* * *

* * *

AMERICAN UNIVERSITY BUSINESS LAW REVIEW

The *American University Business Law Review* is published three times a year by students of the Washington College of Law, American University, 4300 Nebraska Avenue, NW, Suite CT11 Washington, D.C. 20016. Manuscripts should be sent to the Senior Articles Editor at the above listed address or electronically at blr-sae@wcl.american.edu.

The opinions expressed in articles herein are those of the signed authors and do not reflect the views of the Washington College of Law or the *American University Business Law Review*. All authors are requested and expected to disclose any economic or professional interests or affiliations that may have influenced positions taken or advocated in their articles, notes, comments, or other materials submitted. That such disclosures have been made is impliedly represented by each author.

Subscription rate per year is the following: $45.00 domestic, $50.00 foreign, $30.00 alumni, and $20.00 single issue. Periodicals postage is paid at Washington, D.C., and additional mailing offices. The Office of Publication is 4300 Nebraska Avenue, NW, Suite CT11, Washington, D.C. 20016. The Printing Office is Sheridan PA, 450 Fame Avenue, Hanover, Pennsylvania 17331. POSTMASTER: Send address changes to the *American University Business Law Review*, 4300 Nebraska Avenue, NW, Suite CT11, Washington, D.C. 20016.

Subscriptions are renewed automatically on expiration unless cancellation is requested. It is our policy that unless a claim is made for nonreceipt of the *American University Business Law Review* issues within six months of the mailing date, the *American University Business Law Review* cannot be held responsible for supplying those issues without charge.

Citations conform generally to *The Bluebook: A Uniform System of Citation* (21st ed. 2020).
To be cited as: 11 AM. U. BUS. L. REV.

American University Business Law Review
Print ISSN 2168-6890
Online ISSN 2168-6904

American University Business Law Review

Volume 11 • 2021-2022

* * *

*   *   *

*   *   *

AMERICAN UNIVERSITY
WASHINGTON COLLEGE OF LAW FACULTY

Administration

Roger A. Fairfax Jr., B.A., M.A., J.D., *Dean of the Washington College of Law.*
Amanda Cohen Leiter, B.S., M.S., J.D., *Senior Associate Dean for Faculty and Academic Affairs.*
Llezlie Green, A.B., J.D., *Associate Dean of Experiential Education.*
Ezra Rosser, B.A., M.Phil., J.D., *Associate Dean for Part-Time and Evening Programs.*
Jonas Anderson, B.S., J.D., *Associate Dean for Scholarship.*
Laura Herr, B.A., J.D., *Associate Dean of Development and Alumni Relations.*
Robert Campe, B.A., M.B.A., *Assistant Dean of Finance and Administration.*
David B. Jaffe, B.A., J.D., *Associate Dean for Student Affairs.*
Ann Chernicoff, A.B., J.D., *Senior Assistant Dean.*
William J. Snape III, B.A., J.D., *Assistant Dean for Adjunct Faculty Affairs.*
Akira Shiroma, B.A., J.D., *Assistant Dean of Admissions and Financial Aid.*
Lisa Taylor, B.A., J.D., *Assistant Dean of Diversity, Inclusion, and Affinity Relations.*
Catherine Schenker, B.A., J.D., *Assistant Dean for Online Learning.*
Hilary Lappin, B.A., M.A., *Registrar.*

Full-Time Faculty

Padideh Ala'i, B.A., University of Oregon; J.D., Harvard University. *Professor of Law, Director, International and Comparative Legal Studies Program, and Director, Hubert Humphrey Fellowship Program.*
*Hilary Allen, B.A., University of Sydney, Australia; B.L. (LL.B.) University of Sydney, Australia; LL.M., Georgetown University Law Center. *Professor of Law.*
Jonas Anderson, B.S., University of Utah; J.D., Harvard University. *Professor of Law and Associate Dean of Scholarship.*
*Kenneth Anderson, B.A., University of California, Los Angeles; J.D., Harvard University. *Professor of Law.*
Priya Baskaran, B.A., New York University; J.D., University of Michigan Law School; LL.M., Georgetown University Law Center. *Assistant Professor of Law and Director, Entrepreneurship Law Clinic.*
Elizabeth Beske, B.A., Princeton University; J.D., Columbia University. *Associate Professor of Law.*
Susan D. Carle, A.B., Bryn Mawr College; J.D., Yale University. *Professor of Law.*
Michael W. Carroll, A.B., University of Chicago; J.D., Georgetown University. *Professor of Law and Co-Director, Program on Information Justice and Intellectual Property.*
Janie Chuang, B.A., Yale University; J.D., Harvard University. *Professor of Law.*
Jennifer Daskal, B.A., Brown University; B.A., M.A., Cambridge University; J.D., Harvard University. *Associate Professor of Law and Director, Tech, Law, and Security Program.*
Angela Jordan Davis, B.A., Howard University; J.D., Harvard University. *Distinguished Professor of Law.*
Robert D. Dinerstein, A.B., Cornell University; J.D., Yale University. *Professor of Law, Director of the Disability Rights Law Clinic.*
N. Jeremi Duru, B.A., Brown University; M.P.P., J.D., Harvard University. *Professor of Law.*
*Walter A. Effross, A.B., Princeton University; J.D., Harvard University. *Professor of Law.*
Lia Epperson, B.A., Harvard University; J.D., Stanford University. *Professor of Law.*
Roger A. Fairfax Jr., B.A., Harvard College; M.A., University of London; J.D., Harvard Law School. *Professor of Law and Dean.*
*Christine Haight Farley, B.A., State University of New York, Binghamton; J.D., State University of New York, Buffalo; LL.M., J.S.D., Columbia University. *Professor of Law and Co-Director, Program on Information Justice and Intellectual Property.*
Andrew Guthrie Ferguson, B.A., Williams College; J.D., University of Pennsylvania School of Law; LL.M., Georgetown University Law Center. *Professor of Law.*
Susan D. Franck, B.A., Macalester College; J.D., University of Minnesota; LL.M. , University of London. *Professor of Law.*
Amanda Frost, B.A., J.D., Harvard University. *Professor of Law and Ann Loeb Bronfman Distinguished Professor of Law and Government.*
Robert K. Goldman, B.A., University of Pennsylvania; J.D., University of Virginia. *Professor of Law and Louis C. James Scholar.*
Llezlie Green, A.B., Dartmouth College; J.D., Columbia University. *Associate Professor of Law and Associate Dean of Experiential Education.*
Claudio M. Grossman, Licenciado en Ciencias Juridicas y Sociales, Universidad de Chile, Santiago; Doctor of Science of Law, University of Amsterdam. *Professor of Law, Dean Emeritus, Raymond I. Geraldson Scholar for International and Humanitarian Law.*
Lewis A. Grossman, B.A., Ph.D., Yale University; J.D., Harvard University. *Professor of Law.*
Rebecca Hamilton, B.Econ., University of Sydney, Australia; M.A., J.D., Harvard University. *Associate Professor of Law.*
Heather L. Hughes, B.A., University of Chicago; J.D., Harvard University. *Professor of Law and Director, S.J.D Program.*
David Hunter, B.A., University of Michigan; J.D., Harvard University. *Professor of Law.*
Cynthia E. Jones, B.A., University of Delaware; J.D., American University. *Professor of Law.*
Benjamin Leff, B.A., Oberlin College; A.M., University of Chicago; J.D., Harvard University. *Professor of Law and Director, JD/MBA Dual Degree Program.*
Amanda Cohen Leiter, B.S., M.S., Stanford University; M.S., University of Washington; J.D., Harvard University. *Professor of Law, Director, Program on Environmental and Energy Law, and Senior Associate Dean for Faculty and Academic Affairs.*
James P. May, B.A., Carleton College; J.D., Harvard University. *Professor of Law.*
Binny Miller, B.A., Carleton College; J.D., University of Chicago. *Professor of Law and Co-Director, Criminal Justice Clinic.*

Fernanda Nicola, B.A., University of Turin; Ph.D., Trento University; LL.M., Harvard University. *Professor of Law and Director, International Organizations and Development.*
Diane F. Orentlicher, B.A., Yale University; J.D., Columbia University. *Professor of Law.*
Andrew F. Popper, B.A., Baldwin Wallace College; J.D., DePaul University; LL.M., The George Washington University. *Professor of Law.*
Jayesh Rathod, A.B., Harvard University; J.D., Columbia University. *Professor of Law, Director of the Immigrant Justice Clinic.*
Ira P. Robbins, A.B., University of Pennsylvania; J.D., Harvard University. *Professor of Law and Justice, Director of the JD/MS Dual Degree Program in Law and Justice, and Barnard T. Welsh Scholar.*
Jenny Roberts, B.A., Yale University; J.D., New York University. *Professor of Law and Co-Director, Criminal Justice Clinic.*
Ezra Rosser, B.A., Yale University; J.D., Harvard University. *Professor of Law and Associate Dean, Part-Time and Evening Division.*
Ann Shalleck, A.B., Bryn Mawr College; J.D., Harvard University. *Professor of Law, Director of the Women and the Law Program, and Carrington Shields Scholar.*
Anita Sinha, B.A., Barnard College, Columbia University; J.D., New York University. *Assistant Professor of Law and Director, International Human Rights Law Clinic.*
Brenda V. Smith, B.A., Spelman College; J.D., Georgetown University. *Professor of Law and Director of Community Economic and Equity Development Clinic.*
David Snyder, B.A., Yale University; J.D., Tulane University. *Professor of Law and Director, Business Law Program.*
Brandon M. Weiss, B.S., Stanford University; M.P.P,, Harvard Kennedy School of Government; J.D., Harvard Law School. *Associate Professor of Law.*
Lindsay F. Wiley, A.B., J.D., Harvard University; M.P.H., Johns Hopkins University. *Professor of Law and Director, Health Law and Policy Program.*
Paul R. Williams, A.B., University of California-Davis; J.D., Stanford University. *Rebecca I. Grazier Professor of Law and International Relations and Director of the JD/MA Dual Degree Program.*

Law Library Administration

Khelani Clay, B.A., Howard University; J.D., American University; M.L.S., Catholic University of America. *Assistant Law Librarian.*
John Q. Heywood, B.S., Northern Arizona University; J.D., American University. *Associate Law Librarian.*
Adeen Postar, A.B., Washington University; J.D., Washington University; M.L.S., Catholic University of America. *Director of Law Library and Professor of Practice of Law.*
*Shannon M. Roddy, B.A., University of North Carolina at Chapel Hill; J.D., American University Washington College of Law; M.L.S., The Catholic University of America. *Assistant Law Librarian.*
William T. Ryan, B.A., Boston University; J.D., American University; M.L.S., University of Maryland. *Law Librarian.*
Ripple L. Weistling, B.A., Brandeis University; M.A., King's College, London, England; J.D., Georgetown University; M.L.S., The Catholic University of America. *Assistant Law Librarian.*
Wanhong Linda Wen, B.A., Hunan Normal University; M.S., University of South Carolina. *Associate Law Librarian.*

Emeriti

David E. Aaronson, B.A., M.A., Ph.D., George Washington University; LL.B., Harvard University; LL.M., Georgetown University. *Professor of Law Emeritus.*
Nancy S. Abramowitz, B.S., Cornell University; J.D., Georgetown University. *Professor of Practice of Law.*
Evelyn Abravanel, A.B., Case Western Reserve; J.D., Case Western Reserve. *Professor of Law Emerita.*
Jonathan B. Baker, A.B., J.D., Harvard University; M.A., Ph.D., Stanford University. *Research Professor of Law Emeritus.*
Susan D. Bennett, B.A., M.A., Yale University; J.D., Columbia University. *Professor of Law and Director of the Community and Economic Development Clinic.*
Daniel Bradlow, B.A., University of Witwatersrand, South Africa; J.D., Northeastern University; LL.M., Georgetown University. *Professor of Law Emeritus.*
Barlow Burke Jr., A.B., Harvard University; LL.B., M.C.P., University of Pennsylvania; LL.M., S.J.D., Yale University. *Professor of Law and John S. Myers and Alvina Reckman Myers Scholar.*
David Chavkin, B.S., Michigan State University; J.D., University of California at Berkley. *Professor of Law Emeritus.*
John B. Corr, B.A., M.A., John Carroll University; Ph.D., Kent State University; J.D., Georgetown University. *Professor of Law.*
Peter Jaszi, A.B., J.D., Harvard University. *Professor of Law Emeritus.*
Billie Jo Kaufman, B.S., M.S., Indiana University; J.D., Nova Southeastern University. *Professor of Law Emerita.*
Patrick E. Kehoe, B.C.S., Seattle University; J.D., M.Libr., University of Washington. *Law Librarian Emeritus.*
Candace S. Kovacic-Fleischer, A.B., Wellesley College; J.D., Northeastern University. *Professor of Law Emerita.*
Susan J. Lewis, B.A., University of California, Los Angeles; J.D., Southwestern University; M.Libr., University of Washington in Seattle. *Law Librarian Emerita.*
Elliott S. Milstein, B.A., University of Hartford; J.D., University of Connecticut; LL.M., Yale University. *Professor of Law Emeritus.*
Sima Mirkin, B.Sc., Byelorussian Polytechnic Institute, Minsk, Belarus; M.L.S., University of Maryland. *Associate Law Librarian.*
Teresa Godwin Phelps, B.A., M.A., Ph.D., University of Notre Dame; M.S.L., Yale University. *Professor of Law Emerita.*
Andrew D. Pike, B.A., Swarthmore College; J.D., University of Pennsylvania. *Professor of Law Emeritus.*
Nancy D. Polikoff, B.A., University of Pennsylvania; M.A., The George Washington University; J.D., Georgetown University. *Professor of Law Emerita.*
Jamin B. Raskin, B.A., J.D., Harvard University. *Professor of Law Emeritus.*
Herman Schwartz, A.B., J.D., Harvard University. *Professor of Law Emeritus.*
Michael E. Tigar, B.A., J.D. , University of California, Berkeley. *Professor of Law Emeritus.*
Mary Siegel Trotter, A.B., Vassar College; J.D. , Yale University. *Professor of Law Emerita.*
Robert Vaughn, B.A., J.D., University of Oklahoma; LL.M., Harvard University. *Professor of Law Emeritus.*

Richard J. Wilson, B.A., DePauw University; J.D., University of Illinois. *Professor of Law Emeritus.*

Special Faculty Appointments

Michelle Assad, B.A., New York University; J.D., American University Washington College of Law. *Practitioner in Residence.*

Jonathan B. Baker, A.B., Harvard University; J.D., Harvard Law School; Ph.D. Stanford University. *Research Professor of Law.*

Margaret Martin Barry, B.A., Luther College; J.D., University of Minnesota Law School. *Re-Entry Clinic Director, Visiting Professor of Law.*

Maria L. Dooner, B.S., University of Pennsylvania; M.P.P., University of Michigan; J.D., University of Minnesota Law School. *Practitioner-in-Residence, Janet R. Spragens Federal Tax Clinic.*

Paul Figley, B.A., Franklin and Marshall College; J.D., Southern Methodist University. *Associate Director of the Legal Rhetoric Program and Legal Rhetoric Instructor.*

Sean Flynn, B.A., Pitzer College; J.D., Harvard University. *Associate Director of the Program on Information Justice and Intellectual Property and Professorial Lecturer in Residence.*

Elizabeth A. Keith, B.A., University of North Carolina at Chapel Hill; J.D., George Mason University. *Legal Rhetoric Instructor.*

Kathryn Kleiman, B.A., Harvard University; J.D., Boston University. *Practitioner in Residence.*

Daniela Kraiem, B.A., University of California, Santa Barbara; J.D., University of California-Davis. *Assistant Dean Office of Career and Professional Development, Practitioner in Residence.*

Katie Kronick, B.A., Claremont McKenna College; J.D., LL.M., Georgetown University Law Center. *Practitioner in Residence.*

Jeffrey S. Lubbers, A.B., Cornell University; J.D., University of Chicago. *Professor of Practice in Administrative Law.*

Claudia Martin, J.D., Universidad de Buenos Aires; LL.M., American University. *Professorial Lecturer in Residence.*

Juan E. Mendez, LL.B., Stella Maris Catholic University, Argentina. *Professor of Human Rights Law in Residence.*

Jessica Millward, B.A., Trinity College; J.D., American University; LL.M., Georgetown University Law Center. *Practitioner in Residence.*

Amy Myers, B.A., University of the South; J.D., University of Michigan Law School. *Distinguished Practitioner-in-Residence, Gender Justice Clinic.*

Horacio A. Grigera Naon, J.D., LL.D., University of Buenos Aires; LL.M., S.J.D., Harvard University. *Distinguished Practitioner in Residence.*

Victoria Phillips, B.A., Smith College; J.D., American University. *Professor of Practice of Law.*

Adeen Postar, A.B., Washington University; J.D., Washington University; M.L.S., Catholic University of America. *Director of Law Library and Professor of Practice of Law.*

Heather E. Ridenour, B.B.A., Texas Women's University; J.D., Texas Wesleyan University. *Legal Rhetoric Instructor.*

Diego Rodriguez-Pinzon, J.D., Universidad de los Andes; LL.M., American University; S.J.D., The George Washington University. *Professorial Lecturer in Residence.*

Susana SáCouto, B.A., Brown University; MALD, Tufts University; J.D., Northeastern University. *Professorial Lecturer in Residence.*

Anne Schaufele, B.A., DePauw University; J.D., American University. *Practitioner in Residence.*

William J. Snape III, B.A., University of California, Los Angeles; J.D., The George Washington University. *Assistant Dean of Adjunct Faculty Affairs and Fellow in Environmental Law.*

*David H. Spratt, B.A., The College of William and Mary; J.D., American University. *Acting Director, Legal Rhetoric Program.*

Rangeley Wallace, J.D., Georgetown University Law Center; LL.M., American University Washington College of Law. *Practitioner-in-Residence.*

Diane Weinroth, B.A., University of California, Berkeley; J.D., Columbia University. *Supervising Attorney.*

Stephen Wermiel, B.A., Tufts University; J.D., American University. *Professor of Practice of Law.*

* *American University Business Law Review* Faculty Advisory Committee

*   *   *

AMERICAN UNIVERSITY BUSINESS LAW REVIEW

Volume 11 · 2023 · Issue 2

TABLE OF CONTENTS

* * *

RECENT LAW REFORMS IN EU SUSTAINABLE FINANCE: REGULATING SUSTAINABILITY RISK AND SUSTAINABLE INVESTMENTS

FÉLIX E. MEZZANOTTE*

Responding to increasingly degrading environmental and social conditions, the European Commission has fostered important legal and regulatory reforms to achieve sustainable finance objectives in Europe. However, these reforms are numerous, complex, and fast-paced. They have proved difficult to grasp and contextualize, while adding to the intricacies of an already highly sophisticated EU legal and regulatory regime. This Article outlines and examines such reforms with the purpose of providing necessary insights into the current state of EU law and regulation in the area of sustainable finance. The first part of the Article conceptualizes the meaning of sustainability risk and of sustainable investments. Understanding these two concepts is crucial as they underlie the entire reform process, from climate risk management to the development of sustainable markets and products. The second part of this Article provides an overview and analysis of key sustainability-related reforms. Changes to the non-financial information disclosure regime are outlined covering the Corporate Sustainability Reporting Directive, the Sustainable Finance Disclosure Regulation, and the EU Taxonomy Regulation. Emphasis is placed on the "double materiality" principle in sustainability reporting. Modifications to EU financial services law are also examined with focus on changes made to the Markets in Financial Instruments Directive (MiFID II), which is the central legislation governing securities regulation in Europe. Finally, a brief overview of the evolving prudent person rule contained in the Institutions for Occupational Retirement Provision Directive is offered. The Article concludes by shedding light on key challenges afflicting

*Assistant Professor and Co-Director of the MSc Programme in Law and Finance, School of Law, Trinity College Dublin. Email: felix.mezzanotte@tcd.ie. Funding support granted by the Arts and Social Science Benefactions Funds, Faculty of Arts, Humanities and Social Sciences, Trinity College Dublin, is greatly acknowledged. Claims and errors are the sole responsibility of the author.

reform implementation.

I. INTRODUCTION

In recent years, the European Commission (Commission) has implemented a new legal and regulatory framework for the development of sustainable finance in Europe.[1] The rationale underlying this policy points to a new world reality characterized by increasingly degrading

1. *See Action Plan: Financing Sustainable Growth*, at 2, COM (2018) 97 final (Mar. 8, 2018) [hereinafter EU Action Plan]. The EU Action Plan builds upon recent policies promoted by the 2015 Paris Agreement on Climate Change and the United Nations 2030 Agenda for Sustainable Development. *UN Sustainable Development Goals*, UNITED NATIONS (2015), https://sdgs.un.org/goals [hereinafter UN Sustainable Development Goals]. It has been part of the EU's Capital Markets Union (CMU) project and the EU "green deal" policies. *A Capital Markets Union for People and Businesses-New Action Plan*, COM (2020) 590 final (Sept. 24, 2020); *Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions*, COM (2019) 640 final (Dec. 11, 2019).

environmental and social conditions.[2] The growing capacity of environmental and social phenomena, such as climate change or social inequality, to damage people and property has become more apparent.[3] Moreover, scientific evidence has more robustly than ever before exposed the detrimental effects of human conduct — especially business activity — on factors that are essential to a sustainable economy, society and planet.[4] In addition to acknowledging these problems, the EU policy on sustainable finance has sought to tackle them by creating adequate conditions for the financial sector to take up a paramount role in advancing Europe's economic, environmental and social policy agenda.[5] As stated by the Commission: "As we are increasingly faced with the catastrophic and unpredictable consequences of climate change and resource depletion, urgent action is needed to adapt public policies to this new reality. The financial system has a key role to play here."[6] Within this policy framework, financial market participants in Europe have been sought, among other strategies, to integrate environmental, social, and governance factors in their business models, services and products.[7]

2. *Strategy for Financing the Transition to a Sustainable Economy,* at 1, COM (2021) 390 final (July 6, 2021) [hereinafter *Strategy for Financing*] ("The EU also aims to strengthen its resilience to climate change, to reverse biodiversity loss and the broader degradation of the environment and to leave nobody behind in the process.").

