Zyprexa and Srattera violate its treaty rights as an investor under NAFTA Section 1709(1), the TRIPS agreement and the Patent Cooperation Treaty allegedly resulting in expropriation of the value of Eli Lilly's investment, unfair treatment of the pharmaceutical sector and failure to provide Eli Lilly with a minimum standard of treatment.[29] Eli Lilly claims damages against Canada in an amount not less than 500 million Canadian dollars.[30]

Canada has not yet responded to Eli Lilly's arbitration demand, but it can be expected to vigorously contest Eli Lilly's claims. Whether Eli Lilly can obtain relief against Canada in connection with this action—essentially a challenge to the Canadian courts' interpretation of the requirements of its domestic patent law—will be instructive regarding whether other parties pursue future challenges to state restrictions on intellectual property.[31] Nonetheless, Eli Lilly's arbitration demand suggests that patent holders are beginning to include investment arbitration in their arsenal of tools to protect their patent rights.

D. Patent Reform and Cutting Edge Technology

Patent reform is currently a hot issue. The United States, for example, is contemplating a variety of patent reforms to combat what some see as inappropriate assertion of patent rights by entities that do not themselves practice patented inventions (referred to as non-practicing entities or less politely as "patent trolls"). As of December 2013 at least eleven pending patent reform proposals have been introduced in the United States Congress.[32] Most of the proposed reforms are procedural changes, but clearly Congress is interested in reforming the patent system and international patent holders aggrieved by reforms may choose to seek relief through investor-state arbitration.

Similarly, the continued evolution of the law regarding patentability of DNA-related inventions could lead to investment claims. Last year the U.S. Supreme Court overruled the Federal Circuit Court of Appeals (which decides all patent related appeals) and decided that while synthetically created DNA is patentable, the isolation of naturally occurring DNA is not patentable.[33] The Supreme Court rejected an argument that the isolation of DNA should be held patentable based upon the Patent and Trademark Office's ("PTO") past practice of awarding patents on extracted DNA.[34] A foreign inventor who had relied on PTO practice might seek relief with an investment treaty claim.[35]

"As the amounts claimed in the Eli Lilly arbitration demonstrate, patent rights can be enormously valuable. With stakes that high, patent owners are likely to look far and wide for new tools to protect their patent rights."

E. Conclusion

As the amounts claimed in the Eli Lilly arbitration demonstrate, patent rights can be enormously valuable. With stakes that high, patent owners are likely to look far and wide for new tools to protect their patent rights. To date, intellectual property has not been an active area in investor state arbitration. It will be interesting to see whether more such arbitration develops in the future as states balance their international IP harmonization commitments with their domestic patent policy.

Endnotes

1. 2012 U.S. Model Bilateral Investment Treaty, Art. 1: Definitions.
2. *See, e.g.*, U.S. Uruguay Bilateral Investment Treaty (in force as of November 1, 2006), Article 1 ("investment" includes "intellectual property"); U.S. Turkey Bilateral Investment Treaty (in force as of May 18, 1990), Article 1(c) ("investment" includes "intellectual property, including rights with respect [to] copyrights and related patents, trademarks and tradenames, industrial designs, trade secrets and know-how, and goodwill"); U.S. Czech Republic BIT (in force as of December 10, 1992 and amended May 1, 2004), Article 1(a) ("investment" includes "intellectual property which includes, inter alia, rights pertaining to: literary and artistic works including sound recordings, inventions in all fields of human endeavor, industrial designs, semiconductor mask works, trade secrets, know-how, and confidential business information, and trademarks, service marks and trade names").
3. CAFTA explicitly includes intellectual property in its definition of "investment." CAFTA, Article 10.28. The investment definition in the NAFTA treaty is less clear, stating that "investment" includes "real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes." NAFTA, Article 1139. However, both CAFTA and NAFTA provide in detail for protection of intellectual property. CAFTA, Chapter 14; NAFTA, Chapter 17. U.S. bilateral free trade agreements also provide for protection of intellectual property investment although not always for investor-state arbitration. *See, e.g.*, U.S. Australia Free Trade Agreement, Article 11.17.4(f) (providing for protection of intellectual property investments but not providing for investor-state arbitration).
4. *See e.g.*, France Model Bilateral Investment Treaty, Article 1.1(d); Germany Model Bilateral Investment Treaty, Article 1.1(d).
5. The ICSID 2013 Annual Report describes the oil, gas and mining sector as "dominant" with respect to new proceedings in 2013 with 25% of total proceedings concentrated in that sector.
6. Notice of Arbitration, Philip Morris Asia Limited and the Commonwealth of Australia, 21 November 2011.
7. *Id.*, ¶ 5.6. Intellectual property is defined in the Australia-Hong Kong BIT as "intellectual property rights including rights with respect to copyright, patents, trademarks, trade names, industrial designs, trade secrets, know-how and goodwill." Australia-Hong Kong BIT, Article 1(e)(iv).
8. Notice of Arbitration, Philip Morris Asia Limited and the Commonwealth of Australia, 21 November 2011, Paragraph 7.2.
9. *Id.*, ¶ 7.15-7.17.
10. Procedural Order No. 7, Philip Morris Asia Limited and the Commonwealth of Australia, December 31, 2012.
11. *See, Tobacco Firms' Strategy Limits Poorer Nations' Smoking Laws*, New York Times, December 13, 2013.
12. *Philip Morris Barands SARL, et al. and Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, July 2, 2013 Decision on Jurisdiction.
13. *Tobacco Firms' Strategy Limits Poorer Nations' Smoking Laws*, New York Times, December 13, 2013. According to the New York Times, countries that have backed off on tobacco restrictions due to threats of investment claims include developing countries such as Namibia and Uganda and even developed countries like New Zealand and Canada.
14. Agreement on Trade Related Aspects of Intellectual Property Rights ("TRIPS"), Article 30.
15. *Id.*
16. WTO Website: TRIPS and Health: Frequently asked Questions – licensing of pharmaceuticals and TRIPS, http://www.wto.org/english/tratop_e/trips_e/public_health_faq_e.htm.
17. *See, e.g.*, *Brazilian President Silva Issues Compulsory License for Merck's Antiretroviral Efavirenz*, Kaiser Health News, May 7, 2007.
18. *See, e.g.*, *Thailand Defies Drug Makers on Patent Issue*, New York Times, April 11, 2007.
19. Agreement on Trade Related Aspects of Intellectual Property Rights ("TRIPS"), Article 64.
20. *See, e.g.*, Gibson, Christopher, *A Look at the Compulsory License in Investment Arbitration: The Case of Indirect Expropriation*, American University International Law Review, Vol. 25, p. 357 (2010); Peter B. Rutledge, TRIPS and BITs: An Essay on Compulsory Licenses,