3. *The Implications of Climate Change for Financial Stability*, FINANCIAL STABILITY BOARD (Nov. 23, 2020), https://www.fsb.org/wp-content/uploads/P231120.pdf (last visited Dec. 09, 2021) [hereinafter FSB] ; *see also A Call for Action: Climate Change as a Source of Financial Risk*, NETWORK FOR GREENING THE FINANCIAL SYSTEM (NGFS) (Apr. 2019), https://www.ngfs.net/sites/default/files/medias/documents/synthese_ngfs-2019_-_17042019_0.pdf [hereinafter NGFS 2019]; *Overview of Environmental Risk Analysis by Financial Institutions*, NETWORK FOR GREENING THE FINANCIAL SYSTEM (NGFS) (Sept. 2020), https://www.ngfs.net/sites/default/files/medias/documents/overview_of_environmental_risk_analysis_by_financial_institutions.pdf [hereinafter NGFS 2020]. The NGFS is an association composed largely of central banks and financial regulators. *See Membership*, NGFS (June 14, 2022), https://www.ngfs.net/en/about-us/membership (last visited Dec. 09, 2021).

4. An authoritative report in relation to the impact of climate change is the IPCC, CLIMATE CHANGE 2021: THE PHYSICAL SCIENCE BASIS. CONTRIBUTION OF WORKING GROUP I TO THE SIXTH ASSESSMENT REPORT OF THE INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE (Valérie Masson-Delmotte et al. eds., Cambridge University Press 2021).

5. *See* EU Action Plan, *supra* note 1, at 1 (stating that reforms in the area of sustainable finance have been largely viewed as vital to ensure the stability of the financial sector and sustainable economic growth in Europe).

6. *Id.*

7. *Id.*

The Commission has defined sustainable finance as "the process of taking due account of environmental and social considerations in investment decision-making, leading to increased investments in longer-term and sustainable activities."[8] In building an institutional architecture for sustainable finance, the Commission has aspired to erect the necessary legal and regulatory tools for the proper management of climate risk and for the development of sustainable finance markets and products across Europe. Unsurprisingly, the achievement of such an objective has required multiple and substantial reforms.[9] The EU Action Plan has laid down the goals of these reforms in terms of integrating sustainability risk in decision-making, accelerating sustainable investments, and promoting transparency and long-term thinking in the financial sector.[10] Thus far, the reforms undertaken have been relevant and conducive. However, they have also been numerous, complex, and fast-paced. They have proved difficult to grasp and contextualize, while amplifying the intricacies of an already highly sophisticated EU legal and regulatory regime.

Contributing to a better understanding of the current state of EU law and regulation in sustainable finance, this article outlines and examines recent sustainability-related reforms in the area of (1) information disclosure obligations—including the newly enacted Sustainable Finance Disclosure Regulation (SFDR),[11] the EU Taxonomy Regulation,[12] and the draft Corporate Sustainability Reporting Directive (CSRD)[13] — and in the area of (2) EU financial services law, with focus on the Markets in Financial Instruments Directive (MIFID II).[14] In addition, a brief overview of the

8. *Id*. at 2.

9. *See id.*

10. *See id.* at 1 (identifying the objectives of sustainable finance policy and the proposed reforms corresponding to each one of these objectives).

11. Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019, on Sustainability-Related Disclosures in the Financial Services Sector, 2019 O.J. (L 317)) [hereinafter SFDR].

12. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020, on the Establishment of a Framework to Facilitate Sustainable Investment and Amending Regulation (EU) 2019/2088, 2020 O.J. (L198) [hereinafter EU Taxonomy Regulation].

13. Proposal for a Directive of the European Parliament and of the Council Amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as Regards Corporate Sustainability Reporting, Brussels, COM (2021) 189 final (April 21, 2021) [hereinafter Draft CSRD].

14. Directive 2014/65/EU, of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU, art. 24(1), 2014 O.J. (L 173/349) [hereinafter MiFID II]; *see also* Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May

evolving prudent person rule contained in the Institutions for Occupational Retirement Provision Directive (IORP II Directive) is also offered as this rule is relevant to the discussion on sustainability and investments in the context of pension funds.[15]

Sustainable finance policy requires that companies and financial market participants adequately identify and manage at least two crucial factors: first, sustainability risk and, second, the sustainability properties of economic activities and investments.[16] Consequently, this Article examines the meaning of sustainability risk and sustainable investments upfront in Section II.1 and Section II.2, respectively.[17] From the vantage point of financial analysis, sustainability risk denotes a type of financial risk.[18] As the Commission put it: "Including environmental and social goals in financial decision-making aims to limit the financial impact of environmental and social risks."[19] In this sense, sustainable finance aims to "manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues."[20] This type of events, and the financial risk they embody can affect, negatively and in large scale, corporate financial performance, the real economy, and ultimately the stability of the financial sector.[21] With these severe implications, this subject has become a top policy

2014, on Markets in Financial Instruments and Amending Regulation (EU) No 648/2012 [hereinafter MiFIR]; Commission Delegated Regulation (EU) 2017/565 of 25 April 2016, Supplementing Directive 2014/65/EU of the European Parliament and of the Council as Regards Organisational Requirements and Operating Conditions for Investment Firms and Defined Terms for the Purposes of That Directive, 2017 O.J. (L 87/1) [hereinafter MiFID II DR].

15. Directive (EU) 2016/2341, of the European Parliament and of the European Council of 14 December 2016 on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORPs), art. 19(1) 2016 O.J. (L 354/37) [hereinafter IORP II Directive]. Following the publication of the IORP II Directive in the Official Journal of the European Union, Member States had 24 months to transpose this Directive into national law. *Id.*

16. *See* EU Action Plan, *supra* note 1, at 1–4 (stating that a large fraction of the reforms proposed in the EU Action Plan are meant to address problems generated by the presence of sustainability risk and by the adequate classification and treatment of the sustainability properties in investments).

17. *See infra* Sections II.1–2.

18. EU Action Plan, *supra* note 1, at 3–4; *see also* FSB, *supra* note 3; *Recommendations of the Task Force on Climate-Related Financial Disclosures*, TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (June 2017), https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf [hereinafter TCFD]; NGFS 2019, *supra* note 3.

19. EU Action Plan, *supra* note 1, at 3–4.

20. *Id.*

21. *See* NGFS 2019 *supra* note 3; NGFS 2020 *supra* note 3.

priority especially among central bankers, financial regulators and other actors influencing financial policy.[22]

As explained in Section II.2 of this Article, the Commission has also made the promotion of sustainable investments a policy priority.[23] According to the EU Action Plan, a critical objective of sustainable finance has been to "reorient capital flows towards sustainable investments in order to achieve sustainable and inclusive growth."[24] This objective has built upon existing trends in markets across the globe showing that values in sustainable investment assets are mounting, from nearly USD 22.9 trillion in 2016 to USD 30.7 trillion in 2018 and USD 35.3 trillion in 2020.[25] Similar trends have been observed in European markets, which have witnessed a strong surge in investors' demand for sustainable investment products.[26] In light of this reality, the Commission acted to consolidate and accelerate these market trends across the EU yet making sure that the EU internal market and the rights of investors are protected.[27] After exploring the Commission's justifications for reform in the sustainable investment arena, including concerns of greenwashing,[28] the section outlines key definitions, criteria and classification tools designed to determine the extent to which an economic activity or financial product is or is not sustainable.[29]

Section III examines key reforms aimed at improving the availability and quality of non-financial—or more recently denominated as 'sustainability'—information.[30] Recent European regulations, namely the SFDR[31] and the EU Taxonomy Regulation,[32] have mandated the disclosure of sustainability-related information. Furthermore, the CSRD will also impose mandatory disclosure requirements on companies for them to disclose, side by side,

22. *See* NGFS 2019 *supra* note 3; NGFS 2020 *supra* note 3.

23. *See infra* Section II.2.

24. EU Action Plan*, supra* note 1, at 3.

25. *See* Global Sustainable Investment Alliance, *Global Sustainable Investment Review 2020*, http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf (covering sustainable investment assets in Europe, the United Stated, Canada, Australia, New Zealand, and Japan) [hereinafter GSIR 2020].

26. *Id.* For further discussion on this trend in European Markets, see *infra* Section II.2A.

27. *See, e.g.*, SFDR, *supra* note 11, at 3.

28. *See infra* Section II.2.A–B.

29. *See infra* Section II.2.C.

30. *See infra* Section III.

31. SFDR, *supra* note 11, at 3.

32. *See* EU Taxonomy Regulation, *supra* note 12, at 3.

sustainability and financial information.[33] The CSRD is of vital importance to sustainable finance insofar as sustainability reporting at the corporate level constitutes the primary source of sustainability information spilling over the whole investment chain.[34] For this reason, a central tenet of the EU sustainable finance reform has been to increase the supply of corporate sustainability information.[35] In this specific context, particular attention is drawn to the "double materiality" principle in sustainability information disclosure.[36] Although this principle will ultimately delineate the scope of the corporate sustainability reporting obligation, there has been little discussion about it in the legal scholarship.[37]

Section IV of this article is dedicated to EU sustainable finance reforms modifying the obligations of providers of investment services.[38] Amendments have been made to rules relating to MIFID II,[39] the Alternative Investment Fund Managers Directive (AIFMD),[40] the Undertakings for the Collective Investment of Transferable Securities Directive (UCITS

---

33. Draft CSRD, *supra* note 13.

34. *See* ENVIRONMENTAL RESOURCES MANAGEMENT, STUDY ON SUSTAINABILITY-RELATED RATINGS, DATA AND RESEARCH, PUBLICATIONS OFFICE OF THE EUROPEAN UNION (Nov. 2020), https://www.consob.it/documents/46180/46181/CE_Study_Nov-2020.pdf/81ab8351-1554-44b3-9b53-f21f355b0012 ("Data sources utilized by providers across all of their sustainability-related products and services fall into three major categories: Data directly from the company covered, unstructured company data from alternative sources, and third-party data that has already flowed through a different provider. Though the primary source of information identified by most providers is self-disclosed company data, providers commonly utilize data from all three sources with distinctions depending on the methodology, approach and product or service offered.").

35. *See* Draft CSRD, *supra* note 13, at 5.

36. *Id.* at 2 (explaining the double materiality principle); *see also* Directive 2014/95/EU, of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU As Regards Disclosure of Non-Financial and Diversity Information by Certain Large Undertakings and Groups, 2014 O.J. (L 330) [hereinafter NFRD].

37. *See generally* Joseph Baumüller & Michaela-Maria Schaffhauser-Linzatti, *In Search of Materiality for Nonfinancial Information—Reporting Nonfinancial Information—Reporting Requirements of the Directive 2014/95/EU,* 26 SUSTAINABILITY MGMT. FORUM 101 (2018) (examining materiality in both financial and non-financial disclosure in Europe).

38. *See Sustainable Finance Package,* EUROPEAN COMMISSION (Apr. 21, 2021), https://ec.europa.eu/info/publications/210421-sustainable-finance-communication_en (listing the Commission's delegated acts commanding these reforms).

39. *See* MiFID II, *supra* note 14, at 138.

40. Directive 2011/61/EU, of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and Amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 2011 O.J. (L 174/1, 1.07.2011) [hereinafter AIFMD].

Directive),[41] and the Insurance Distribution Directive (IDD).[42] A key goal pursued by these changes has been to bring in sustainability-related requirements into the current regime of investor protection. Investors, especially retail investors, face increasingly complex investment products in a context characterised by asymmetries of information and of expertise.[43] Nowadays, investors are more prone to make mistakes,[44] and greater exposed to abuses from mis-selling[45] and agency costs.[46] Markets in sustainable finance products are not exempted from such hazards, and investors may

---

41. Commission Proposal for a Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the Coordination of laws, Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers, COM (2011) 747 final (Nov. 15, 2011) [hereinafter UCITS Directive].

42. Directive 2016/97, of the European Parliament and of the Council of 20 January 2016 on Insurance Distribution, 2016 O.J. (L 26/19).

43. *See* JOHN ARMOUR ET AL., PRINCIPLES OF FINANCIAL REGULATION 205–25 (2016).

44. *See* Ann-Francoise Lefevre & Michael Chapman, *Behavioral Economics and Financial Consumer Protection OECD Working Papers on Finance, Insurance and Private Pensions*, OECD (Dec. 14, 2021), http://dx.doi.org/10.1787/0c8685b2-en (discussing, among other items, that consumers of financial services make mistakes as a result of literacy problems, limited amount of time dedicated to financial decisions, overwhelming amount of information, product complexity and behavioral biases, etc.); *see also* EUROPEAN COMMISSION, FINAL REPORT OF THE CONSUMER VULNERABILITY ACROSS KEY MARKETS IN THE EUROPEAN UNION, at 340–42 (2016) (explaining that consumers' difficulty processing complex information concerning financial products and services results in sub-optimal choices in the marketplace and citing cognitive limitations and inexperience with financial services to explain this difficulty).

45. Arjan Reurink, *Financial Fraud: A Literature Review*, 32 J. ECON. SURVS. 1292, 1307–08 (2018); *see also* JONATHAN KIRK ET AL., MIS-SELLING FINANCIAL SERVICES (2019).

46. Evidence has shown that problems of conflict of interest and of self-dealing curtail investors' protection and the performance of investments. *See, e.g.*, Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 58 J. FIN. 3, 4–15 (1999); Simeon Djankov et al., *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430, 430 (2008); R. David McLean et al., *Why Does the Law Matter? Investor Protection and Its Effects on Investment, Finance, and Growth*, 67 J. FIN. 313, 314 n.1 (2012); VERONIKA K. POOL ET AL., IT PAYS TO SET THE MENU: MUTUAL FUND INVESTMENT OPTIONS IN 401 (K) PLANS, 5 (Nat'l. Bureau. Econ. Rsch. 2013); Thomas W. Doellman & Sabuhi H. Sardarli, *Investment Fees, Net Returns, and Conflict of Interest in 401(k) Plans*, 39 J. FIN. RSCH. 5, 6 (2016). In the U.S. context, see, e.g., 17 C.F.R. § 276 (2019) (producing an interpretation of the fiduciary duty of investment advisers under section 206 of the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1–21); Marianne M. Jennings, *A Literature Review: Investment Professionals and Fiduciary Duties*, CFA INSTITUTE RESEARCH FOUNDATION, Sept. 17, 2014, at 1–2 (explaining that different standards apply to investment advisers compared with broker/dealers); Robert H. Sitkoff, *The Fiduciary Obligations of Financial Advisors Under the Law of Agency*, 27 J. FIN. PLAN. 42, 43 (2014) (addressing these same issues but in the E.U. context).

suffer damage from abusive business conduct such as the practice of greenwashing in investment products.[47] After offering a general description of the sustainability-related changes made in the area of EU financial services law, the focus of this section turns to the specific reforms affecting the MiFID II's conduct obligations.[48] Amendments have been introduced to the obligation to disclose information to clients,[49] the suitability requirements,[50] conflict of interest rules,[51] and product governance rules.[52]

Finally, the extent to which managers of pension funds are able to pursue sustainable investment strategies, in the absence of a specific mandate provided by the group of beneficiaries, has also been the subject of debate in sustainable finance. This debate has been particularly vigorous in the United States in the context of the fiduciary duties of pension fund trustees.[53] In the early stages of this debate, fiduciary duties were viewed as creating barriers for trustees to engage in sustainable investment strategies. However, this conventional view of fiduciary duties is evolving.[54] In search for answers, scholars have examined the meaning and scope of the phrase "the best interest," or even "the sole interest," of beneficiaries as well as the role that

47. STEVEN MAIJOOR, SUSTAINABLE FINANCIAL MARKETS: TRANSLATING CHANGING RISKS AND INVESTOR PREFERENCES INTO REGULATORY ACTION 4 (Feb. 12, 2020) [hereinafter ESMA].

48. In its package of sustainable finance reforms, the Commission has labelled the changes in EU financial services law as "Amending Delegated Acts on sustainability preferences, fiduciary duties and product governance." *See* EUROPEAN COMMISSION, *supra* note 38.

49. MiFID II, *supra* note 14, at art. 24(3)–(6).

50. *Id.* at art. 25(2); MiFID II DR, *supra* note 14, at art. 54–55; Eur. Sec. Mkt. Auth. Guidelines on Certain Aspects of the MiFID II Suitability Requirements ESMA35-43-1163, 5–29, 2018 [hereinafter Guidelines on Suitability]; Eur. Sec. Mkt. Auth. Questions and Answers on MiFID II and MiFIR Investor Protection and Intermediaries Topics ESMA35-43-349, 2020 [hereinafter ESMA Q&A Document].

51. MiFID II, *supra* note 14, at art. 16(3), 23.

52. *Id.* art. 16(3), 24(2); Commission Delegated Directive (EU) 2017/593 of 7 April 2016, art. 9–10, 2017 O.J. (L 87) (EU) [hereinafter MiFID II DD]; Eur. Sec. Mkt. Auth. Guidelines on MiFID II product governance requirements ESMA35-43-620, 5–21, 2018 [hereinafter ESMA Product Governance Guidelines].

53. *See, e.g.*, Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 382 (2020); Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and ESG Integration*, 90 U. COLO. L. REV. 731, 785 (2019); Max M. Schanzenbach & Robert H. Sitkoff, *ESG Investing: Theory, Evidence, and Fiduciary Principles*, J. FIN. PLAN. 42, 42 (2020); William Sanders, *Resolving the Conflict Between Fiduciary Duties and Socially Responsible Investing*, 35 PACE L. REV. 535, 564–65 (2014); Benjamin J. Richardson, *Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?,* 22 BANKING AND FIN. L. REV. 145, 169–85 (2007).

54. Richardson, *supra* note 53, at 169–85.

the "prudent investor rule" plays in enabling sustainable investing.[55] Such problems, predominantly discussed in the setting of US rules and experience, are nevertheless echoed in the context of pension funds in Europe. In this light, Section V of this Article looks at the prudent person rule contained in the IORP II Directive,[56] and briefly analyzes the implications of this rule for sustainability within the EU Action Plan framework, including the plan's objective of fostering long-termism in financial and economic activity.[57]

Final considerations are offered at the end of this Article shedding light on the shortcomings, largely challenges of implementation, that EU sustainable finance policy has faced, and will face, as reforms start confronting and shaping the reality of business practices.

II. SUSTAINABILITY RISK AND SUSTAINABLE INVESTMENTS

A. The Meaning of Sustainability Risk

At the core of EU sustainable finance policy is the management of sustainability risk. Sustainability risk under the SFDR is defined as "an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment."[58] This definition serves as a central reference to define the concept in the EU sustainable finance regime. In a way, such events or conditions have been conceived as belonging to the category of "sustainability factors" defined in terms of "environmental."[59] As we will examine in this section, companies (and their economic and financial value) are exposed to sustainability risk, and so are, more generally, investments (e.g. equity portfolios) and the stability of the financial system.

Currently, the most evident source of sustainability risk has been climate-related phenomena, especially global warming.[60] A review of studies and reports produced in this area shows that current knowledge has largely concentrated on the sustainability risk caused by climate change.[61] Formally,

55. *Id.*

56. IORP II Directive, *supra* note 15, at art. 19.

57. EU Action Plan, *supra* note 1, § 1.3–4. Another reform underpinning long-termism in the field of corporate strategy will address "rules according to which directors are expected to act in the company's long-term interest." *Id.* § 4.2, Action 10.

58. SFDR, *supra* note 11, at art. 2(22).

59. *Id.* at art. 2(24).

60. *See generally* TCFD, *supra* note 18.

61. FSB, *supra* note 3, at 4; *see also* TCFD, *supra* note 18, at 5–7; NGFS 2019, *supra* note 3, at 4, 11; Julia Anna Bingler & Chiara Colesanti Senni, *Taming the Green Swan: How to Improve Climate-Related Financial Risk Assessments*, at 11 (ETHzürich,

climate-related sustainability risk has been decomposed into physical and transition risks. "Physical risks" have been defined as "the possibility that the economic costs of (1) climate-change related extreme weather events or/and (2) more gradual changes in climate, might erode the value of financial assets and/or increase liabilities."[62] Increasingly observed in everyday life and widely reported in news outlets, physical risks identify the negative impact of climate-related phenomena such as bushfires, ice melting causing rising sea levels, floods in agriculture land and urban areas, droughts, hurricanes, and the gradual change in weather patterns, among other events.[63] These events have become a serious concern to persons and businesses.[64] They are detrimentally affecting life on the planet and property such as damaging plants and animal ecosystems, food and water supply, housing and other basic infrastructure in towns and cities.[65] Harm to businesses trickles down to falling values of corporate assets and weaker financial performance.[66]

"Transition risks" constitute the other component of sustainability risk.[67] These risks arise from changes in government policy towards low-carbon practices, the advancement of new technologies as well as shifts in market preferences.[68] For instance, public policy globally has been strongly disrupted by the Paris Agreement, adopted under the United Nations

---

Working Paper No. 20/340, 2020) (showing the status quo and areas for improvement of climate transition risk tools and metrics).

62. FSB, *supra* note 3, at 4.

63. NGFS 2019, *supra* note 3, at 12.

64. IPCC, *supra* note 4. For comments on the economic impact of climate change, see Ian Smith, *Extreme Weather Blows out Catastrophe Insurance Losses to $40bn*, FIN. TIMES (Aug. 12, 2021), https://www.ft.com/content/1053aebb-474f-4f35-9034-2475272404e1; Martin Arnold, *ECB Stress Test Reveals Economic Impact of Climate Change*, FIN. TIMES (Mar. 18, 2021), https://www.ft.com/content/7b734848-1287-4106-b866-7d07bc9d7eb8; Michael S. Derby, *Fed's Brainard: Climate Change Already Affecting Economy, Financial System*, WALL ST. J. (Feb. 18, 2021), https://www.wsj.com/articles/fed-s-brainard-climate-change-already-affecting-economy-financial-system-11613653221; NGFS 2019, *supra* note 3, at 13 ("Overall, worldwide economic costs from natural disasters have exceeded the 30-year average of USD 140 billion per annum in 7 of the last 10 years.").

65. IPCC, *supra* note 4, at 8, 25.

66. *See* FSB, *supra* note 3, at 5–6, 8; NGFS 2019, *supra* note 3, at 14 n.12; NGFS 2020, *supra* note 3, at 4.

67. FSB, *supra* note 3, at 4, 12–16; TFCD, *supra* note 18, at 5–7; NGFS 2019, *supra* note 3, at 11, 15–17

68. FSB, *supra* note 3, at 1; TFCD, *supra* note 18, at 5–7; NGFS 2019, *supra* note 3, at 15–17.

Framework Convention on Climate Change.[69] The Paris Agreement has been conceived as a response to mounting evidence indicating that global temperatures are rapidly increasing due to excessive greenhouse gas emissions. Among other estimations, global surface temperatures "will continue to increase [relative to the 1850–1900 period] until at least the mid-century [2050] under all emissions scenarios considered. Global warming of 1.5°C and 2°C will be exceeded during the 21st century unless deep reductions in CO2 and other greenhouse gas emissions occur in the coming decades."[70] In this light, the Paris Agreement seeks to strengthen the response of signatory countries to climate change and global warming by setting reduction targets in greenhouse gas emissions. The objective has been to limit global warming to well below 2° C, preferably 1.5° C, compared to pre-industrial levels.[71]

In line with the Paris Agreement, the European Union (EU) set out its Green Deal policy. By way of this policy, the EU committed "to increase the EU's greenhouse gas emission reductions target for 2030 to at least 50% and towards 55% compared with 1990 levels in a responsible way."[72] This commitment, however, requires profound reforms in regulation, law and policy. As stated by the Commission, "[t]o deliver these additional greenhouse gas emissions reductions, the Commission will, by June 2021, review and propose to revise where necessary, all relevant climate-related policy instruments."[73] Among other repercussions, the EU Green Deal reforms have triggered a process of decarbonization in industries.[74] As well as creating new investment opportunities, this decarbonization process is also costly for businesses to the extent that companies are impelled to deploy a great deal of resources to meet new emission reduction targets.[75] On a

69. *See The Paris Agreement*, U.N. CLIMATE CHANGE, https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement (last visited July 24, 2022) ("The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties at COP 21 in Paris, on 12 December 2015 and entered into force on 4 November 2016.").

70. IPCC, *supra* note 4, at 14.

71. *See* Paris Agreement art. 2, Dec. 12, 2015, T.I.A.S. 16-1104.

72. *Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions*, at 4, COM (2019) 640 final (Dec. 11, 2019).

73. *Id.* at 4–5.

74. *See* Mark Leonard et al., *The Geopolitics of the European Green Deal*, EUR. COUNCIL ON FOREIGN RELS. (Feb. 3, 2021), https://ecfr.eu/publication/the-geopolitics-of-the-european-green-deal/.

75. *See* Dickon Pinner, *Decarbonizing Industry Will Take Time and Money—But Here's How to Get a Head Start*, MCKINSEY SUSTAINABILITY (Dec. 14, 2018),

global basis, estimates indicate that reaching the Paris Agreement global warming targets could amount to USD 830 billion yearly until 2050.[76] Decarbonization costs will require investments "ranging from USD 1 trillion to USD 4 trillion in constant terms when considering the energy sector alone, or up to USD 20 trillion when looking at the economy more broadly."[77]

In order to accommodate new climate-related reforms, economic sectors may face structural changes especially as they implement decarbonization objectives. This is most likely the case in carbon-intense industries.[78] In these industries, decarbonization has generated new uncertainty, augmented costs, and created profitability problems, as reflected by the emergence of new business risks, increased production and distribution costs (including the costs of transitioning to cleaner — and at the time being more costly — technology and processes), the risk of assets becoming stranded, and shifts in consumer preferences towards low-carbon options.[79] As the Federal Stability Board noted, "the market value of equities of firms in some heavily polluting industries is being impacted by policy measures and market trends related to a transition to a low-carbon economy."[80] In support of this statement, the report points to evidence of poor performance in the coal industry: "the Dow Jones Coal Index fell by 85% in 2011-2018 in line with a significant increase in the use of natural gas for power generation and climate-related policy measures."[81] Unless they commit to a credible plan to decarbonize, companies facing high transition risk will inevitably face greater investor activism towards change[82] and become a less attractive investment due to high sustainability risk and, as we will examine in the next subsection of this Article, their negative environmental impact.[83]

---

https://www.mckinsey.com/business-functions/sustainability/our-insights/sustainability-blog/decarbonizing-industry-will-take-time-and-money-but-heres-how-to-get-a-head-start.

76. EUROPEAN SYSTEMIC RISK BOARD, POSITIVELY GREEN: MEASURING CLIMATE CHANGE RISKS TO FINANCIAL STABILITY 10 (2020).

77. *Id.*

78. *See* NGFS 2020, *supra* note 3, at 15.

79. *See id.*; *see also* TFCD, *supra* note 18, at 5–8.

80. FSB, *supra* note 3, at 12.

81. *Id.*

82. *See, e.g.*, Sarah McFarlane & Christopher M. Matthews, *Oil Giants Are Dealt Major Defeats on Climate-Change as Pressures Intensify*, WALL ST. J. (May 26, 2021), https://www.wsj.com/articles/oil-giants-are-dealt-devastating-blows-on-climate-change-as-pressures-intensify-11622065455; Anjili Raval et al., *Shell Verdict Sets Scene for More Corporate Climate Cases*, FIN. TIMES (May 28, 2021), https://www.ft.com/content/f18269ee-c9d8-45c4-bbee-28561b065e6b.

83. *See infra* Section II.2.A.

Sustainability risk has raised the alarm among key actors in the financial sector because this risk undermines a company's financial position (by increasing costs, downgrading the valuation of corporate assets, and reducing the company's profitability and creditworthiness) and can spread widely across whole industries.[84] Central bankers, financial regulators, government officials, and finance-related business associations are increasingly aware that this problem, if ignored or mismanaged, will pose a credible threat to the real economy and ultimately, to the stability of the financial sector.[85] Realizing the importance and strength of financial markets to change corporate behavior, these actors have provided strong support to the EU policy of managing sustainability risk by way of integrating this risk into investment decision-making and by introducing adequate prudential regulations.[86]

B. The Meaning of Sustainable Investments

1. Sustainable Investments as a Market Trend

From the vantage point of the investment management industry, sustainable investments refer to an "investment approach that considers environmental, social and governance (ESG) factors in portfolio selection and management."[87] Underlying this definition lies a characterization of the investor as a person conscious of societal and/or environmental investment objectives. This type of investor, which in the past was mostly circumscribed to marginal niches, has grown in size and importance in recent years, as has market demand for sustainable investment products.[88] In major financial centers, an increasingly rich variety of sustainable investment options are available to investors by mainstream financial market participants.[89] At the level of portfolio design, for example, the adoption of sustainable investment strategies such as negative screening, best in class, norms-based screening, sustainability themes, engagement, impact investing, and engagement,

84. FSB, *supra* note 3, at 12–13.

85. *See id.* at 28.

86. Although the need for prudential regulation has been identified as an increasingly important theme in sustainable finance policy, this Article will not cover this theme. Central references to planned policy measures in this area can be found in *Strategy for Financing the Transition to a Sustainable Economy*, *supra* note 2, at 3.

87. GSIR 2020, *supra* note 25, at 7.

88. *Id.* at 5.

89. *See* CFA Institute, *Future of Sustainability in Investment Management: From Ideas to Reality*, at 11–12 (2020).

among others, has skyrocketed.[90]

With this market for sustainable investment products being investor-driven, it has become apparent that sustainability themes are influencing investors' choices.[91] The presence of a "sustainable" investor has become increasingly felt and established. A recent study conducted by 2º Investing Initiative found that a large majority of retail investors in France and Germany are interested in sustainable investing.[92] Judged by the value growth in sustainable investments, investors in US markets are also showing preferences evolving towards sustainability. The SIF Foundation calculated US$17 trillion in investments considering environmental, social and governance factors in 2020, up 42 percent from 2018.[93] In the first semester of 2018, European sustainable funds received net inflows of €32.1 billion, up from €28.8 billion in the previous six months.[94] More globally, the GSIR reported that global sustainable investments reached US$ 35.3 trillion in early 2020 (a 55 percent increase from the past four years), with one quarter of the investments made by retail investors and the rest by institutional investors.[95]

Investors would choose to invest sustainably even if this strategy entailed foregoing profits. A recent study conducted by the University of Cambridge Institute for Sustainability Leadership found that the median saver prefers a sustainable fund even if it connotes a sacrifice of up to 2.5 per cent of annual

---

90. *See* GSIR 2020, *supra* note 25, at 7, 10–12; *see also* EUROSIF, EUROPEAN SRI STUDY 2018, at 16–17 (2018); SWISS SUSTAINABLE FINANCE, SWISS SUSTAINABLE INVESTMENT MARKET STUDY 2021 4–5 (2021).

91. *See* Aisha I. Saad & Diane Strauss, *The New "Reasonable Investor" and Changing Frontiers of Materiality: Increasing Investor Reliance on ESG Disclosures and Implications for Securities Litigation*, 17:2 BERKELEY BUS. L. J. 397, 398–400 (examining the extent to which the current notion of materiality in information disclosure guards consistency with the new "sustainable" investor).

92. 2° INVESTING INITIATIVE (2DII), A LARGE MAJORITY OF RETAIL CLIENTS WANT TO INVEST SUSTAINABLY 5 (Mar. 2020).

93. US SIF Foundation, *Report on US Sustainable and Impact Investment Trends* 1 (2020), https://www.ussif.org/files/Trends%20Report%202020%20Executive%20Summary.pdf; *see also* Samuel M. Hartzmark & Abigail B. Sussman, *Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows*, 74 J. FIN. 2789, 2789–92 (describing how, in the US market, mutual fund investors collectively value sustainability as shown by more money being allocated to highly sustainable funds and less money to funds that perform poorly on sustainability).

94. UNITED NATIONS ENVIRONMENTAL PROGRAMME, SUSTAINABLE FINANCE PROGRESS REPORT 9 (2019), https://wedocs.unep.org/bitstream/handle/20.500.11822/34534/SFPR.pdf?sequence=1&isAllowed=y.

95. GSIR 2020, *supra* note 25, at 9, 12–13.

returns.[96] Among funds with similar past returns, 75 percent of savers chose the more sustainable fund.[97] Sustainability preferences were stronger among younger people (less than 35 years old) and less experienced investors.[98] Focusing on pension funds, the UNPRI finds that "[v]arious surveys globally indicate that beneficiaries increasingly expect their money to be invested responsibly and, in some cases, express a willingness to forego financial returns to achieve sustainability impact."[99] Similarly, a survey conducted by the Department of International Development among nearly 2000 people in the United Kingdom (with the aim of understanding whether they want to invest their money in ways that support the UN sustainable development goals), concluded that "[m]ore than 50% of people say they are interested in investing sustainably now or in the future," and that "28% of people would make a responsible and impactful investment even if the returns they received were lower than other investments if they knew the investment made a difference to something they really care about."[100]

These are only a few among an increasing number of studies indicating a shift in investors' preferences. It is thus unsurprising that the definition of the average investor as denoting a rational man whose sole aim is to reap financial returns has been challenged.[101] The evolving market reality suggests that a broader investor's profile, which includes the "sustainable investor," has gained substantial traction within the investment community. As well as searching for financial returns, this new investor cares about sustainability reporting and the performance of investments and companies in terms of social, environmental and governance factors.[102] The well-

---

96. CAMBRIDGE INSTITUTE FOR SUSTAINABILITY LEADERSHIP, WALKING THE TALK: UNDERSTANDING CONSUMER DEMAND FOR SUSTAINABLE INVESTING 14 (2019), https://www.cisl.cam.ac.uk/system/files/documents/cisl-vie-report-single-pages.pdf.

97. *Id.*

98. *Id.* at 16.

99. U.N. PRINCIPLES OF RESPONSIBLE INVESTMENTS, UNDERSTANDING AND ALIGNING WITH BENEFICIARIES SUSTAINABILITY PREFERENCES 9 (2021), https://www.unpri.org/download?ac=13321.

100. UNITED KINGDOM DEPARTMENT FOR INTERNATIONAL DEVELOPMENT, INVESTING IN A BETTER WORLD: SURVEY RESULTS, 6, 11 (2019), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/834208/Investing-in-a-better-wold-survey-results.pdf.

101. *See generally* Saad & Strauss, *supra* note 91, at 392–413 (focusing "on challenging the interpretation of the reasonable investor currently enshrined in legal doctrine and advances that a revised consideration of this legal reference must take into account contemporary investor concerns regarding corporate ESG performance").

102. *See id.* at 393–94 ("These dual trends-the increased demand for ESG disclosures by mainstream investors and the expanding investment market share claimed by sustainability-minded investors-challenge a traditional characterization of the

known "socially responsible investor" integrates this broad category of sustainability-minded investors whose strategies combine profits and sustainability goals.[103] These mixed investment strategies are distributed widely, however, and they are not driven by a single motivation. Profit-driven mainstream investors may look at social, environmental or governance investment objectives only if they contribute to the overarching goal of maximizing the short-term returns of their portfolios.[104] At the other extreme, the purpose of an investor's choice may be largely driven by moral- or ethical-based principles in relation to society and the environment.[105]

2. The Need to Regulate Sustainable Investments

Responding to this new reality, the European Commission proposed reforms with the purpose of facilitating the development of markets in sustainable investment products.[106] Over the last decades, such markets

---

'reasonable investor' that sits at the heart of American securities doctrine. The reasonable investor archetype, which arose from early 20th century case law, conceives of the investor as an economically rational actor who relies solely on financial disclosures in making decisions about the purchase and sale of securities. A widening rift between this reasonable investor archetype and contemporary investors who make demands for and rely on nonfinancial information, including corporate ESG performance, challenges doctrinal precedent that deems non-financial ESG disclosures to be immaterial.").

103. *See id.* Data on use and performance of mixed investment strategies are typically reported by organizations involved in sustainable investment. *See, e.g.*, GSIR, *supra* note 26; Eurosif, *supra* note 91; SWISS SUSTAINABLE FINANCE, SWISS SUSTAINABLE INVESTMENT MARKET STUDY (2021), https://www.sustainablefinance.ch/upload/cms/user/2021_06_07_SSF_Swiss_Sustainable_Investment_Market_Study_2021_E_final_Screen.pdf.

104. *See* Gary, *supra* note 53, at 750–54 (looking at evidence indicating that ESG portfolios have performed equal or better than traditional portfolios); *see also* Gunnar Friede et al., *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies* 5 J. SUSTAINABLE FIN. & INV. 210, 226 (2015) (finding a positive correlation superior ESG performance with superior equity performance).

105. Schanzenbach & Sitkoff, *supra* note 53, at 398. Depending on the purpose of the investment, the authors differentiate between "collateral benefits" or "improved risk-adjusted returns." In collateral benefits, the "ESG investing [is] motivated by providing a benefit to a third party or otherwise for moral or ethical reasons," whereas risk-adjust return investment "entails the use of ESG factors as metrics for assessing expected risk and return with the aim of improved return with less risk. A typical risk-return ESG strategy is to use ESG factors to pick stocks or other securities on the theory that those factors can identify market mispricing and therefore profit opportunities (we'll call this active investing). For example, a risk-return ESG analysis of a fossil fuel company might conclude that the company's litigation and regulatory risks are underestimated by its share price, and therefore that reducing or avoiding investment in the company will improve risk-adjusted return." *Id.*

106. *See, e.g.*, SDFR, *supra* note 11 (requiring certain environmental disclosures in the financial services sector in the EU).

developed on a self-regulatory basis.[107] In the views of the Commission, however, self-regulation cannot warrant market development across the European Union in ways that promote transparency, stability, and investor protection. The Commission has articulated such concerns in various documents. Stressing on the need to harmonise information disclosure rules across the EU, the Commission has claimed that the various business practices observed in mainstream markets for sustainable finance had shown "commercially-driven priorities that produce divergent results," and these outcomes would end up fragmenting the internal market and creating inefficiencies.[108] The Commission also noted that the investors' choice of sustainable finance products would be distorted in the presence of "divergent disclosure standards and market-based practices [that] make it very difficult to compare different financial products, [and that] create an uneven playing field for such products and for distribution channels."[109]

Another critical justification for regulation has been the serious concerns arising from greenwashing practices undertaken by companies or financial intermediaries. According to Lyon and Montgomery, a "[p]opular usage of the term greenwash encompasses a range of communications that mislead people into adopting overly positive beliefs about an organization's environmental performance, practices, or products."[110] Involving the manipulation of information content, greenwashing may take various forms including, among other types, the use of slight exaggeration or vague claims, the misuse of visual imagery, or the full fabrication about environmental (or social) performance.[111] Selective disclosure has proved particularly worrisome. It denotes the "[s]elective disclosure of positive information about a company's environmental or social performance, without full disclosure of negative information on these dimensions, so as to create an

107. A valuable study on the state of law in various countries in relation to ESG investing was produced early on by the Nations Environmental Programme in cooperation with Freshfields law firm—the Freshfield Report. *See* UNITED NATIONS ENVIRONMENTAL PROGRAMME, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTING 36–39 (2005), https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf (describing the minimal pan-EU ESG initiatives enacted prior to 2005 and evaluating legal standards applicable to sustainable investing).

108. SFDR, *supra* note 11, at 9.

109. *Id.* at 9–10.

110. Thomas P. Lyon & A. Wren Montgomery, *The Means and End of Greenwash*, 28 ORG. & ENV'T 223, 225 (2015).

111. *Id.*

overly positive corporate image"[112] Greenwashing practices, at the level of corporate disclosure and/or product disclosure (e.g. misleading product advertisements or labels) may provide short-term benefits to companies yet at the expense of society. Among other sources, societal costs may arise from undermined trust in corporate environmental impacts, greater consumer cynicism and mistrust, as well as consumers being overwhelmed and confused about a company's claims in relation to its corporate social responsibility activities and impacts.[113]

In a legal and regulatory context, concerns over greenwashing have been clearly stated in the explanations justifying the need for the EU Taxonomy Regulation as follows:

> Making available financial products which pursue environmentally sustainable objectives is an effective way of channeling private investments into sustainable activities. Requirements for marketing financial products or corporate bonds as environmentally sustainable investments, including requirements set by Member States and the Union to allow financial market participants and issuers to use national labels, aim to enhance investor confidence and awareness of the environmental impact of those financial products or corporate bonds, to create visibility and to address concerns about 'greenwashing'. In the context of this Regulation, greenwashing refers to the practice of gaining an unfair competitive advantage by marketing a financial product as environmentally friendly, when in fact basic environmental standards have not been met.[114]

Similarly, the Chair of the European Securities and Markets Authority (ESMA) has explained greenwashing conduct from an enforcement perspective when he stated that:

> [Greenwashing] refers to a wide variety of practices that range from mislabelling to misrepresentation and mis-selling of financial products. As the number of products that claim to be linked to the sustainability performance of firms increases, driven by market demand, we need to be careful to ensure that investors do not end up buying products which are marketed as sustainable when in reality they are not. Here, we should not be nai The many risks that can lead to misleading financial information are also valid in the case of non-financial information.[115]

The problem of greenwashing has been reported widely in the business media. In the asset management industry, concerns have been identified in

112. *Id.*
113. *See id.* at 238–39 (citing various sources).
114. EU Taxonomy Regulation, *supra* note 12, at 11.
115. ESMA, *supra* note 47, at 5.

relation to the opaque composition of investment funds branded as "sustainable."[116] The Financial Times reported that "many of the funds that use the ESG label . . . are not as sustainable as they first appear. Several popular ESG funds, for example, invest in the world's largest carbon emitters."[117] Finding out which managers are or are not committed to sustainability has proved difficult for investors who "have struggled to find out what funds were invested in and just how seriously asset managers were thinking about issues such as climate change."[118] Comparability between sustainable products has also been difficult, "[s]ome [financial advisers] are saying almost every fund is marketed as sustainable now. How do they determine which are the most sustainable?"[119] Issues related to costs and fees have also proved contentious. Exchange-Traded Funds (ETFs) labelled as "sustainable ETFs" have charged higher fees than non-ESG ETFs in spite of the fact that both groups of funds have shown a similar asset composition.[120]

In addition, concerns of greenwashing have emerged in the context of corporate claims or pledges about their environmental strategies. The Financial Times has recently reported that "[t]he deluge of corporate climate pledges are yet to translate to meaningful action, as only a handful of the 159 companies responsible for more than 80 per cent of global industrial emissions have set adequate targets"[121] and that "almost all of the pledges

116. Greenwashing concerns in the banking industry have been reported widely as in the Financial Times. *See, e.g.*, Billy Nauman & Stephen Morris, *Global Banks' $750bn in Fossil Fuels Finance Conflicts with Green Pledges*, FIN. TIMES (Mar. 24, 2021).

117. *See* Attracta Moony, *Greenwashing in Finance: Europe's Push to Police ESG Investing*, FIN. TIMES (Mar. 10, 2021), https://www.ft.com/content/74888921-368d-42e1-91cd-c3c8ce64a05e; *see also* REGINA SCHWEGLER ET AL., SUSTAINABILITY FUNDS HARDLY DIRECT CAPITAL TOWARDS SUSTAINABILITY: A STATISTICAL EVALUATION OF SUSTAINABILITY FUNDS IN CH AND LUX (May 3, 2021), https://www.greenpeace.org/static/planet4-luxembourg-stateless/2021/06/ac190a73-inrate-study-on-sustainability-funds-for-greenpeace.pdf (finding that sustainable investment strategies used in investment funds are failing to channel private funds to sustainable activities).

118. *See* Moony, *supra* note 117.

119. *Id.* (quoting James Alexander, the chief executive of the UK Sustainable Investment and Finance Association).

120. *See* Jason Zweig, *You Want to Invest Responsibly. Wall Street Smells Opportunity,* WALL ST. J. (Apr. 16, 2021), https://www.wsj.com/articles/you-want-to-invest-responsibly-wall-street-smells-opportunity-11618586074.