Expropriation, and International Arbitration, 13 N.C. L.J. & Tech. On. 149 (2012). At least one law firm has issued a marketing piece suggesting treaty arbitration as a means of defending against compulsory licenses. Treaty Protection for Global Patents: A response to a Growing Problem for Multinational Pharmaceutical Companies, Jones Day Commentary, October 2012.

21. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013.
22. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 25-27.
23. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 20-21.
24. TRIPS Agreement, Article 27, § 1.
25. TRIPS Agreement, n. 5.
26. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶ 8.
27. See, Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 34-39; see also, Apotex Inc. v. Pfizer Canada Inc., Federal Court of Appeal 2011 FCA 236, ¶ 30. The closest analog to the promise doctrine under United States patent law is the requirement of "enablement" under 25 U.S.C. § 112 ¶ 1, which generally requires that a patent must enable a person of skill in the art to practice the claimed invention. Enablement requires that a person of skill be able to practice the invention without undue experimentation. The difference between the U.S. enablement concept and the promise doctrine is arguably one of degree rather than concept.
28. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 48-65.
29. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013.
30. Notice of UNCITRAL Arbitration, Eli Lilly and Company and Canada, September 12, 2013, ¶¶ 85.
31. Interestingly, NAFTA does not directly refer to intellectual property as a protected investment, suggesting it may be one of the less attractive treaties for alleging patent related investment claims.
32. SHIELD Act, H.R. 845; End Anonymous Patents Act, H.R. 2024; Patent Litigation and Innovation Act, H.R. 2639; Stopping the Offensive Use of Patents Act, H.R. 2766; Innovation Act, H.R. 3309; Innovation Protection Act, H.R. 3349; Demand Letter Transparency Act, H.R. 3540; Patent Quality Improvement Act, S. 866; Patent Abuse Reduction Act, S. 1013; Patent Litigation Integrity Act, S. 1612; Patent Transparency and Improvements Act, S. 1720.
33. Association for Molecular Pathology v. Myriad Genetics, Inc., 133 S. Ct. 2107 (2013).
34. *Id.* at 2118.
35. One district court has applied Myriad to hold that a patent on diagnostic methods using the extraction of natural DNA sequences are likewise not patentable. Ariosa Diagnostics, Inc. v. Sequenom, Inc., 2013 U.S. Dist. LEXIS 156554 (N.D. Cal. 2013). Should this decision be upheld by the Federal Circuit, a large number of issued patents may be rendered useless. It is worth noting, though, that the TRIPS agreement includes a specific exception allowing states to exclude from patentability "diagnostic, therapeutic and surgical methods for the treatment of humans or animals." TRIPS Agreement, Art. 27.3(a).

Sherman Kahn, skahn@mkwllp.com, is with Mauriel Kapouytian Woods LLP in New York City and Chair-Elect of the Dispute Resolution Section of the New York State Bar Association.