121. Camilla Hodgson, *Powerful Investor Group Finds Net Zero Pledges Distant and Hollow*, FIN. TIMES (Mar. 22, 2021), https://www.ft.com/content/12fd1c09-61fb-444e-a9cc-0b50fe0ea411.

[made by such companies] are both distant and hollow."[122] This dissociation between sustainability-related pledges and business action — firms failing to walk the talk — has often displayed evidently in the investment industry: "New bonds sold by fossil fuel companies were being snapped up by leading exchange traded fund (ETF) providers including BlackRock and State Street even as these managers were preparing to pledge to slash their carbon emissions exposure, researchers have found."[123]

EU sustainable finance policy has therefore been driven, on the one side, by the goal of further developing markets for sustainable investment products and on the other side, by the imperative of achieving this goal without undermining, or in ways that strengthen, the EU internal market and investor protection standards. In this context, an important question has been how to identify the sustainability properties of an investment or economic activity, and how to do this in a way that is objective and systematic while averting divergent criteria across EU member States. Reforms in this area have been aimed at creating classification tools, including the enactment of the EU Taxonomy Regulation, to determine whether an investment or economic activity is or is not sustainable, or whether investor preferences do or do not contain sustainability objectives. Key tools are briefly outlined in the next subsection.

3. The Classification of Activities and Preferences in Terms of Sustainability

The EU sustainable finance policy has engineered a regime that includes a new set of definitions and of tools for the classification of sustainable investment activities. As mentioned earlier in this section, the SFDR has defined key terminology, notably the meaning of sustainability risk and factors.[124] In addition, it has provided a definition of "sustainable investment" as follows:

> [A]n investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource

122. *Id.*

123. *See* Chris Flood, *ETF Providers Have Been Misleading Buyers of New Fossil Fuel Bonds, Finds Study*, FIN. TIMES (Jun. 14, 2021), https://www.ft.com/content/5f35f3b4-4509-4dc6-985c-46af5187c27d ("About 14 percent of the value of new bonds bought by 35 of the largest US corporate bond ETFs between 2015 and 2020 were issued by carbon-intensive companies in the oil and gas, utilities and coal mining sectors were, according to a new analysis by the Oxford Sustainable Finance Programme at the University of Oxford's Smith School of Enterprise and the Environment.").

124. *See* SFDR, *supra* note 11, at art. 2(22), (24).

> efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.[125]

Drawing from this definition, a necessary condition for an investment to be sustainable is that the economic activity underlying the investment contributes to an environmental and/or social objective along the lines depicted in the definition.[126] Other conditions have added restrictions to this definition of sustainable investment, notably, the "do not significantly harm" and the "good governance" conditions.[127] From a conceptual and operational perspective, this definition has been instrumental for classifying financial products in terms of sustainability. As a matter of fact, three categories of sustainable financial products have currently been defined, all these categories finding its conceptual foundation in the SFDR.[128]

The first type of product category refers to financial instruments that have as objective a sustainable investment.[129] Strictly speaking, this type of investment — referred to as "dark green" products — satisfies the definition of sustainable investments under Article 2(17) SFDR and the falls within the scope of Article 9 of the SFDR. The second type of product category, defined in Article 8 of the SFDR, encompasses those financial instruments that promote environmental or social characteristics, or a combination of those characteristics.[130] This category of financial products, so-called "light green" products, is wider in scope; it allows for a rich variety of instruments that are capable of promoting or ameliorating environmental and social

125. *Id.* at art. 2(17).

126. *See id.*

127. *See id.*

128. *See generally id.* (acknowledging that the distinction between these two groups of products corresponded to an existing industry reality, and that disclosure requirements have been adjusted accordingly).

129. *See id.* at art. 2(1), 9.

130. *See id.* at art. 8(1).

outcomes.[131] More recently, industry practice has defined a third category of investment products, namely Article 6 SFDR products. This third category can be seen as a residual one because it encompasses products that are neither dark green nor light green.[132] However, Article 6 SFDR products do consider sustainability risk if relevant to the product and may consider principal adverse impact on sustainability factors.[133]

Another way by which an investment can be classified as sustainable is by reference to the criteria laid down in the EU Taxonomy Regulation.[134] In basic terms, the EU Taxonomy Regulation has designed a classification tool in order to guide the task of determining whether an economic activity is or is not environmentally sustainable.[135] Its objective is to provide a baseline reference for green activities for use across the European Union.[136] According to the Commission, the Taxonomy Regulation "is an important enabler for scaling up sustainable investment and implementing the European Green Deal as part of the EU's response to the climate and environmental challenges."[137] This taxonomy "provides uniform criteria for companies and investors on economic activities that can be considered environmentally sustainable . . . and thus, aims to increase transparency and consistency in the classification of such activities and limit the risk of greenwashing and fragmentation in the EU internal market."[138]

This Taxonomy lays down the criteria for an economic activity to qualify as environmentally sustainable.[139] Under these criteria, all four requirements must be met as follows. Firstly, the activity contributes substantially to one or more — out of a total of six — of the "environmental objectives" enumerated by the Taxonomy Regulation.[140] Currently, the first two environmental objectives to be implemented are the climate change mitigation objectives and the climate change adaptation objectives (starting January 2022).[141] Secondly, the activity does not significantly harm (DNSH)

131. *See id.*

132. *See id.* at art. 6(1).

133. *See id.*

134. *See* EU Taxonomy Regulation, *supra* note 12.

135. *See id.* at art. 3(1).

136. *See id.* at art. 1(1).

137. Commission Regulation 2020/852, 2021 O.J. (C 2800) 1 [hereinafter DA Taxonomy Regulation].

138. *Id.*

139. *See* EU Taxonomy Regulation, *supra* note 12, at art. 3.

140. *Id.* at art. 3(a), 9–16 (listing and describing the six environmental objectives).

141. *Id.* at art. 9.

any of the other environmental objectives.[142] An economic activity should not qualify as environmentally sustainable, the rationale goes, if it causes more harm to the environment than the benefits it brings. Thirdly, the activity is carried out in compliance with the minimum safeguards identified in Article 18 of the Taxonomy Regulation.[143] And, fourthly, the activity complies with the technical screening criteria as established by the Commission.[144] For each economic activity considered, the Technical Screening Criteria specifies environmental performance requirements that, assuming they are met, lead to the conclusion that the activity makes a substantial contribution to the environmental objective in question and does not significantly harm other environmental objectives.[145] In relation to climate change mitigation and adaptation objectives, these Technical Screening Criteria have been released recently by way of delegated act.[146]

These two ways of classifying investments as sustainable, namely the criteria in article 2(17) SFDR (along with Articles 6, 8 and 9 SFDR) and the criteria in Article 3 of the EU Taxonomy Regulation, have been incorporated into the MiFID II regime.[147] More specifically, modifications to the MiFID II DR have been introduced through the draft DA MiFID II, a key item of this reform being the recognition that clients may show "sustainability preferences."[148] More particularly, the draft DA MiFID II has defined, for the very first time, the meaning of a client's "sustainability preferences" in terms of a choice, exercised by the client or potential client, of financial instruments. This choice requires the client or potential client to decide:

> . . . whether and, if so, to what extent, one or more of the following financial instruments shall be integrated into his or her investment:
> (a) a financial instrument for which the client or potential client determines that a minimum proportion shall be invested in environmentally sustainable investments as defined in Article 2, point (1), of Regulation (EU) 2020/852 of the European Parliament and of the Council;
> (b) a financial instrument for which the client or potential client determines that a minimum proportion shall be invested in sustainable

142. *Id.* at art. 3(b), 17.

143. *Id.* at art. 3(d).

144. *Id.* at art. 3(d).

145. *Id.* at art. 11.

146. *See* DA Taxonomy Regulation, *supra* note 137.

147. *See* SFDR, *supra* note 11, at art. 2(17), 6, 8–9; *see also* EU Taxonomy Regulation *supra* note 12, at art. 3.

148. Commission Delegated Regulation Amending Delegated Regulation (EU) 2017/565, 2021 O.J. (C 2021) 1 [hereinafter Draft DA MiFID II].

> investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088 of the European Parliament and of the Council;
> (c) a financial instrument that considers principal adverse impacts on sustainability factors where qualitative or quantitative elements demonstrating that consideration are determined by the client or potential client;[149]

In the definition above cited, three categories of financial instruments are included. The first category (subparagraph (a)) refers ultimately to instruments able to meet the criteria in Article 3 of the EU Taxonomy Regulation. The second category (subparagraph (b)) refers to instruments pursuing sustainable investments (Article 2(17) and Article 9(1) SFDR). Although the interpretation of the third category (subparagraph (c)) is not completely settled, this category seems to be broad enough to contain financial instruments that promote environmental or social characteristics (Article 8(1) SFDR — light green products) and even products making no positive contribution to the environment or society (Article 6 SFDR products), provided that such instruments consider principal adverse impact on sustainability factors.[150] The consideration of principal adverse impact is intended to show to actual or prospective investors the extent to which and how the instrument has, or may have, a negative impact on sustainability factors relating to environmental, social and employee matters, respect for human rights, anti-corruption, and anti-bribery matters.[151]

Before concluding this section, it is worth noting that the EU Taxonomy, as a classification tool, can, and likely will, find multiple uses. In relation to transitional finance, companies may rely on the EU Taxonomy to design a plan for their climate and environmental transition and raise finance for this transition.[152] Manufacturers of financial products may opt to use the EU Taxonomy as a basis to design credible green financial instruments. In this

149. *Id.* at art. 1.

150. *See* SFDR, *supra* note 11, at art. 6, 8. In the situation whereby an Article 6 SFDR product or Article 8 SFDR product did not consider principal adverse impact (consideration that works on a comply or explain basis), it is the opinion of this author that, according to the current state of law, such products would be unsuitable to meet a client's sustainability preferences under MiFID II. *See* discussion *infra* Section IV.2.B. There is therefore a clear incentive to disclose principal adverse impact in Article 8 SFDR and Article 6 SFDR insofar as, without such disclosure, these products may not be used to service clients with sustainability preferences. *See* SFDR, *supra* note 11, at art. 6, 8.

151. *See* SFDR, *supra* note 11, at art. 2(24) (outlining sustainability factors).

152. EU PLATFORM ON SUSTAINABLE FINANCE, TRANSITION FINANCE REPORT (March 2021), https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/210319-eu-platform-transition-finance-report_en.pdf.

sense, the Commission has already profited from the EU taxonomy to propose green bond criteria that require, among other factors, that the totality of the funds raised through the green bond be allocated to economic activity aligned with the EU taxonomy.[153] Similarly, the Commission's recent efforts to establish criteria for EU Eco-levels and EU climate benchmarks rely on the EU Taxonomy.[154] Furthermore, taxonomy-aligned information disclosure will be a valuable resource for investors and shareholders having sustainability preferences.[155]

As the next section of this Article will explain, the EU Taxonomy Regulation has also created mandatory disclosure obligations on companies and Financial Market Participants (FMPs).[156] Broadly speaking, such information disclosure will indicate the extent to which the economic activity of a company, or the economic activity underlying investment products (e.g., portfolios), satisfies the taxonomy classification. Finally, the Commission is working on the design of a social taxonomy, which will serve as basis to classify sustainable investments driven by social investment objectives.[157]

III. CORPORATE SUSTAINABILITY REPORTING AND OTHER INFORMATION DISCLOSURE OBLIGATIONS

Without the availability of quality and sufficient data, it is difficult, if not unfeasible, to adequately manage sustainability risk and realise an investment's sustainability properties and impact.[158] The critical value of sustainability-related information has been rightfully upheld by the Commission in its Action Plan, which has proposed, among other measures,

---

153. Proposal for a Regulation Of The European Parliament and of The Council on European Green Bonds*,* COM (2021) 391 final (June 7, 2021); *see* EUROPEAN GREEN BOND STANDARD, EUROPEAN COMMISSION, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/european-green-bond-standard_en.

154. *See Strategy for Financing*, *supra* note 2 at 4, 6–7 (planning to expand the use of the EU Ecolabel to financial products in order to provide retail investors with a "credible, reliable and widely recognized label for retail financial products").

155. *See id.* at 15.

156. *See* EU Taxonomy Regulation, *supra* note 12, at art. 8; *see also* EUROPEAN SECURITIES AND MARKETS AUTHORITY, FINAL REPORT: ADVICE ON ARTICLE 8 OF THE TAXONOMY REGULATION (2021) https://www.esma.europa.eu/sites/default/files/library/esma30-379-471_final_report_-_advice_on_article_8_of_the_taxonomy_regulation.pdf.

157. PLATFORM ON SUSTAINABLE FINANCE, DRAFT REPORT BY SUBGROUP 4: SOCIAL TAXONOMY (2021) https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sf-draft-report-social-taxonomy-july2021_en.pdf.

158. *See* Draft CSRD, *supra* note 13, at 24–25.

the overhaul of the current regime governing corporate non-financial information reporting.[159] The current EU rules based on the NFRD[160] will soon be fully replaced by a new legal framework for corporate sustainability reporting enshrined in the CSRD.[161]

The CSRD expands the scope of application of the reporting obligation, which will reach out to a larger number of companies.[162] Unlike the NFRD, which has imposed reporting obligations on a comply or explain basis,[163] the CSRD has introduced mandatory reporting standards.[164] Those standards — that will be designed by the European Financial Reporting Advisory Group (EFRAG) — are conceived to provide a flow of sustainability-related information which "is understandable, relevant, representative, verifiable, comparable, and is represented in a faithful manner."[165] Available to shareholders, investors and other corporate stakeholders, the information contained in sustainability reports will be externally audited.[166] This step is crucial to the extent that auditors shall provide, among other elements, an expert opinion as to the report's compliance with the CSRD rules and the applicable EU common reporting standards.[167] Mandatory and audited reporting standards, along with other changes introduced by the CSRD, are expected to tackle the most pressing information disclosure problems found in the operation of NFRD, problems that threaten to derail the successful

159. *See* EU Action Plan, *supra* note 1, at 3.

160. *See* NFRD, *supra* note 36.

161. *See* Draft CSRD, *supra* note 13 (amending four EU legislative instruments: the Accounting Directive (2013/34/EU); the Transparency Directive (2004/109/EC); the Audit Directive (2006/43/EC); and the Audit Regulation (537/2014)).

162. *Id.* at art. 1(3) (replacing art. 19(a) of the Accounting Directive 2013/34/EU). For the scope of application of the new regime of sustainability reporting under the draft CSRD, see Directive 2013/34/EU of The European Parliament and of The Council of 26 June 2013 On the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Types of Undertakings, Amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, art. 1, 2013 O.J. (L. 182) 19; *see also* Draft CSRD, *supra* note 13, at art. 1(3).

163. *See* NFRD, *supra* note 36, at art. 1(1) (inserting art. 19(a) in the Accounting Directive 2013/34/EU).

164. *See* Draft CSRD, *supra* note 13, at art. 1(3)–(4) (replacing art. 19a and introducing articles 19b, 19c and 19d to the Accounting Directive 2013/34/EU).

165. *See id.* at art. 1(4) (introducing art. 19b(2) to the Accounting Directive 2013/34/EU).

166. *See id.* at arts. 2–4 (amending the Transparency Directive 2004/109/EC, Audit Directive 2006/43/EC and Audit Regulation (EU) No 537/2014; ordering the creation of new "independent assurance provider services" in the field of sustainability reporting).

167. *Id.* at recitals 53–55.

development of EU sustainable finance policy.[168]

Importantly, both the NFRD and the CSRD have adhered to the principle of "double materiality" in order to delimit the boundaries of the sustainability reporting obligation.[169] According to this principle, the disclosure of information shall duly account for not only the impact of sustainability factors on the company's financial position and performance (outside-in effect) but also for the impact of the company's economic activity on sustainability factors (inside-out effect).[170] The first pillar of the double materiality principle orbits around the identification, measurement and more generally, management of sustainability risk to which the company is exposed, whereas the second pillar captures the concept of sustainable investments and their impact on sustainability factors, such as the environment or the community.[171] These two pillars together determine a company's sustainability performance. The materiality principle utilized in the NFRD and CSRD derives from the more conventional principle of materiality long established in financial reporting.[172] As such, and without disregarding their distinctive definitions and features, it can reasonably be argued that the shortcomings arising from the operation of materiality in the context of corporate financial reporting will, to an extent, also be present in the realm of corporate sustainability reporting.

Widely used in corporate financial reporting, materiality in information disclosure refers to "the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking."[173] As a

---

168. *See id*. at recitals 11–14 (emphasizing the negative implications flowing from a non-financial data gap created by the NFRD between users' information needs and the sustainability information reported by undertakings).

169. *See id*. at recital 25; *see also* NFRD*, supra* note 36, at art. 1(1) (inserting art. 19a(1) in the Accounting Directive 2013/34/EU); European Commission, *Guidelines on Reporting Climate-Related Information*, at 6–8, 4409 final (July 17, 2019) [hereinafter EC Reporting Guidelines].

170. *See* Draft CSRD, *supra* note 13, at art. 1(3) (replacing art. 19(a)(1) of the Accounting Directive 2013/34/EU); *see also* SFDR, *supra* note 11, at art. 2(24) (defining "sustainability factors").

171. *See* Draft CSRD, *supra* note 13, at 5.

172. Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, 2013 O.J. (L 182), art. 2(16) [hereinafter Accounting Directive 2013/34/EU]. *See generally* Baumüller & Schaffhauser-Linzatti, *supra* note 37, at 101–11 (examining materiality in both financial and non-financial disclosure).

173. *See* Accounting Directive 2013/34/EU, *supra* note 172, at art. 2(16).

legal requirement, the evaluation of materiality has been essential for companies to manage serious risks associated with financial information disclosure. More particularly, the disclosure may omit relevant information, contain misstatements concerning relevant information and/or overflood investors with irrelevant or useless information.[174] By assessing the materiality status of information, companies have been able to draw a line and realise what information is or is not relevant to users, and therefore, what information shall or shall not be reported. Deciding on the materiality status of information, however, involves discretionary judgment on the part of corporate officers who must determine whether a piece of information can reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking.[175] Subjective judgment may deliver sound decisions; nevertheless, it may also prove opportunistic or erratic.[176] Ultimately, the materiality requirement delineates the scope of the financial information disclosure obligation[177] and, to this extent, enforcement agencies and investors (especially in the United States) have actively monitored due compliance with this principle.[178]

Building upon this experience, the legal framework for corporate sustainability reporting in Europe has also adopted the materiality principle, yet shaped in a different conceptual format, namely the 'double materiality' principle.[179] Pursuant to Article 19(a)(1) of the NFRD, companies are required to disclose information "to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters . . . ."[180] This provision has been construed as containing not only a

174. *See* Baumüller & Schaffhauser-Linzatti, *supra* note 37, at 101–03.

175. *See* Accounting Directive 2013/34/EU, *supra* note 172, at art. 2(16).

176. *See* Baumüller & Schaffhauser-Linzatti, *supra* note 37, at 101–03; *see also* Ernest L. Hicks, *Materiality*, 2 J. Acct. Rsch. 158, 159 (1964) ("Determining whether something is material remains, in most instances, completely subjective — a matter of judgment."); Shane Moriarity & F. Hutton Barron, *A Judgment-Based Definition of Materiality*, 17 J. ACCT. RSCH. 114, 114–35 (1979).

177. *See* Baumüller & Schaffhauser-Linzatti, *supra* note 37, at 101–03.

178. *See*, *e.g.,* European Securities and Markets Authority (ESMA), Feedback Statement: Considerations of Materiality in Financial Reporting, ESMA/2013/218 (Feb. 14, 2013).

179. *See* Draft CSRD, *supra* note 13, at art. 19a(1), recital 25; *see also* NFRD*, supra* note 37, at art. 1(1) (inserting art. 19a(1) in the Accounting Directive2013/34/EU); European Commission, *Guidelines on Reporting Climate-Related Information*, supra note 169, at 6–8.

180. NFRD*, supra* note 36, at art. 19a(1).

requirement for financial materiality ("to the extent necessary for an understanding of the company's development, performance and position") but also a requirement for environmental and social materiality (impact of the company's activities relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters).[181] It is worth noting that, according to the Commission, these two dimensions of materiality operate independently.[182]

On the one hand, financial materiality encompasses sustainability-related information that is relevant to corporate value and, concomitantly, to data users' decision-making, these users being primarily shareholders, investors and/or creditors.[183] Crucially, financial materiality in sustainability information accounts for the exposure of a company to sustainability risk. That is, it reports on the impact of sustainability factors on the company's value (outside-in effect).[184] On the other hand, social or environmental materiality refers to the impact on society or the environment, respectively, of the company's activities in carrying on business (inside-out effect). This information may, but need not, relate to the company's financial value.[185] An increasing number of users, such as NGOs, workers, consumers and other stakeholders, have shown to be less sanguine about corporate value but more interested in the company's behavior — leading to positive or negative implications—towards the environment and society.[186] The Commission's guidelines have associated the term 'impact' included in art 19(a)(1) NFRD with social or environmental materiality as follows:

> The reference to "impact of [the company's] activities" indicates environmental and social materiality. Climate-related information should be reported if it is necessary for an understanding of the external impacts of the company. This perspective is typically of most interest to citizens, consumers, employees, business partners, communities, and civil society organisations. However, an increasing number of investors also need to know about the climate impacts of investee companies in order to better

181. *Guidelines on Reporting Climate-Related Information*, *supra* note 169, at 6–7; *see also*, Mathilde Bossut et al., *What Information is Relevant for Sustainability Reporting? The Concept of Materiality and the EU Corporate Sustainability Reporting Directive*, Sustainable Finance Research Platform Policy Brief, July 2021, at 5–6, https://wpsf.de/wp-content/uploads/2021/09/WPSF_PolicyBrief_7-2021_Materiality.pdf.

182. *See* Bossut, *supra* note 181, at 10.

183. EC Reporting Guidelines, *supra* note 169, at 6–7

184. *Id.*

185. *Id.*

186. *Id.*

> understand and measure the climate impacts of their investment portfolios.[187]

Nevertheless, the Commission's guidelines recognize that in future the two perspectives of the "double materiality" principle may, and likely will, increasingly overlap: "As markets and public policies evolve in response to climate change, the positive and/or negative impacts of a company on the climate will increasingly translate into business opportunities and/or risks that are financially material."[188] The assessment of the materiality of sustainability climate-related information should consider a long-term time horizon and "[w]hen assessing the materiality of climate-related information, companies should consider their whole value chain, both upstream in the supply-chain and downstream."[189]

The "double materiality" principle in corporate sustainability disclosure is critical for the adequate management of sustainability risk (e.g., to address the effects of climate risk on financial performance and on the stability of the financial system) and for the development of sustainable investment markets and products.[190] Consistently with these objectives, the CSRD has not only maintained this principle but also articulated it in a more accurate way relative to the NFRD: "Undertakings . . . shall include in the management report information necessary to understand the undertaking's impacts on sustainability matters, and information necessary to understand how sustainability matters affect the undertaking's development performance and position."[191] The rationale underlying the double materiality principle, as well as the Commission's vision in this policy area, is that information disclosure on sustainability risk is a necessary yet insufficient condition for the development of sustainable finance, in general, and in particular, or sustainable investment markets and products.[192] A description of, and metrics on, the impact of the company's economic activity on sustainability factors (inside-out effect) has also been deemed as a necessary, vital piece of information to end users, including company financiers (investors and banks) and other company stakeholders.[193]

---

187. *Id. But see* Baumüller & Schaffhauser-Linzatti, *supra* note 37, at 105–10 (discussing an alternative interpretation).

188. Communication from the Commission, 2019 O.J. (C 2019) 1, 4.

189. *Id.* at 5.

190. *See id.*

191. *See* Draft CSRD, *supra* note 13, at art. 1(3) (replacing art. 19(a)(1) of the Accounting Directive 2013/34/EU).

192. *See id.*

193. *See id.* at recital 12 (noting that organizations involved in sustainability must include "a report" that details "information necessary to understand how sustainability

Corporate sustainability reporting obligations are but one piece of the wider, comprehensive information disclosure regime engineered under the EU sustainable finance policy. Other key sustainability-related information disclosure obligations have been enshrined in the SFDR[194] and in the EU Taxonomy Regulation.[195] The Commission has envisioned an ambitious information disclosure regime that encompasses multiple actors including, among others, large companies, financial market participants (FMPs) and investment advisors (IAs). As the Commission noted, "the NFRD [that will be replaced by the incoming CSRD], together with the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation, are the central components of the sustainability reporting requirements underpinning the EU's sustainable finance strategy. The purpose of this legal framework is to create a consistent and coherent flow of sustainability information throughout the financial value chain."[196] From the vantage point of investors, this comprehensive disclosure regime aims to provide them with sufficient and relevant information to determine what investment is or is not sustainable, how much sustainable the investment is, and how the sustainability level of an investment compares across investments.[197]

Under the SFDR, FMPs (such as MiFID investment firms) and IAs are subject to new sustainability-related reporting requirements.[198] More particularly, these actors shall disclose information on the entity's policy to integrate sustainability risk,[199] as well as information, at product level, on how sustainability risk has been integrated in the product and the extent to

matters affect the undertaking's development, performance, and position").

194. SFDR, *supra* note 11.

195. EU Taxonomy Regulation, *supra* note 12.

196. Draft CFRD, *supra* note 11; *see also* Cadwalader, Wickersham & Taft LLP, *Investors and Regulators Turning Up the Heat on Climate-Change Disclosures: Attempting to Make Sense of the State of Play in the US, EU, and UK*, JDSUPRA (Sept. 14, 2021), https://www.jdsupra.com/legalnews/investors-and-regulators-turning-up-the-6538549/.

197. *See, e.g.*, EU Taxonomy Regulation, *supra* note 12, at recitals 13, 19 (explaining the role of information and uniform standards in supporting comparisons across financial products by investors).

198. *See* SDFR, *supra* note 11, at art. 1 (seeking "transparency with regard to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products").

199. *Id.* at art. 3; *see also* EUROPEAN SECURITIES AND MARKETS AUTHORITY, ESMA'S TECHNICAL ADVICE TO THE EUROPEAN COMMISSION ON INTEGRATING SUSTAINABILITY RISKS AND FACTORS IN MIFID II' FINAL REPORT (Apr. 30, 2019).

which this risk impacts on the product's financial return.[200] On the sustainable investment side, FMPs and IAs disclose information on the sustainability properties of their investment products[201] and, at the level of both entity (mandatory for firms with more than 500 employees) and product (on a comply and explain basis), information on the principal adverse sustainability impact (PAI) of their investment strategies on sustainability factors.[202] As well as the positive contribution to sustainability derived from the activity and products of FMPs and IAs, the SFDR has made clear that the negative impacts on sustainability also matter and shall be disclosed.

Additional sustainability-related disclosure obligations arise from the EU Taxonomy Regulation.[203] This regulation provides a classification framework whereby the economic activities of investee companies are categorised as environmentally sustainable.[204] In turn, both companies and FMPs, among other actors, are obliged to disclose information organized in accordance with this classification framework, thereby showing the extent to which their economic activity and investments (including investment products made available to customers) are taxonomy compliant.[205]

IV. SUSTAINABILITY-RELATED REFORMS IN EU FINANCIAL SERVICES LAW

A. General Overview

Recent legislative reforms in the context of EU financial services law, have created additional obligations on financial market participants (FMPs) to integrate sustainability risk in decision-making and to account for the sustainability preferences of investors. Amendments have been introduced

200. *See* SDFR, *supra* note 11, at art. 6

201. *Id.* at arts. 1–9. The SFDR has introduced the requirement of principal adverse sustainability impact (PAI) to be disclosed by FMPs at both entity level (mandatory for firms with more than 500 employees) and product level (on a comply and explain basis), *Id.* at art. 3, 7). It thus matters the positive contribution that an investment product can make to the environment or society as well as the fact that such a product may cause material, or likely material, negative effects on sustainability factors.

202. *Id.*

203. See *infra* Section II.2.C of this article offering a basic introduction to the EU Taxonomy Regulation as a tool to classify activities and investments as environmentally (or socially) sustainable.

204. EU Taxonomy Regulation, *supra* note 12, at arts. 3, 9–16.

205. *Id.* at arts. 1, 5–8.

to the AIFMD,[206] the UCITS Directive,[207] MIFID II,[208] and IDD.[209] As a result, sustainability-related obligations have now become part of the existing body of law regulating the investment and financial services industry in Europe.

According to the amendments to the AIFMD and the UCITS Directive, managers of alternative investment funds and UCITS management companies must consider and manage sustainability risk, evaluate principal adverse impact of investment decisions on sustainability factors and evaluate sustainability-related conflict of interest in their business operations.[210] Senior management is responsible for ensuring due compliance with these new requirements.[211] Changes to the MiFID II and IDD regimes have included the obligation of investment firms to integrate sustainability risk in the firm's organization, risk management and decision making. Moreover, the clients' sustainability preferences shall be duly accounted for,[212] as shall the new requirements relating to conflict of interest[213] and to product governance.[214]

---

206. AIFMD, *supra* note 40.

207. UCITS Directive, *supra* note 41.

208. MiFID II, *supra* note 14, at art. 24(1); *see also* MiFID II DR, *supra* note 14, at art. 54–55.

209. IDD, *supra* note 42.

210. Commission Delegated Regulation (C(2021) 2615 final / 21.04.2021), art. 1 [hereinafter Draft DA AIFMs] (amending/replacing several articles of the MiFID II DR); Commission Delegated Directive (C(2021) 2617 final / 21.04.2021), art. 1 [hereinafter Draft DD UCITS] (amending/replacing several articles of Directive 2010/43/EU).

211. Draft DA AIFMs, *supra* note 211, at art. 1(7) (adding this item as art 60(2)(i) of Delegated Regulation (EU) 231/2013); Draft DD UCITS, *supra* note 211, at art. 1(5) (adding this item as art 9(2)(g) of Directive 2010/43/EU).

212. Draft DA MIFID II, *supra* note 148; Commission Delegated Regulation (*EU) Amending Delegated Regulation (EU) 2015/35 as Regards the Integration of Sustainability Risks in the Governance of Insurance and Reinsurance Undertakings,* art. 1, COM (2021) 2628 final (May 21, 2021) [hereinafter Draft DA Insurance]; Commission Delegated Regulation *Amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as Regards the Integration of Sustainability Factors, Risks and Preferences into the Product Oversight and Governance Requirements for Insurance Undertakings and Insurance Distributors and Into the Rules on Conduct of Business and Investment Advice for Insurance-Based Investment Products*, art. 1, COM (2021) 2614 final (May 21, 2021) [hereinafter Draft DA IDD].

213. *E.g.*, Draft DA MIFID II, *supra* note 148, at art. 1(4) (replacing art. 33 MiFID II DR).

214. *Commission Delegated Directive (EU) Amending Delegated Directive (EU) 2017/593 as Regards the Integration of Sustainability Factors Into the Product Governance Obligations*, art. 1, COM (2021) 2612 final (May 21, 21 2021) [hereinafter Draft DD Product Governance].

In order to delve deeper into these reforms, and for the sake of brevity, the rest of this chapter will be dedicated to the reforms amending the MiFID II regime, which constitutes the backbone of securities regulation in the European Union.[215] Modifications to MIFID II have been completed largely through amendments to the Commission Delegated Regulation (EU) 2017/565 (MiFID II DR) and to the Commission Delegated Directive (EU) 2017/593 (MiFID II DD).[216] Most of these reforms have involved changes to the operating conditions of investment firms, in two areas. The first area looks at the firms' organization and management systems.[217] The Commission acknowledged that the current version of the MiFID II DR has not explicitly referred to sustainability risk, and that the integration of sustainability risk would demand reform at the level of processes, systems and internal controls of investment firms, and at the level of the technical capacity and knowledge necessary to analyze sustainability risk.[218] In this light, changes to the MiFID II DR have been proposed—changes undertaken through the draft DA MiFID II—in order to make sure that investment firms account for sustainability risk as they set up, execute, and monitor their organization requirements, internal controls and reporting. [219]

The second area of sustainability-related reforms of MiFID II has concentrated on the investment firm-client relationship and, especially on the need to preserve investor protection.[220] It is known that investors, particularly retail investors, are exposed to problems of information, including asymmetries of information, that affect investors negatively when forming preferences and making investment choices.[221] Such problems, compounded by product complexity and cognitive limitations, have rendered investors more prone to making mistakes.[222] Investors are also exposed to

215. For further reading on MiFID II, see MATTHIAS LEHMANN AND CHRISTOPH KUMPAN, *Part 1: Securities Markets and Services in* EUROPEAN FINANCIAL SERVICES LAW: ARTICLE-BY-ARTICLE COMMENTARY (1st ed. 2019); Niamh Moloney, EU SECURITIES AND FINANCIAL MARKETS REGULATION (3d ed. Oxford University Press 2016).

216. *See* e.g., Draft DA MIFID II, *supra* note 148; Draft DD Product Governance, *supra* note 215.

217. *See* Draft DA MiFID II, *supra* note 148, recital 3.

218. *Id*.

219. *See* Draft DA MiFID II, *supra* note 148, at arts. 1(2)(a), 1(3), 1(6)(c) (amending art. 21 (para 1), replacing art. 23(1)(a) and modifying art 54(9) of MiFID II DR).

220. *See* EU Action Plan, *supra* note 1, at 2; *see also* discussion *supra* Section II.2.B.

221. Armour, *supra* note 43, at 205–25.

222. Lefevre & Chapman, *supra* note 44 and accompanying text.

problems of conflict of interest[223] and of abusive conduct from providers including the mis-selling of financial services. Mis-selling occurs where financial intermediaries sell to their clients' products that do not adequately fit the client's needs or expectations.[224] Retail investors are more vulnerable to abuse due to their relative ignorance and poor literacy as these factors aggravate asymmetries.[225] It is reasonable to estimate that such dangers to investors, which have been long observed in the context of traditional investment products, are also likely to emerge from and taint the provision of sustainable investment products (e.g., greenwashing conduct).[226]

Keeping investor protection concerns in mind, the reform of the MiFID II regime has consisted of several amendments to the rules setting out the conduct standards applicable to investment firms. These conduct standards have included, among others, the obligation to provide information to clients (section IV.2.A below), suitability requirements (section IV.2.B below), conflict of interest requirements (section IV.2.C below), and product governance requirements (section IV.2.D below).[227] The rest of this section will look at these amendments insofar as they are crucial to investor protection in the realm of sustainability.

B. MiFID II Regime: The Integration of Sustainability Risk, Factors and Preferences

1. Disclosing Information to Clients

In MiFID II, the obligation to disclose information to clients (as well as the other obligations examined in this section IV.2) derives from the more general duty born by investment firms under article 24(1) MiFID II to act "honestly, fairly and professionally in accordance with the best interests of its clients."[228] Within this framework, investment firms shall disclose information to their clients about the firm (e.g., address, contact information, etc.), the services offered (e.g., brokerage, investment advice, portfolio management, etc.) the client category (e.g., retail, professional investor or eligible counterparty), the characteristics of the financial instruments offered, the costs and charges of products and services, the custody of assets,

223. *Supra* note 46 and accompanying text.
224. Reurink, *supra* note 45, at 1302–03.
225. *Id*.
226. *See* discussion *supra* Section II.2.B.
227. *See* discussion *infra* Section IV.2.
228. MiFID II, *supra* note 14, art. 24(1); Danny Busch, *MiFID II: Stricter Conduct of Business Rules for Investment Firms 12* C*AP*. M*ARKETS* *L.J.* 340, 350 *(2017*).

and the firm's status in relation to the independence of the services it provides.[229]

Importantly, the information that the investment firm furnishes to their actual or potential clients shall be "fair, clear and not misleading."[230] This means that the information must be accurate and give "a fair and prominent indication of any relevant risks when referencing any potential benefits of an investment service or financial instrument."[231] Moreover, the investment firm must use "a font size in the indication of relevant risks that is at least equal to the predominant font size used throughout the information provided, as well as a layout ensuring such indication is prominent."[232] The firm shall also make sure that "the information does not disguise, diminish or obscure important items, statements or warnings."[233]

Sustainability-related reforms in this context have been limited to article 52(3) MiFID II DR relating to information on financial instruments and advice. This provision seeks that investment firms provide to their clients' information about the selection of financial instruments as well as about the content of the advisor's recommendation.[234] As amended, sustainability considerations have been added to article 52(3)(c) MiFID II DR as follows:

> 3. Investment firms shall provide a description of: (a) the types of financial instruments considered; (b) the range of financial instruments and providers, analyzed per each type of instrument according to the scope of the service; (c) where relevant, the sustainability factors taken into consideration in the selection process of financial instruments; (d) when providing independent advice, how the service provided satisfies the conditions for the provision of investment advice on an independent basis, and the factors taken into consideration in the selection process used by the investment firm to recommend financial instruments, including risks, costs and complexity of the financial instruments.[235]

The Commission has recognised that the industry has thus far developed "[f]inancial instruments with various degrees of sustainability-related ambition".[236] For this reason, investment managers and advisors are expected to explain to the client the sustainability properties embedded in such

229. MiFID II, *supra* note 14, art. 24.
230. *Id*. art. 24(3).
231. MIFID II DR, *supra* note 14, art. 44(2)(b).
232. *Id*. art. 44(2)(c).
233. *Id*. art. 44(2)(e).
234. *Id.* art. 52(3).
235. Draft DA MiFID II, *supra* note 148, art. 1(5) (replacing art. 52(3) MiFID II DR).
236. *Id.* recital 6.

financial instrument and the extent to which such properties match the client's sustainability preferences. From the perspective of information disclosure, the policy objective is to make sure that the client or potential client "understand those different degrees of sustainability and take informed investment decisions in terms of sustainability".[237]

Early in the reform process, it became clear that the Commission had intended a broader scope of changes. It had proposed amendments to Article 47 MiFID II DR (information about the investment firm and services offered), Article 48 MiFID II DR (information about financial instruments) and Article 52 of MiFID II DR (information about investment advisory services).[238] But since the enactment of the SFDR had addressed these information points, the Commission limited the changes and went ahead only with changes to Article 52(3) MiFID II DR. [239] On top of the already meaningful sustainability-related disclosure requirements introduced by the SFDR and the EU Taxonomy Regulation, this modification to the MiFID II DR has added a further layer of sustainability information that will operate within the client-firm relationship.

2. Suitability Requirements

It is known that information disclosure is often an insufficient tool to mitigate investors' mistakes and exposure to abuse.[240] That investors read, if at all, the information furnished to them has not been apparent.[241] Moreover,

---

237. *Id*. On the definition of sustainability preferences and the type of instruments capable of satisfying such preferences, see Section II.2.C of this Article.

238. Draft DA MiFID II (early 2018 version), art. 1(2)–1(4).

239. Draft DA MiFID II (early 2019 version), Explanatory Memorandum, 5 ("As Article 4 of the legislative proposal for a Disclosure Regulation lays down that financial market participants (including IDD and MiFID firms providing investment advice and portfolio management) must include pre-contractual disclosure information on how they incorporate sustainability risks, the pre-contractual disclosure requirements in Articles 47 and 48 have been removed from this delegated regulation. This shall ensure a harmonised application of pre-contractual disclosure rules amongst financial market participants. However, at a later stage, the Commission could revise the Regulation (EU) 2017/565 accordingly.").

240. ARMOUR, *supra* note 43, at 205–25.

241. *See, e.g.*, Thomas S. Ulen, *A Behavioral View of Investor Protection*, 44 LOY. U. CHI. L.J., 1357, 1370 (2013) ("It is expensive to comply with mandated disclosure plans. Consumers, who are presumed to benefit from the information disclosures, often find themselves overwhelmed by the amount of information with which they must deal. Consumers have a limited ability to retain the information in working memory (typically retaining no more than a third of information disclosed to them); and the mandatory information can have undesirable unintended consequences (for instance, crowding out useful information, harming competition, and fostering inequity)." (citing Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV.

behavioral biases may distort the process by which investors process and integrate information and make decisions.[242] These problems, compounded by the risk of mis-selling conduct on the part of service providers,[243] have motivated more interventionist approaches to investor protection based on the notion that investors will be better off if the conduct of service providers is restricted.[244] The MiFID II suitability requirements have precisely served this purpose, as have product governance requirements.[245] The statutory basis governing the suitability obligation is provided by Article 25(2) MiFID II, supplemented by Articles 54 and 55 of MiFID II DR and ESMA's relevant guidelines.[246] The obligation applies to advisors and portfolio managers, and it requires that they gain a reasonable understanding of the profile and characteristics of the client before providing services to that client. In procuring, the provider must perform an assessment that consists of the following three core steps.[247]

The first step consists of collecting data about the client.[248] Data collection is often done through a questionnaire that the clients fill out as well as other data search tools internally utilized by the service provider.[249] The second step involves the product due diligence conducted by the service provider in

647 (2011)).

242. *See generally* ARMOUR, *supra* note 43, at 212; RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (New Heaven, Yale University Press 2008) (examining how failures in human reasoning, so called "behavioral market failures" contribute to suboptimal decision-making in several contexts including financial decisions);Colin Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism"* 151 U. OF PA. L. REV. 1211 (2003); H. KENT BAKER,ET AL., FINANCIAL BEHAVIOR: PLAYERS, SERVICES, PRODUCTS, AND MARKETS (1st ed. 2017).

243. Reurink, *supra* note 45.

244. *See* ARMOUR, *supra* note 43, at 222–23, 233–44.

245. Product governance rules are examined *infra* Section IV.2.D of this Article. Suitability requirements are also prescribed by the IDD in the context of insurance industry. *See* Draft DA IDD, *supra* note 213. In this Article, however, only MiFID II suitability requirements are analyzed.

246. *See* MiFID II, *supra* note 14, at art. 25(2); MiFID II DR, *supra* note 14, at art. 54–55; Guidelines on Suitability, *supra* note 50.

247. MiFID II, *supra* note 14, at arts. 25(2),25(6); MiFID II DR, *supra* note 14, at art. 54(2). *See generally* Félix E. Mezzanotte, *Accountability in EU Sustainable Finance: Linking the Client's Sustainability Preferences and the MiFID II Suitability Obligation*, 16 CAP. MARKETS L.J. 482, (2021); Félix E. Mezzanotte, *The EU Policy on Sustainable Finance: A Discussion on the Design of ESG-Fit Suitability Requirements*, 40 REV. BANKING & FIN. L. 249 (2020).

248. MiFID II, *supra* note 14, at art. 25(2); MiFID II DR, *supra* note 14, at art. 54(2).

249. MiFID II DR, *supra* note 14, at arts. 54–55; Guidelines on Suitability, *supra* note 50, no.2 to no.5.

order to make sure that the selected products match the client's profile. More particularly, the products recommended by advisor or invested in by the portfolio manager on behalf of their clients must meet the client's (a) investment objectives, (b) financial situation, and (c) investment knowledge and experience.[250] In the third step, a suitability report is prepared by the advisor or the portfolio manager in order to inform and explain to the retail client how the recommendation or portfolio suits the client.[251] Placed at the center of the client-provider relationship, this assessment of suitability creates an optimal space for interaction where sustainability preferences can be identified and serviced.

Since the suitability assessment creates a valuable setting for the client-provider interaction, the Commission has viewed such an assessment as an adequate vehicle to identify a client's sustainability preferences and integrate them in the investment chain.[252] Ideally, investors should be able to explicitly state their sustainability preferences to the asset manager or advisor. But evidence from industry practices has pointed to a different reality: these providers have often failed to ask clients about their sustainability preferences.[253] Whether caused by problems of data availability,[254] product complexity and poor financial incentives,[255] clients' inertia,[256] or inadequate training,[257] it remains to be seen the extent to which this reform will steer the client-provider interaction in the right direction. One of the objectives of the

250. MiFID II DR, *supra* note 14, at arts. 54–55

251. MiFID II, *supra* note 14, at art. 25(6).

252. EU Action Plan, *supra* note 1, § 2.4 (proposing the reform of the suitability requirements by the European Commission in the 2018 Action Plan).

253. EU Action Plan, *supra* note 1, § 2.4, 3.2; EUROPEAN COMMISSION, *Feedback Statement: Public Consultation on Institutional Investors and Asset Managers' Duties Regarding Sustainability*, at 9–10 (2018), https://ec.europa.eu/info/sites/default/files/2017-investors-duties-sustainability-feedback-statement_en.pdf [hereinafter Commission Feedback Statement]; 2DII, *supra* note 92, at 5 (finding the presence of a large disconnect between the questions posed by the advisers and the actual, non-financial investment objectives of retail clients).

254. Commission Feedback Statement, *supra* note 254. A reason that may have precluded advisers and portfolio managers from discussing ESG issues with their clients is the lack of "convincing and easily available data clearly showing the importance of ESG factors". *Id.*

255. *Id.* at 13–14.

256. EU Action Plan, *supra* note 1, §§ 2.4, 3.2.

257. Ulf Schrader, *Ignorant Advice—Customer Advisory Service for Ethical Investment Funds*, 15 BUS. STRATEGY & ENV'T 200, 207–08 (2006) (reasoning that ESG products may prove unfamiliar to the advisers who supply their clients with information that is "usually incomplete, often vague and provided mostly after long consultation of their databases").

reform is to get providers to inquire about the client's sustainability preferences at the very time of providing advice services or portfolio management services to the client.[258] In addition, the suitability evaluation is expected to account for the client's sustainability preferences in a way that safeguards the client's best interest. This includes protection against abusive practices including greenwashing.[259]

This rationale has guided the reform of the MiFID II suitability assessment within the frame of EU sustainable finance policy.[260] Advisors and portfolio managers, when conducting the suitability assessment, shall meet "the investment objectives of the client in question, including the client's risk tolerance and any sustainability preferences".[261] Moreover, "[t]he information about the investment objectives of the client or potential client shall include, where relevant, information about the length of time for which the client wishes to hold the investment, his or her preferences regarding risk taking, his or her risk tolerance, the purpose of the investment and in addition his or her sustainability preferences."[262] Among other issues, the reform also stressed that the treatment of sustainability preferences shall be stated and explained to the retail client in the suitability report.[263]

Importantly, the Commission has also provided a formal definition of sustainability preferences in article 1(1) of the Draft DA MiFID II. As examined earlier in Section II.2.C of this Article, sustainability preferences have been defined as a client's or potential client's choice of financial instruments containing sustainability properties, and such financial instruments have been classified under the SFDR: the financial instrument meets the criteria set out in article 2(17) SFDR, or qualifies as sustainable under the EU Taxonomy Regulation, or considers principal adverse impact on sustainability factors.[264] Only such instruments can be utilized to satisfy the stated sustainability preferences of the client. Instruments falling outside

258. Draft DA MiFID II, *supra* note 148, recital 5 ("Investment firms that provide investment advice and portfolio management should be able to recommend suitable financial instruments to their clients and potential clients and should therefore be able to ask questions to identify a client's individual sustainability preferences.").

259. Section II.2.B *infra* elaborates on the conduct of greenwashing.

260. EU Action Plan, *supra* note 1, § 2.4, action 4.

261. Draft DA MiFID II, *supra* note 148, art. 1(6)(a) (replacing art. 54(2)(a) of MiFID II DR).

262. *Id.* art. 1(6)(b) (replacing art. 54(5) of MiFID II DR).

263. *Id.* art. 1(6)(e) (replacing art. 54(12) first paragraph of MiFID II DR).

264. *Id.* art. 1(1) (amending art. 2(7) MiFID II DR), recital 6. Section II.2.C *supra* has presented an overview of the definition of sustainability preferences as laid down in the SFDR.

such categorization are deemed to be uncapable of meeting sustainability preferences and therefore cannot be recommended by the advisor or the portfolio manager to those clients who stated having sustainability preferences.[265]

Since the sustainability preferences of clients can be, and will likely be, widely distributed, it is unlikely that providers may always find a suitable product for those clients.[266] In such a case, investment firms "shall not recommend or decide to trade where none of the services or instruments are suitable for the client."[267] This obligation to refrain from recommending, and from trading in, instruments that are inadequate to satisfy the client's sustainability preferences has the purpose, as explained by the Commission, of fighting greenwashing.[268] Under this obligation, the "investment firm shall explain to the client or potential client the reasons for not [recommending or deciding to trade] and keep record for those reasons."[269] A margin for flexibility has been introduced by allowing for the reformulation of stated preferences in the client-provider space, provided that the client's consent is duly accounted for.[270] In the situation where "no financial instrument meets the sustainability preferences of the client or potential client, and the client decides to adapt his or her sustainability preferences, the investment firm shall keep records of the decision of the client, including the reasons for that decision."[271]

3. Conflict of Interest Requirements

Although the regulation of conflict of interest under MiFID II is already abundant, a statement on sustainability preferences has been explicitly

265. *Id.* art. 1(6)(d) (amending art. 54(10) MiFID II DR), recital 6.

266. *See, e.g.*, Joakim Sandberg, *Socially Responsible Investment and Fiduciary Duty: Putting the Freshfields Report into Perspective*, 101 J. BUS. ETHICS 143–62 (2011) (analyzing the various purposes of social investment); UNEP FINANCE INITIATIVE, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT (Oct. 2005), http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf [hereinafter Freshfield Report].

267. Draft DA MiFID II, *supra* note 148, art. 1(6)(d) (replacing art. 54(10) MiFID II DR).

268. *Id.* recital 7 ("In order to prevent mis-selling and greenwashing, investment firms should not recommend or decide to trade financial instruments as meeting individual sustainability preferences where those financial instruments do not meet those preferences.").

269. *Id.* art. 1(6)(d) (replacing art. 54(10) MiFID II DR).

270. *Id.*

271. *Id.*

added. Under MiFID II, the investment firms are required to put in place internal measures to prevent or manage conflicts of interest (1) between the investment firm and its clients and (2) between one client and another.[272] As a general rule, the existence of a conflict of interest does not in itself attract a duty to disclose the conflict to the client. The requirement for disclosure is triggered whenever the firm is unable to sufficiently prevent or manage the conflict of interest and this situation poses a risk of harm to the client's interests.[273] A conflict of interest that carries a risk of harm to the client has been broadly identified in the directive, such as the situation whereby the investment firm is likely to make a financial gain, or avoid a financial loss, at the expense of the client or where the firm receives inducements, in the form of monetary or non-monetary benefits or services, from a third party.[274] To the extent that the risk of causing detriment to the interests of the client cannot be duly prevented by the firm, disclosure duties are attracted to protect the client's informed choice.[275] Working this way, the duty to disclose a conflict of interest has been conceived as a last resort measure.[276]

When required, the disclosure must provide a detailed description of the conflict of interest (nature and sources) that arises in the provision of investment and/or ancillary services as well as a description of the risks to the client that emerge from this conflict so that the client is able to make an informed investment decision.[277] The disclosure must also indicate the steps undertaken by the investment firm to mitigate these risks.[278] From the perspective of its internal operations, the firm is required to establish, implement and maintain an effective conflict of interest policy.[279] Such a policy shall be 'set out in writing and appropriate to the size and organisation of the firm and the nature, scale and complexity of its business'[280] It shall be disclosed to clients containing policy descriptions in summary form,[281] and

272. MiFID II, *supra* note 14, arts. 16(3), 23(1).

273. *Id.* art. 16(3), 23(2); MiFID II DR, *supra* note 14, arts. 33–43.

274. MiFID II DR, *supra* note 14, art. 33(a) and art. 33(e). For additional rules on inducements see, MiFID II, *supra* note 14, art. 24(9); MiFID II DD, *supra* note 52, ch IV, arts 11-13.

275. MiFID II, *supra* note 14, art. 16(3) and art. 23; MiFID II DR, *supra* note 14, art. 33 and art. 34(4). Information disclosure assists retail investors in making informed choices. *See* MiFID II, *supra* note 14, art. 24(5).

276. MiFID II DR, *supra* note 14, art 34(4).

277. *Id.*

278. *Id.*

279. MiFID II, *supra* note 14, arts. 16(3), 23; MiFID II DR, *supra* note 14, art. 34.

280. *Id.*; MiFID II DR, *supra* note 14, art. 34(1).

281. MiFID II DR, *supra* note 14, art. 46(1)(h) (complementing art. 24(4) of MiFID

the clients may access further details upon request.[282] Moreover, the investment firm must assess and periodically review, at least annually, their conflict of interest policy and take all appropriate measures to address any deficiencies. In this sense, "[o]ver-reliance on disclosure of conflict of interest shall be considered a deficiency in an investment firm's conflicts of interest policy."[283]

In the context of sustainability-related reforms, the Commission's objective has been to maintain a high standard of investor protection. To this effect, 'investment firms should, when identifying the types of conflicts of interest, the existence of which may damage the interests of a client or potential client, include those types of conflicts of interest that stem from the integration of a client's sustainability preferences.'[284] The text of the reform states that "[f]or the purposes of identifying the types of conflict of interest that arise in the course of providing investment and ancillary services or a combination thereof and whose existence may damage the interests of a client, including his or her sustainability preferences,(. . .)".[285] Drawing from the text quoted above, conflict of interest in a sustainability context has been thought of in terms of this conflict having the potential to harm the sustainability preferences of the client. The client's interest must be served first, and this interest, embodied in the client's sustainability preferences, shall be protected in the course of service provision.

This obligation is best construed by reference to the last resort principle spelled out earlier in this section. The investment firm is required to prevent or manage conflict of interest afflicting the service of sustainability preferences.[286] If unable to do so, and the risk of damage to the client's sustainability preferences is present, this conflict of interest will need to be dealt with through disclosure to the client.

4. Product Governance Requirements

Changes related to sustainability have also been made in the MiFID II rules setting out product governance requirements. These requirements have been created in view of investor protection goals.[287] They are laid down in

---

II).

282. *Id.* art. 46(1)(i) (providing that art 3(2) of the same regulation is satisfied (complementing art. 24(4) of MiFID II).

283. *Id.* art. 34(5).

284. Draft DA MiFID II, *supra* note 148, recital 4.

285. *Id*. art. 1(4) (replacing art. 33 MiFID II DR).

286. MiFID II DR, *supra* note 14, at 7.

287. LEHMANN & KUMPAN, *supra* note 216, at 89 (stating that the requirement for

Articles 16(3) and 24(2) MiFID II supplemented by the Commission Delegated Directive (EU) 2017/593 (MiFID II DD)[288] and guidelines produced by ESMA.[289] According to product governance rules, "[a]n investment firm which manufactures financial instruments for sale to clients shall maintain, operate and review a process for the approval of each financial instrument and significant adaptations of existing financial instruments before it is marketed or distributed to clients."[290] The manufacturing of financial instruments encompasses "the creation, development, issuance and/or design of financial instruments."[291] The process of product approval involves the analysis of potential conflict of interest each time a financial instrument is manufactured. In this context, the investment firm "shall assess whether the financial instrument creates a situation where end clients may be adversely affected".[292] The firm should also consider whether the financial instrument "may represent a threat to the orderly functioning or to the stability of financial markets."[293] Importantly, the process of product approval involves the identification of the target market of end clients to make sure that "all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market."[294]

The target market must be identified "at a sufficiently granular level . . . for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives the financial instrument is compatible."[295] Moreover, the investment firm shall also identify a so-called negative target market, namely "any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible."[296] Based on its own analysis, the investment firm shall determine "whether a financial instrument meets the identified needs, characteristics and

product approval "is a qualification of the general requirements to make the client's interest paramount when pursuing investment services" and "the product approval process goes even beyond any client protection in that it must consider the orderly functioning of markets as such").

288. MiFID II DD, *supra* note 52 arts. 9–10.

289. *See* ESMA Product Governance Guidelines, *supra* note 52.

290. MiFID II, *supra* note 14, art. 16(3).

291. MiFID II DD, *supra* note 52 art. 9(1); ESMA Product Governance Guidelines, *supra* note 52, ¶ 6.

292. MiFID II DD, *supra* note 52, art. 16(3).

293. *Id.* art. 9(4).

294. MiFID II, *supra* note 14, art. 16(3).

295. MiFID II DD, *supra* note 52, art. 9(9).

296. *Id.*

objectives of the target market."[297] Among other factors, such evaluation will include whether the risk/reward profile of the instrument is consistent with the identified target market and whether "the financial instrument design is driven by features that benefit the client and not by a business model that relies on poor client outcomes to be profitable." [298] To this effect, the manufacturer "shall determine the needs and characteristics of clients for whom the product is compatible based on their theoretical knowledge of and past experience with the financial instrument or similar financial instruments, the financial markets and the needs, characteristics and objectives of potential end clients."[299] Moreover, it shall undertake "a scenario analysis of their financial instruments which shall assess the risks of poor outcomes for end clients posed by the product, and in which circumstances these outcomes may occur."[300]

Distributors of financial instruments are also subject to the obligation of identifying the financial instrument's target market. A distributor denotes an investment firm that offers, sells, or recommends investment products and services to a client.[301] In order to meet this obligation, distributors "shall use the information obtained from manufacturers and information on their own clients to identify the target market and distribution strategy. When an investment firm acts both as a manufacturer and a distributor, only one target market assessment shall be required."[302] Since the information drawn from the product approval process of a financial instrument is important to distributors, the manufacturer shall provide them with this information including "the appropriate channels for distribution of the financial instrument, the product approval process and the target market assessment."[303] The quality of such information must show "an adequate standard to enable distributors to understand and recommend or sell the financial instrument properly."[304] In turn, the distributors shall put in place adequate arrangements to obtain and process the information about financial instruments and target markets received from the manufacturers.[305] The

297. *Id.* art. 9(11).
298. *Id.*
299. *Id.* art. 9(9).
300. *Id.* art. 9(10).
301. *Id.* recital 15, art. 10(1); ESMA Product Governance Guidelines, *supra* note 52, ¶ 6.
302. MiFID II DD, *supra* note 52, art. 10(2).
303. *Id.* art. 9(13); MiFID II, *supra* note 14, art. 16(3).
304. MiFID II DD, *supra* note 52.
305. MiFID II DD, *supra* note 52, art. 16(3).

distributors "shall determine the target market for the respective financial instrument, even if the target market was not defined by the manufacturer."[306]

In the views of the Commission, the formal integration of sustainability matters into the processes governing the manufacturing and distribution of financial instruments is a necessary response to the ever-increasing demand for sustainable products.[307] The Commission stated that the adequate implementation of the EU Action Plan will further encourage investors to demand sustainable investments and, therefore, it is "necessary to clarify that sustainability factors, and sustainability related objectives should be considered within the product governance requirements set out in Commission Delegated Directive (EU) 2017/593."[308] As a result, investment firms are now required to consider sustainability factors in the product approval process including the target market assessment.[309] Here, the amended text of the law directs investment firms to consider the sustainability objectives of clients in the process of determining the target market for the financial instrument:

> "Member States shall require investment firms to identify at a sufficiently granular level the potential target market for each financial instrument and specify the type(s) of client with whose needs, characteristics and objectives, including any sustainability related objectives, the financial instrument is compatible."[310]

To be sufficiently granular, the firm manufacturing and distributing financial instruments will need to "specify to which group of clients with sustainability related objectives the financial instrument is supposed to be distributed."[311] In the product approval process, investment firms will need to evaluate the financial instrument against the needs, characteristics and objectives of the identified target market including, among others, whether "the financial instrument's sustainability factors, where relevant, are consistent with the target market."[312] Moreover, "[t]he sustainability factors of the financial instrument shall be presented in a transparent manner and provide distributors with the relevant information to duly consider any

306. *Id.* art. 10(1).
307. *See* discussion *supra* Section II.2.B.
308. Draft DD Product Governance (n 215) recital 4.
309. *Id.* recital 5.
310. *Id.* art. 1(2) (replacing art. 9(9) of MiFID II DD).
311. *Id.* recital 6.
312. *Id.* art. 1(2) (replacing art. 9(11) of MiFID II DD).

sustainability related objectives of the client or potential client."[313]

V. FIDUCIARY DUTY, PENSION FUNDS AND THE IORP II DIRECTIVE

This section briefly outlines sustainable finance policy in the context of pension funds. From a legal perspective, the question has been to what extent pension funds are legally permitted to pursue sustainable investment strategies. This question has been particularly relevant in the United States. Here, pension trustees are bound to fiduciary duties, and it has remained unclear to what extent such duties prevent pension trustees from engaging in sustainable investing.[314] The legal position is different in the European Union since statutory provisions under the IORP II Directive have promoted—albeit on a comply or explain basis—sustainable investments.[315]

Broadly defined, the fiduciary duty entails "a duty to act with the highest degree of honesty and loyalty toward another person and in the best interest of the other person (such as the duty that one partner owes to another)".[316] Fiduciary relationships are representative in character: a person (agent) acts on behalf of and for the benefit of another person (principal). This representative property creates the risk of opportunistic behaviour or abuse by the agent towards its principal.[317] With the aim of mitigating such a risk, the law imposes fiduciary obligations upon the agent—in its capacity of fiduciary—towards the principal. As explained by Gold and Miller, "[f]iduciary law governs relationships marked by asymmetries of power. Fiduciaries enjoy power over beneficiaries. And fiduciary law expresses an expectation that fiduciaries act in their beneficiaries' interests."[318]

A product of judge-made law in the fields of trusts and equity, the fiduciary duty has long been recognized in common law jurisdictions,[319] and

313. *Id.* art. 1(2) (adding this text to art. 9(13) MiFID II DD).

314. *See* John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 MICH. L. REV. 72, 97–98; *see also* Schanzenbach & Sitkoff, *supra* note 53, at 392–99.

315. IORP II Directive, *supra* note 15, at 393.

316. *Fiduciary Duty*, Black's Law Dictionary, (11th ed. 2019).

317. Fiduciary law has been viewed as a mechanism to mitigate agency costs. *See* Robert H. Sitkoff, "An Economic Theory of Fiduciary Law," PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW (Andrew S. Gold & Paul B. Miller eds., (Oxford University Press, 2014), 204-08; *see* Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621 (2004).

318. Introduction," PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW at 1 (Andrew S. Gold and Paul B. Miller eds., 2014).

319. The Law Commission, "Fiduciary Duties of Investment Intermediaries," LAW COM No 350 (20 June 2014, United Kingdom), ¶¶ 1.16-1.20, ch. 3 [hereinafter UK Law Commission].

operated in the context of fiduciary relationships including the relationship between the trustee and the beneficiary, the solicitor and its client, the company director and the company, among other categories.[320] In some countries, the duty has also been codified in statutory rules, such as the case of the United States in the area of securities law and of pension law.[321] The definition of the fiduciary duty has evolved over time, and its content is not uniform but has varied across jurisdictions. Advancing its interpretation of the fiduciary duty set forth in the US Investment Advisers Act of 1940, the Securities and Exchange Commission (SEC) has stressed that

> [a]n investment adviser's fiduciary duty under the Advisers Act comprises a duty of care and a duty of loyalty. This fiduciary duty requires an adviser to adopt the principal's goals, objectives, or ends. This means the adviser must, at all times, serve the best interest of its client and not subordinate its client's interest to its own.[322]

In the sector of pensions, the Employee Retirement Income Security Act of 1974 (ERISA) has codified a trustee's fiduciary duty in terms of duty of loyalty and duty of prudence.[323] According to ERISA, a trustee should "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries . . . ",[324] and do so "with the

---

320. *Id*. ¶¶ 3.14–3.15 (citing a rich body of judge-made law). Outside the traditionally accepted categories of fiduciary relationships, other relationships may also be categorized as fiduciary provided that the particular facts so indicate as, for example, when a person undertake to act on behalf of or in the interest of another. *Id*. ¶¶ 3.16-3.24.

321. Statutory fiduciary duties have created in the United States at the levels of federal and state law. *See* Securities and Exchange Commission (SEC), "Commission Interpretation Regarding Standard of Conduct for Investment Advisers," 17 CFR Part 276 (Release No. IA-5248; File No. S7-07-18), Jul. 12 2019, https://www.sec.gov/rules/interp/2019/ia-5248.pdf [hereinafter "SEC"] (producing an interpretation of the standard of conduct of investment advisers under the Investment Advisers Act of 1940 and citing *SEC v. Capital Gains Research Bureau, Inc.* (1963) in which the U.S. Supreme Court recognized the fiduciary nature of the investment advisory relationship); *see also* Marianne M. Jennings, *Investment Professionals and Fiduciary Duties*, 9 CFA Institute Research Foundation, at 7 (2014) (noting that different standards apply to investment advisers compared with broker/dealers). A trustee operating under the Employee Retirement Income Security Act of 1974 ("ERISA") is subject to fiduciary duties encompassing the duty of loyalty and the duty of prudence (care). Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1104(a)(1), 1104(a)(1)(B).

322. SEC, *supra* note 322, at 7–8 ("[T]he combination of care and loyalty obligations has been characterized as requiring the investment adviser to act in the 'best interest' of its client at all times.").

323. 29 U.S.C. § 1104(a).

324. *Id*. § 1104(a)(1).

care, skill, prudence, and diligence" of a prudent man.[325]

A narrower interpretation of the content of fiduciary duties is found at common law. According to the UK Law Commission, the duty of loyalty is the core, distinguishing feature of the fiduciary duty: "the principal is entitled to the single-minded loyalty of his fiduciary."[326] In turn, the fiduciary duty does not encompass a duty of care, which stems from the law of torts or law of trusts.[327] Following this construction, the duty of loyalty has various facets whereby the fiduciary

> "must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list . . . ."[328]

This approach to fiduciary duties has stressed the negative or "not to do" obligations of a fiduciary, in particular, the "non-conflict rule" and the "non-profit rule".[329] Separately, a trustee must also exercise reasonable care and skill when using its powers of investment. This duty of care entails that a trustee when investing "is to take such care as an ordinary prudent man would take if he were to make an investment for the benefit of other people for whom he felt morally bound to provide."[330]

Scholars and commentators have largely examined the frictions between the fiduciary duty and sustainable investment strategies in the area of investments decisions of US pension fund trustees.[331] The question has been posed as to whether the fiduciary duty—imposed upon the fiduciary as administrator of others' money—precludes the trustee from making socially responsible investments (SRIs). The most conservative view has argued that

---

325. *Id*. § 1104(a)(1)(B).

326. *See* UK Law Commission, *supra* note 320 ¶ 3.27 (citing Bristol and West Building Society v. Mothew (1998)).

327. *Id*. ¶¶ 3.12, 3.68, 3.75 (referencing section 1 of the Trustee Act 2000, which codifies a trustee's duty of care in England and Wales).

328. *Id*. ¶ 3.27 (citing Bristol & West Building Society v. Mothew).

329. *Id.* ¶¶ 3.28, 3.30–3.36.

330. *Id*. ¶ 3.75.

331. Gary, *supra* note 53; Schanzenbach & Sitkoff,, 'Reconciling Fiduciary Duty' *supra* note 54; UK Law Commission *supra* note 322; Schanzenbach & Sitkoff, 'ESG Investing: Theory' *supra* note 53; Sanders, *supra* note 53; Joakim Sandberg, *(Re-)Interpreting Fiduciary Duty to Justify Socially Responsible Investment for Pension Funds?*, 21 (5) CORP. GOVERNANCE: AN INT'L REV. 436 (2013); Richardson, *supra* note 53; Alexandra Horváthová, Rasmus Kristian Feldthusen and Vibe Garf Ulfbeck, *Occupational Pension Funds (IORPs) & Sustainability: What does the Prudent Person Principle say?* 1 NORDIC J. OF COM. L. 28 (2017).

a trustee pursuing SRIs would breach its fiduciary duties and incur liability, although this view has been challenged.[332] A distinction has been made between the duty to act in the "sole interest" of beneficiaries and the duty to act in the 'best interest' of beneficiaries. In this sense, an ERISA trustee is required to act in the "sole (financial) interest" of the beneficiaries,[333] and this standard has been construed to restrict the trustee's investment strategy to look exclusively at the interest of beneficiaries and, by implication, the interest of any other person is excluded.[334] Purposes other than obtaining a 'financial interest' are also excluded.

Following this understanding, the ERISA fiduciary rule appears as incompatible with sustainable investment strategies to the extent that social or environmental investment objectives look also at the interests of third parties (e.g., societal interest) or involve purposes that may go beyond financial benefits (e.g., moral or ethical goals). It follows that such investment strategies, if unauthorized, would breach the ERISA fiduciary duty and generate liability on the trustee.[335] They would trigger "'an irrebuttable presumption of wrongdoing'".[336] A different stance has applied to the "best interest" rule. This rule—applicable, for instance, to the duty of loyalty in the context of US corporate law, securities regulation as well as trust law of private trusts and charities—has been construed to allow a fiduciary greater freedom of action in the area of sustainable investment, provided that its conduct align with the best interests of beneficiaries and the terms of the trust.[337]

Drawing from the above, the "best interest" rule need not preclude sustainable investment strategies. From the vantage point of financial benefits, for example, recent studies have shown that sustainable funds have performed equal or better compared with conventional funds.[338] This new

332. *See*, *e.g.*, Gary, *supra* note 53.

333. Schanzenbach & Sitkoff, *supra* note 53 at 399–403.

334. *Id*.

335. *Id.* at 403 ("Furthermore, in 'providing benefits' under ERISA, the Supreme Court has held that the relevant purpose to which ERISA's sole interest rule applies is 'financial benefits' for the plan beneficiaries" (quoting Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459, 2468 (2014)).

336. *Id.* at 400–01.

337. *Id. at* 401–03 ("The best interest rule is typically implemented by way of an 'entire fairness' test. The entire fairness test is sometimes expressed in corporate law as requiring fair price and fair dealing. Likewise, a trustee must still 'act fairly, in good faith, and in the interest of the beneficiaries' even if the sole interest rule is waived. Whereas the sole interest rule allows no defense at all to an unauthorized conflict, the best interest rule permits a fiduciary to defend a conflicted action as entirely fair.").

338. Gary, *supra* note 53, at 748–53 (stating that sustainable investing "does not

scenario makes it more likely that mixed purpose investments (by which the investment contains financial and social/environmental motives) are likely to find a 'best interest' justification. If such justification was met, it would not matter whether the purpose of investment partially contained non-financial features, or whether the interest of society or of any other third-party group were also influenced by the investment. A different avenue enabling sustainable investment strategies occurs when pension trustees are provided legal authorization by their beneficiaries to so invest.[339]

In relation to the US prudent investor rule, it has been argued that this rule does not, per se, preclude sustainable investment strategies. Under US trust law, a fiduciary shall satisfy the "prudent investor rule".[340] In simple terms, this rule means that "a fiduciary must invest in only those securities or portfolios of securities that a reasonable person would buy."[341] The prudent investor rule has incorporated modern portfolio theory into the management of investment risk whereby the fiduciary shall diversify its investment portfolio (spreading the risk across the portfolio rather than analyzing risk on an asset-by-asset basis) and make investment decisions based on risk and return objectives reasonably suited to the trust.[342] A portfolio that adds financial value is a "a portfolio that improves returns for a given level of market risk, and it requires aligning the overall risk and return with the terms and purposes of the trust."[343] As Schanzenbach & Sitkoff noted, the prudent investor rule permits a trustee "to undertake any type or kind of investment so long as the resulting overall portfolio is diversified, and its overall risk and return align with the terms and purposes of the trust."[344]

In the absence of new reforms integrating sustainability considerations into the law, the adoption of sustainable investment strategies in the US context depends, ultimately, on the interpretation of existing statutory and

---

necessarily require making a tradeoff in investment performance; on the contrary, sustainable investments often exhibit favorable return and risk characteristics compared to their traditional peers").

339. Sanders, *supra* note 53, at 537.

340. Gary, *supra* note 53, at 789; Schanzenbach and Sitkoff, 'Reconciling', *supra* note 53, at 426 (citing Unif. Prudent Inv'r Act § 2(b) (UNIF. LAW COMM'N 1994), and 3 RESTATEMENT (THIRD) OF TRUSTS §§ 90(a)-(b) (AM. LAW. INST. 2007)).

341. *Prudent Investor Rule*, BLACK'S LAW DICTIONARY (11th ed. 2019).

342. *See* Gary, *supra* note 53, at 789–90; *see also* Schanzenbach & Sitkoff, 'Reconciling . . .', *supra* note 53, at 426.

343. Schanzenbach & Sitkoff, 'Reconciling . . .', *supra* note 53, at 426.

344. *Id.* at 449 ("All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing.").

judge-made rules. In Europe, however, the landscape looks quite different. The IORP II Directive has recently introduced provisions that promote sustainable investments and long-termism goals in investment.[345] The IORP II Directive requires that the Institutions for Occupational Retirement Provision (IORPs) make investment decisions in accordance with a "prudent person rule."[346] This rule contains a loyalty standard seeking managers to invest the pension assets in "the best long-term interest of members and beneficiaries as a whole".[347] Moreover, and specifically on the dimension of sustainability, Article 19 (1)(b) of IORP II Directive states that "Member States shall allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social, and governance factors."[348]

The European Insurance and Occupational Pensions Authority (EIOPA) has construed this sustainability-related provisions in the IORP II Directive as an opportunity for IORPs to manage sustainability risk.[349] Commenting on article 19 (1)(b) of IORP II Directive, EIOPA pointed out that "[t]aking into account ESG factors to reduce the risk exposure of IORPs toward ESG risks is also likely to help IORPs in the pursuit of sustainability goals. Conversely, considering the long-term impact of investment decisions on ESG factors can contribute to mitigating IORPs' exposures to ESG risks."[350] The scope of Article 19(1)(b) of IORP II Directive is nevertheless broad enough to enable sustainable investment strategies undertaken in "the best long-term interest" of beneficiaries and promoting the "the potential long-term impact" of investment decisions on sustainability.[351] The permissiveness of sustainable investment strategies is compounded by the fact that the IORP II Directive's prudent person rule requires a long-term

345. IORP II Directive, *supra* note 15. The formal term "fiduciary duty" has not been adopted in the European Union, except for countries that count with common law. European Commission, DG Environment (2015), "Resource Efficiency and Fiduciary Duties of Investors", Final Report (ENV.F.1/ETU/2014/0002), 26–31, London: Ernst & Young.

346. IORP II Directive, *supra* note 15.

347. *Id.* art. 19(1)(a).

348. *Id.* art. 19(1)(b).

349. See EIOPA, SUSTAINABLE FINANCE ACTIVITIES 2022-24, https://www.eiopa.europa.eu/sites/default/files/publications/other_documents/eiopa-sustainable-finance-activities-2022-2024.pdf.

350. European Insurance and Occupational Pensions Authority, *Opinion on the Supervision of the Management of Environmental, Social and Governance Risks Faced by IORPs*, §2, Annex 2 EIOPA-BOS-19-248 (July 10, 2019), (Annex 1 to the Opinion provides illustration of this interaction).

351. IORP II Directive *supra* note 15, at art. 19(1)(a), 19(1)(b).

horizon in investments.

Given the above, the prudent person rule laid out in the IORP II Directive appears as consistent with portfolios constructed around sustainable investment strategies that rely on long-term value creation as opposed to short-term financial returns.[352] This rule is also consistent with mounting evidence showing that there is a business case for sustainable investment strategies as "[c]ompanies that perform well on material ESG issues, also show a superior financial performance . . . [and] [t]his is consistent with the idea that strong management of material ESG issues brings a real competitive advantage."[353] Successful sustainable investing at the corporate level has been found to require "a lot of strategic planning because it directly relates to decisions with a long-term impact, including production technology, the use natural resources, and the social dimension, which refers to both the relation with the employees and the community. Improper management of the environmental and social dimension may have a serious and negative impact on the ability of the firm to conduct its business."[354]

Moreover, the IORP II Directive's prudent person rule requires that the pension fund's assets "shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole".[355] Within this frame, the lower portfolio risk diversification that results from the inclusion of sustainable investment strategies in the portfolio should not represent a constraint to sustainable investing either. It has been noted that portfolios relying on sustainable investment strategies, such as screening or best in class strategies, can be at odds with principles of portfolio theory due to lower risk diversification: "it is impossible for an ESG-screened universe to be more diversified than a conventional universe, since the former is a subset of the latter. And this raises the possibility that ESG screening could entail an increase in risk through a loss of diversification."[356] However, such

352. Dirk Schoenmaker & Willem Schramade, *Investing for Long-Term Value Creation*, 9 J. SUSTAINABLE FIN. & INV. 356 (2019) (proposing a definition of long-term value creation in terms of a company aiming to "optimise its financial, social and environmental value in the long term, making it prepared for the transition to a more sustainable economic model").

353. *Id.* at 357 (citing several academic sources).

354. *See id.* at 531–32; *see also* Susan N. Gary, *supra* note 53, 779–84 (quoting J Hawley & J Lukomnik, *The Long and Short of It: Are We Asking the Right Questions*?, 41 Seattle U. L. REV. 449 (2018)) (pointing out that long-term investing may even allow for portfolio designs that confront or mitigate systemic risks, and examining the financial rationale long-term investments including the limits of modern portfolio theory to promote long-term investments).

355. IORP II Directive, *supra* note 15, art. 19(1)(c).

356. Tim Verheyden et al., *ESG for All? The Impact of ESG Screening on Return,*

a problem need not curtail financial performance.

Recent studies have shown that sustainable (or socially responsible) investments do not necessarily lead to a loss in risk-adjusted financial returns due to less diversified portfolios. In this sense, even when screening strategies may restrict the number of stocks for selection and increase the correlation between portfolio stocks, evidence has shown that the additional returns compensate for such losses. Relative to unscreened portfolios, sustainability-screened portfolios bring about very small losses from diversification, whereas any such losses are more than offset by a sufficient amount of returns (alpha).[357] To the extent that sustainability screening in portfolios has improved risk-adjusted returns, it has been suggested that restricting the universe of stocks by way of sustainability (ESG) screening is an adequate investment strategy even for those investment managers that are not interested in sustainability.[358]

In overall, this means that within the scope of Article 19(1)(b) of IORP II Directive, the prudent person rule need not preclude a fiduciary to invest in mixed strategies—combining financial and sustainability objectives—provided that such strategies duly reflect the best long-term interest of beneficiaries as a whole.[359] It is worth noting, however, that Article 19(1)(b) of IOPR II Directive does not mandate the consideration of sustainability risks and investments. Rather, it works on a comply or explain basis, although EIOPA, the sector regulator, is weighing the possibility of new reforms in this area in line with recent changes of law and policy in EU sustainable finance.[360]

VI. FINAL CONSIDERATIONS

This Article outlined and examined key legal and regulatory reforms in the area of EU sustainable finance. Relying on the distinction between sustainability risk on the one side, and sustainable investments on the other side, this Article has focused on reforms aimed at managing sustainability risk, largely climate risk, and at promoting instruments and markets in

Risk, and Diversification, 28 J. APPLIED CORP. FIN., 47, 51–52 (2016) (citing Markowitz, H., *Portfolio Selection*, 7 J. FIN. 77–91 (1952)).

357. *See id.* at 53–54.

358. *See id.*

359. *See* Schanzenbach & Sitkoff, *supra* note 53, at 400–02.

360. *See* Susanna Rust, *EIOPA Floats IORP II Change to Require Impact on ESG Consideration*, NEWS IPE (July 17, 2020), https://www.ipe.com/news/eiopa-floats-iorp-ii-change-to-require-impact-on-esg-consideration/10046920.article (evaluating the possibility of making art. 19(1)(b) IORP II Directive requirement mandatory).

sustainable investments. Although these reforms are well-intended and meritorious, it is important to also touch on the basic shortcomings that these reforms will likely face as they enter their implementation phase.

The implementation of the EU Taxonomy Regulation has posed challenges, including how to evaluate and report on the "Do Not Significantly Harm" (DNSH) requirement,[361] and on the Key Performance Indicators (Turnover, CapEX and OpEX).[362] Although the design of the taxonomy has been praised for its science-based standards, the recent proposal sponsored by the Commission has included gas and nuclear power projects in the list of climate-friendly energy sources.[363] The fact that such energies may play a role as bridge technologies to support the transition to a low-carbon economy, and meet the EU's target of net zero emissions by 2050, has not abated the controversy created around this proposal.[364] Further

361. *See* EU Taxonomy Regulation, *supra* note 12, 17; DA Taxonomy Regulation, *supra* note 137, at 5, 7.

362. *See* Supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation, at 2, COM (2022) 4987 final (July 6, 2021).

363. *See* Amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities, at 2, COM (2022) 631 final (03 September, 2022); *see also* Fin. Stability, Fin. Servs. & Cap. Mkt. Union, *EU taxonomy: Complementary Climate Delegated Act to accelerate decarbonization*, EUR. COMM'N. (Feb. 2, 2022) https://ec.europa.eu/info/publications/220202-sustainable-finance-taxonomy-complementary-climate-delegated-act_en (pointing that this new draft delegated act has included in the EU taxonomy classification gas and nuclear energy projects as transitional activities, covered by art. 10(2) of the Taxonomy Regulation); *see also* Questions and Answers on the EU Taxonomy Complementary Climate Delegated Act covering certain nuclear and gas activities, EUR. COMM'N. (Feb. 2, 2022) https://ec.europa.eu/commission/presscorner/detail/en/QANDA_22_712 ("These are activities that cannot yet be replaced by technologically and economically feasible low-carbon alternatives, but do contribute to climate change mitigation and with the potential to play a major role in the transition to a climate-neutral economy, in line with EU climate goals and commitments, and subject to strict conditions, without crowding out investment in renewables.").

364. *See* Kevin O'Sullivan, *Inclusion of Gas and Nuclear in EU Taxonomy Not Necessary – Eamon Ryan*, IRISH TIMES (Feb. 5, 2022) https://www.irishtimes.com/business/energy-and-resources/inclusion-of-gas-and-nuclear-in-eu-taxonomy-not-necessary-eamon-ryan-1.4794040 (reporting that "the EU Financial Services Commissioner with responsibility for the taxonomy file, Mairead McGuinness, repeated this week that the proposal was based on best scientific advice. Four member states have accused the Commission of departing from scientific evidence, and Austria and Luxembourg have threatened to sue, with the possible backing of Denmark."); *see also* Jennifer Rankin, *EU Includes Gas and Nuclear in Guidebook for "Green" Investments,* GUARDIAN (Feb. 22,

complexities will inexorably arise in the near future from the advent of the EU social taxonomy,[365] because conceptualizing and measuring social impact poses difficult questions whose answers are unsettled and often elusive.[366] This means that the classification of an economic activity as environmentally or socially sustainable is not, and will not be, a one-off exercise. Instead, the classification effort will evolve over time accompanying the policy process and transitions and requiring significant flexibility and possibly re-definitions.

It is submitted that the new rules mandating sustainability information disclosures, namely the CSRD, the SFDR and the EU Taxonomy Regulation, will improve the availability and quality of non-financial information. Despite the advantages of more and better sustainability disclosure, the implementation of these rules is expected to be a complex process that must be monitored closely. On the side of corporate sustainability reporting, the double-materiality principle entails that financially immaterial information may nevertheless prove to be socially or environmentally material, a fact that will pose harsh challenges to corporate teams.[367] In order to meet these challenges, companies are expected to put in place due diligence and other management processes to make sure that they make the right judgments. The determination of materiality of social or environmental information can give rise to ambiguity caused by diverging interpretations.[368] Moreover, as suggested by empirical studies, stakeholder groups may show different perceptions of the materiality level of an item (e.g., employees, suppliers and investors may attribute a different level of materiality to the same sustainability item).[369] Due to the nature of non-financial information (such

---

2022), https://www.theguardian.com/environment/2022/feb/02/eu-guidebook-taxonomy-green-investments-gas-nuclear-included.

365. *See* Subgroup 4, Platform on Sustainable Finance, EUR. COMM'N, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/overview-sustainable-finance/platform-sustainable-finance_en#subgroups (accessed on 31 October 2021).

366. *See generally* Luigi Corvo et al., *Mapping Social Impact Assessment Models: A Literature Overview for a Future Research Agenda*, 13 SUSTAINABILITY (2021); Irene Eleonora Lisi, *Determinants and Performance Effects of Social Performance Measurement Systems*, J. BUS. ETHICS (2018); J Reisman, V Olazabal & S Hoffman, *Putting the "Impact" in Impact Investing: The Rising Demand for Data and Evidence of Social Outcomes*, 39 AM. J. EVALUATION (2018); Alno Ebrahimi & Kasturi Rangan, *A Framework for Measuring the Scale and Scope of Social Performance*, 56 UNIV. CAL., BERKELEY (2014).

367. Mathide Bossut et al., *supra* note 181, at 8–9.

368. *See id.* at 9.

369. *See id.*

as biodiversity data), the risk of material omissions and misrepresentations, as well the risk of information overloading, is likely to be higher compared with the case of financial information.[370]

Reporting on principal adverse impact (PAI) of a firm or product on sustainability factors, is likely to be costly and burdensome to FMPs. The SFDR requires that FMPs and IAs fill out mandatory reporting templates on PAI composed of multiple quantitative and qualitative indicators.[371] Restrictions in the availability of data on environmental and social impact, as well as poor quality of available measurements and metrics will certainly remain a concern as the new rules start to be implemented.[372] It is an inescapable reality that the capacity of FMPs and IAs to meet the new reporting obligations imposed by the SFDR, and by the EU Taxonomy Regulation, heavily depends on a full and adequate information disclosure by investee companies. Without investee companies satisfying this role, FMPs and IAs will find irredeemable obstacles in their quest to determine the sustainability characteristics and impact of their portfolios, including the extent to which their portfolios are taxonomy-aligned.[373] Since the corporate sustainability reporting system is the vital source that originates sustainability data and spills these data over market participants and stakeholders, the role that the investee company plays in the process of data origination, processing and measurement is paramount.[374]

This means that the quality and quantity of corporate sustainability reporting is a fundamental factor without which the EU sustainable finance policy will most likely fail. Against this backdrop, the fact that corporate sustainability disclosure will abide to standards that are EU-wide, mandatory and externally audited is of critical importance.[375] Tackling greenwashing

---

370. *See* Baumuller, *supra* note 37, at 101–03.

371. Final Report on draft Regulatory Technical Standards, JC 2021 50 (Oct. 22, 2021).

372. *See Principal Adverse Impacts Reporting: Practical insights for the next stage of SFDR implementation*, IRISH FUNDS 1, 12 (Aug. 2021) (having an evaluation of the current conditions for compliance with the Principal Adverse Impact Reported under the SFDR by the investment fund industry in Ireland has been produced by the Irish Funds Industry Association).

373. *See Testing the Taxonomy. Insights from the PRI Taxonomy Practitioners Group*, PRINCIPLE RESPONSIBLE INV. (Sep. 9, 2020), https://www.unpri.org/eu-taxonomy-alignment-case-studies/testing-the-taxonomy-insights-from-the-pri-taxonomy-practitioners-group/6409.article (identifying data and logistic problems detected by market participants when reporting the alignment of selected investment portfolios with the EU Taxonomy rules).

374. *See* ERM, *supra* note 34, at 18.

375. *See* discussion *supra* Section III.

problems at the corporate level is equally crucial. It is submitted that, among other objectives, the new rules on corporate sustainability reporting have been certainly designed with an eye to mitigating greenwashing practices. It is noted, however, that the typical incentives identified in voluntary information disclosure models towards misstating sustainability performance will not abruptly vanish. Market pressure arising from competition forces,[376] and social pressure requiring companies to demonstrate 'legitimacy' towards society or towards stakeholders[377] will remain, if not intensify, in the coming years. Bowing to these pressures, companies may choose to greenwash (or "socialwash") with the purpose of maintaining or augmenting their competitive performance (false signalling) or their legitimacy towards society and stakeholders (false legitimacy).[378]

Substantial reforms by companies in their operations, due diligence, and management systems are expected in order to ensure compliance with the new rules imposing mandatory and audited reporting on sustainability performance.[379] Member States and designated NCAs in their supervisory and investigative role will take on the challenges of securing the transparency and integrity of the sustainability reporting regime.[380] Similarly, the importance of due compliance with the SFDR is apparent at the level of financial intermediaries, and although designated NCAs are expected to supervise and investigate compliance deficits, this control system has yet to be set up and effectively implemented.[381] In this same light,

376. Signalling theory posits that a company discloses information to the public in sustainability reports because it wants to communicate to the market that they are good performers and, this way, the company aims at differentiating from other competitors (e.g., poor performers) and gain a competitive edge or advantage. *See* Ali Uyar et al., *Is Corporate Social Responsibility Reporting A Tool Of Signaling Or Greenwashing? Evidence From The Worldwide Logistics Sector*, 253 J. CLEANER PROD. (2020). *See generally* Brian L. Connelly et al., *Signaling Theory: A Review And Assessment*, 37 J. MGMT. (2011).

377. *See generally* Craig Deegan, *Introduction: The Legitimising Effect Of Social And Environmental Disclosures–A Theoretical Foundation*, 15 ACCOUNTING, AUDITING, AND ACCOUNTABILITY J. (2002). Legitimacy theory claims that a company discloses information to the public in sustainability reports because it wants to increase or maintain its social legitimacy or stakeholder legitimacy. *See id.*

378. *Id.*

379. *See* discussion *supra* Section III

380. *See, e.g.,* Council Directive 2021/0104, art. 1(12), 2021 O.J. (L 189) 54 (EC). (replacing art. 51 of the Accounting Directive 2013/34/EU) ("[Member States] shall provide for penalties applicable to infringements of the national provisions adopted in accordance with this Directive and shall take all the measures necessary to ensure that those penalties are enforced. The penalties provided for shall be effective, proportionate and dissuasive.").

381. Commission Regulation 2020/852, art. 13, 2020 O.J. (L 198) 38 (EU) ("Member

other mechanisms set up for the protection of investors in the context of MiFID II, more specifically suitability and product governance requirements, will need close supervision and vigorous enforcement as well.

Challenges may emerge from the internal operation and practicalities of the assessment of suitability. The Commission has recently published its findings from a common supervisory action (CSA) with NCAs on the application of MiFID II suitability rules across the European Union.[382] Conducted throughout 2020, this CSA looked at the application of suitability requirements covering a total of 206 firms located in 26 countries of the EU and European Economic Area.[383] The CSA found adequate compliance in relation to items of the suitability requirement already regulated under MiFID I "such as firms" understanding of products and clients and the processes and procedures to ensure the suitability of investments.'[384] Shortcomings were also detected, however, especially in relation to requirements newly imposed by MiFID II, "notably the requirement to consider the cost and complexity of equivalent products, the costs and benefits of switching investments and suitability reports."[385] This CSA report did not investigate the integration of sustainability considerations into the suitability assessment. However, it is reasonable to expect that implementation problems will emerge in relation this new sustainability dimension of the suitability requirements.

The Commission has decided to adopt a so-called "two-step" suitability assessment.[386] Under this mechanism, the service provider shall first make sure that the products selected satisfy the client's financial objectives. Only after that first step is concluded will the provider consider the client's stated sustainability preferences. Although the underlying logic of this two-step mechanism makes good sense, a degree of caution is required until evidence

---

States shall ensure that the competent authorities designated in accordance with sectoral legislation . . . The competent authorities shall have all the supervisory and investigatory powers that are necessary for the exercise of their functions under this Regulation."); *see also* EU Taxonomy Regulation, *supra* note 12, art. 21–22.

382. European Securities and Markets Authority, *ESMA Presents The Results Of The 2020 Common Supervisory Action (CSA) on Mifid II Suitability Requirements*, Public Statement, (July 21, 2021) [hereinafter *CSA Report on* Sustainability].

383. *Id.* at 2 ("A total of 206 firms where included in the CSA sample, 104 of which credit institutions (CIs), and 83 investment firms (IFs); a few branches of investment firms passported in other Member States and fund management companies were also included in the CSA sample.")

384. *Id.*

385. *Id.*

386. European Securities and Market Authority, *Consultation Paper on Integrating Sustainability Risks and Factors in MiFID II*, Consultation Paper (Dec. 19, 2018).

demonstrates how adequately the second step of the evaluation has been undertaken. The risk is that, as a matter of industry practice, the evaluation of suitability may end up focussing largely in the first step at the expense of the second step of the assessment.[387] From the perspective of enforcement, MiFID II firms shall ensure that they duly account for and treat the client's sustainability preferences. According to Article 25(2) MiFID II, a failure to satisfy the client's sustainability preferences will constitute a breach of the client's investment objectives (provided that a client's sustainability preferences be defined as part of a client's overall investment objectives) and, consequently, a breach of the suitability obligation. This logic would provide a neat and concrete legal basis for supervision and liability.[388]

To the extent that MiFID II product governance rules have also been created to protect investors from mis-selling practices,[389] the rules should also be capable of mitigating greenwashing practices relating to financial instruments. Notwithstanding this potential, it remains to be seen how manufacturers and distributors of financial instruments manage to integrate sustainability risk and preferences in the product approval process.[390] Evidence to this effect is currently lacking. It has been argued that under EU product governance rules manufacturers and distributors of financial instruments are likely to struggle to provide target market descriptions and to collect/share feedback information about clients and markets, the result of which is a restricted product offer.[391] There is a danger of exacerbating this problem as a result of incorporating sustainability-related requirements into

387. Mezzanotte, *supra* note 248.

388. Although this approach has prevailed in the legal formulation of the draft DA MIFID II, further interpretations may be needed as the rule is implemented. *See* European Securities and Market Authority, *Draft implementing technical standards under MiFID* II, Final Report (Dec. 11, 2015) (amending art. 54(2) and art. 54(5) of MiFID II DR); *see also* Mezzanotte, *supra* note 251; Veerle Colaert, *Integrating sustainable finance into the MiFID II and IDD investor protection* frameworks, Jan Ronse Institute, Ku Leuven (Nov. 2020) at 7–11; MiFID II Art. 25 Assessment of Suitability and Appropriateness and Reporting to Clients, European Securities and Markets Authority (Last Visited: June 25, 2022).

389. Veerle Colaert, *Product Governance: Paternalism Outsource to Financial* Institutions, Jan Ronse Institute, Ku Leuven (Nov. 2019) at 2.

390. A survey identifying shortcomings in the implementation of product governance rules has been conducted by CFA Institute without, however, including sustainability issues. *See generally The Brave New World of Product Governance in the EU Asset Management* Industry, CFA Institute (May 2020).

391. Colaert, *supra* note 390 (arguing that the introduction of MiFID II product governance obligation will affect distributors by rendering the identification of product markets and the transmission of information to manufacturers more complicated, thereby creating disincentives to product offer).

the product approval processes. Following ESMA's CSA on suitability requirements, a CSA on product governance requirements has recently been launched.[392] Findings on this latter CSA have yet to be published. Although such findings are expected to yield valuable insights into compliance problems afflicting product governance processes, the goals set for this CSA have not included sustainability considerations.[393]

392. European Securities and Markets Authority, *ESMA Launches a Common Supervisory Action with NCAs on MIFID II Product Governance Rules* (Feb. 1, 2021) https://www.esma.europa.eu/press-news/esma-news/esma-launches-common-supervisory-action-ncas-mifid-ii-product-governance-rules.

393. *See id.*

INTELLECTUAL PROPERTY INVESTMENT FUNCTIONS AND THE LEGAL CHARACTERISTICS OF PRIVATIZATION

P. SEAN MORRIS*

This paper develops and presents the idea of intellectual property investment functions as part of a broader narrative on the privatization of international law. Using jurisprudence and private law arguments the paper charts how early investment treaties and ICSID cases interacts with intellectual property investments and then go on to show the rise of contemporary Free Trade Agreements provisions that upend the understanding of intellectual property as an investment function. The advocates of the investment principles clearly sees no objection on the application of customary international law to investment, and by extent, the investment function of intellectual property. It must also be borne in mind, that, at the same time, those who are also advocating for more clarity and legal certainty in the international legal order, envisage a world where private rights and other factors of globalization see the application of international legal principles to intellectual property investments. Such application, they believe, can help to add legitimacy and give justification of global legal relations based on economic principles. The arguments in this article goes beyond merely theoretical musings or methods. They can also significantly impact the outcome of cases that have to consider the interaction of public international law and private law norms in relation to intellectual property, or other cases, under considerations at international tribunals. Hence, to offer an impartial assessment of such interaction, and to find answers to the privatization issue, it is imperative to fully understand the context and content of private law rights in international law, and what are some of the recourse options available to public international law. Moreover, it is equally fitting to develop and argue a new account of private rights to help explain the occurrence of the privatization of international law. Naturally, it is not possible to pursue all the arguments that may explain the privatization of international law, and as such, pursuing a specific line of argument under intellectual property can open up discourses for other questions that can be explained within the boundaries of private rights in international law. For instance, it is quite possible to ask: what *can best explain the rise of globalization from an international law point of view? What are the conditions that can permit the application of international law in the transposition of private law rights in intellectual property at the global level? What is the investment function of intellectual property, and how is it justified under international law? But more specifically, what is the connection, if any, of HLA Hart's jurisprudence and intellectual property within an international law context? This article takes on some of these difficult questions against the backdrop of the privatization of international law from an intellectual property perspective.*

I. INTRODUCTION

The international intellectual property rights system and international investment law are without a doubt one of the most significant developments, where these regimes collide with (public) international law and the network of tribunals adjudicating disputes on, or, relating to intellectual property as investments.

It is true that other regimes in the international legal system, such as WTO/trade law,[1] investment arbitration,[2] product standards,[3] and others, have questioned or sought to place their proper role within the context of public international law. The purpose of this Article is to follow these established traditions by demonstrating how the legal content and process that contributes to the evolution of the international intellectual property legal system *evolved* as a result of legal and epistemic functions.[4] In doing we it will be possible to show how the regulatory process emerges as a result

1. *See generally* JOOST PAUWELYN, CONFLICT OF NORMS IN PUBLIC INTERNATIONAL LAW: HOW WTO LAW RELATES TO OTHER RULES OF INTERNATIONAL LAW (2003) (setting out how conflict rules occur in international trade regimes).

2. *See generally* GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW (2007) (providing an overview of the development of international arbitration law and the development of the international investment treaty regime).

3. *See generally* HARM SCHEPEL, THE CONSTITUTION OF PRIVATE GOVERNANCE: PRODUCT STANDARDS IN THE REGULATION OF INTEGRATING MARKETS (2005) (providing an overview of the development of private standards over public governance in product standards).

4. *See generally* P. Sean Morris, *From Territorial to Universal — The Extraterritoriality of Trademark Law and the Privatizing of International Law*, 37 CARDOZO ARTS & ENT. L.J. 33, 77–81 (2019) [hereinafter Morris, *From Territorial to Universal*]; *see also* P. Sean Morris, *The Private Foundations of International Law*, 5 JUS GENTIUM : J. OF INT'L LEGAL HIST. 37 (2020); P. Sean Morris, *The Practices of Private Global Norm Production and Intellectual Property Epistemic Communities*, 48 SYRACUSE J. OF INT'L L. & COM. 153 (2020).

of the needs of the community of mostly private rights holders, and to some extent how states and other players in the international intellectual property system acquiesce to private norm generation.

By way of summary, the privatization of international law does not mean that the state has retreated from its primary obligation of international law-making,[5] rather, the state has been ever present, but mostly as a tool of epistemic communities to carry out international law-making obligations. Rather than side-lining the role of the state, this Article takes the view that states are still essential in how law at the global level is made, complied with, enforced and monitored. However, the privatization approach that this Article expounded on is that the global providence and structure of modern rule of law — whether the public international legal structures, or the international private legal structures — functions in a dynamic way that opens new realms of interpretation. Such new realms are not the familiar "transnational law," "constitutionalization of international law," "fragmentation of international law" or "pluralization." Rather, the new realm is the privatization process where law-making and regulatory needs forms part of how changes to the making and function of international law occurs, and the complex global regime of intellectual property rights is the ideal candidate to frame that narrative.[6] Furthermore, situating the emerging narratives on international investment in the intellectual property domain will further strengthen the argument in this Article. For instance, questions relating to fair and equitable treatment (FET), the attempts to regulate tobacco advertising and its impact on the function of trademarks, the role of case law in the World Trade Organization ("WTO") and their relevance for intellectual property investment function will be of utmost importance. But perhaps the novelty of this Article lies in how a reading of HLA Hart[7] and private adjudication helps to steer the narrative into an out-of-box direction so that theory and practice can offer new perspectives on the investment function of intellectual property.

---

5. For arguments suggesting that despite the emergence of private transnational regulatory regimes the state is still capable of performing its function, see Klaus Dieter Wolf, *The Non-Existence of Private Self-Regulation in the Transnational Sphere and its Implications for the Responsibility to Procure Legitimacy: The Case of the Lex Sportiv*, 3 GLOB. CONSTITUTIONALISM 275 (2014).

6. *See* Christoph Beat Graber & Gunther Teubner, *Art and Money: Constitutional Rights in the Private Sphere?*, 18 OXFORD J. LEGAL STUD. 61 (1998) (arguing that constitutional rights need to be extended into the regimes of private governance); *see also* Gillian K. Hadfield, *Privatizing Commercial Law: Lessons from ICANN*, 6 J. SMALL & EMERGING BUS. L. 257, 267 (2002) (discussing public choice and law and economic approaches).

7. H.L.A. HART, THE CONCEPT OF LAW (1961).

Some scholars have argued over the years that the commercial nexus and international law as such are creating multiple legalities in the international system, but most of them have set their arguments against the backdrop of one-size fits all descriptions (or criticisms).[8] But, more significantly what has been missing was a detailed break-down of the emergence of the new international legal order as a result of the interference of "domestic law like" situations in public international law, or as I frame it in this article, the investment function of intellectual property rights against public international law. I do not exclude theory from my arguments in this Article; however, I am keener to show how different encumbrances have contributed to the need to look at new ways of how private adjudication is changing the way in which international law and sub-fields as such is changing the image of the international legal order.

Because international law has long been "confronted with a serious process of privatization"[9] then, how we approach such privatization really matters, especially if the approach to "[p]rivatization, also on the international level, must not undermine the rule of law."[10] Because intellectual property rights are governed by strong private rules, both in the domestic and the global system, it is difficult to see how the regulation of intellectual property rights can undermine the rule of law. Although, an argument can be made that stringent intellectual property rules can impede the economic growth of societies, this still does not meet any criteria of undermining the rule of law.

II. THE RULE OF LAW AND THE PRIVATIZATION NEXUS

The starting point for framing privatization as the rule of law is to come to terms with the two notions. On the one hand, privatization captures how epistemic communities exercise some form of *state-like authority* in international law-making, and on the other, the rule of law,[11] among other

8. *See, e.g.,* THE CONSTITUTIONALIZATION OF INTERNATIONAL LAW (Jan Klabbers, Anne Peters & Geir Ulfstein eds., 2009).

9. Jan Klabbers, *Setting the Scene*, *in* CONSTITUTIONALIZATION OF INTERNATIONAL LAW, *supra* note 8, at 1, 16–17.

10. Anne Peters, *Membership in the Global Constitutional Community*, *in* THE CONSTITUTIONALIZATION OF INTERNATIONAL LAW, *supra* note 8, at 154, 248.

11. *See* LON L. FULLER, THE MORALITY OF LAW, 41–90 (Yale Univ. Press, revised ed. 1969) (setting out eight principles of legality). These principles have been traditionally identified as: generality, publicity, nonretroactivity, clarity, noncontradiction, possibility of compliance, stability, and congruence between official and declared action. See also Lisa M. Austin, *Property and the Rule of Law*, 20 LEGAL THEORY 79 (2014) (discussing these forms of legality in the context of the rule of law).

things, suggest that authority derives from law.[12] Of course, the *vague* idea of the rule of law cannot be explained away as a mere linkage to "authority",[13] but nevertheless, as it is not my intention to engage in an analysis of the rule of law, that linkage will suffice.

The broader purpose here is to demonstrate privatization as a *form* of the rule of law and this is quite possible given the *impreciseness* in the concept of the rule of law.[14] Hence, in the same fashion that privatization captures the legal process and interactions of epistemic communities in international law-making, the notion of rule of law also can capture the intersection and expansion of different legal regimes.[15] But irrespective of the *validity* that rule of law takes, a fundamental question is whether the rule of law contains any formal and procedural aspects that supports the participation of epistemic communities in international law-making.[16]

A related question is then to what extent does the rule of law embrace the system of international private law that relies much on the *privateness* in the international economic sphere.[17] These questions are significant for the fact

---

12. *See* A.V. DICEY, INTRODUCTION TO THE STUDY OF THE LAW OF THE CONSTITUTION, 110 (8th ed. 1915) (noting that the rule of law encompass "the exercise by persons in authority of wide, arbitrary, or discretionary powers of constraint").

13. *See, e.g.*, Timothy A. O. Endicott, *The Impossibility of the Rule of Law*, 19 OXFORD J. LEGAL STUD. 1 (1999); JOSEPH RAZ, THE AUTHORITY OF LAW, 153 (Oxford Univ. Press 1979) ("A rule of law is valid if and only if it has the normative consequences it purports to have. It is legally valid if and only if it is valid because it belongs to a legal system in force in a certain country or is enforceable in it, i.e. if it is systematically valid.") *But see* Adam Shinar, *One Rule to Rule Them All? Rules of Law Against the Rule of Law*, 5 THEORY & PRACT. LEGIS. 149 (2017) (discussing the tension within the rule of law).

14. For debates, see, for example, Frank Lovett, Article, *A Positivist Account of the Rule of Law*, 27 L. & SOC. INQUIRY 41 (2002).

15. *See, e.g.*, Sergio M. Carbone, *Rule of Law and Non-State Actors in the International Community: Are Uniform Law Conventions Still a Useful Tool in International Commercial Law*, 21 UNIF. L. REV. 177 (2016); Peter-Tobias Stoll, *International Investment Law and the Rule of Law*, 9 GOETTINGEN J. INT'L L. 267 (2018); STEPHEN HUMPHREYS, THEATRE OF THE RULE OF LAW: TRANSNATIONAL LEGAL INTERVENTION IN THEORY AND PRACTICE (2010).

16. *Cf.* Austin, *supra* note 11, at 79–80 (questioning whether the rule of law is one of form or substance in the context of property law); RICHARD EPSTEIN, DESIGN FOR LIBERTY: PRIVATE PROPERTY, PUBLIC ADMINISTRATION, AND THE RULE OF LAW, 30, 43–65 (2011) (discussing "the limitations in natural law theory that point to adopting an explicit utilitarian approach that evaluates all laws in the light of their systematic consequences for society as a whole").

17. I use the term "international private law" as reference to non-international law instruments that apply in the private sphere at the international level, which may include those on intellectual property and investment law related activities. In one way the term as used in this Article is also synonymous with private international law, however, I am

that they include, and/or make, the connection to the system of *private law rules* — such as those found in intellectual property rights or investment law both at the domestic and international level. In addition, privatization takes into account a form of legal ordering, in other words, when the process of rulemaking in international law is seen as driven by a common framework of international intellectual property economic governance.

For epistemic communities, the rule of law operates or is fully functional when their objectives are met when treaties are adopted that provide for the protection of intellectual property and recourse to adjudication. This is often evident in investor-state dispute settlement cases where tribunals often attempts to frame issues in a rule of law context. For instance, in the ICSID arbitration Tecnicas Medioambientales,[18] the tribunal notes that "the foreign investor expects the host State to act in a manner, free from ambiguity and totally transparently in its relations with foreign investor."[19] This language by the tribunal may be equated to the generality of the principle of the rule of law that Fuller described in his work.[20] But more significantly, for my purpose, this example connects the rule of law to the system of international adjudication in investor-state dispute settlement where the systems of international private law and its legal ordering are essential to privatization as a form of the rule of law.

We have seen how it is not difficult to understand *how* and *why* investment arbitration decisions such as the *Tecmed* example (although there are numerous other examples) elucidates an epistemic conception of the rule of law.[21] The private actor, i.e., the private investor, expects the host state to uphold to the basic conventions of law, that is, the rule of law, in a manner that is free from ambiguity. In other words, the law must have clarity when considering Fuller's principle of *clarity* regarding the rule of law — and therefore, the expectation from the private investor is that any form of non-compliance may suggest that there are defects in the host state *rule of law* system.[22]

If one considers the amount of investor-state dispute settlement awards

avoiding that term as such, given that a slew of other issues such as contracts or applicable law will need an explnation, but see my own discussions in P. Sean Morris, *To What Extent Do Intellectual Property Rights Drive the Nature of Private International Law in the Era of Globalism?* 28 TRANSNAT'L L. & CONTEMP. PROBS. 455 (2019) (where I have attempted to set out some of the private international law matters such as applicable law to the debate on the nexus of international law and intellectual property).

18. ICSID Case No. ARB (AF)/00/2, Award (May 29, 2003).

19. *Id.* ¶ 154.

20. *See* FULLER, *supra* note 11 at 39.

21. *See Tecmed*, ICSID Case No. ARB (AF)/00/2, Award, ¶ 154.

22. See FULLER, *supra* note 11, at 39.

over the years, then my previous claim has merits given that those awards are often against states which are generally perceived to have a system of *weak* rule of law. But, as tempting as this claim is, my point of highlighting it is to make the connection of the rule of law from a privatization perspective. Of course, the *positive* effect of this claim is that it serves as good news for the conception of privatization. It partly captures the participation of private actors in international adjudication, and any efforts to globalize their rulemaking and adjudicatory activities as standard or norms in international legal discourse is good news.

Hence, from this perspective, privatization as a form of rule of law serves as a powerful element in legality. This is especially the situation when Fuller's approach is factored into the debate. Other considerations are also important such as seeing the entire corpus of global economic governance as anchored on the private governance aims of private actors and the institutional support of the public international law system through international private law norms and legal content.

The public international law system for the most part is built upon the rule of law where international treaties, institutions and tribunals serve an interconnected *value* system based on commitments to uphold (the international) rule of law.[23] And despite the lack of an international legislature — the rule of law flourishes in international legal relations[24] especially on matters relating to economic governance.[25] Private investors have long seen the rule of law as central to investment law and its *ad hoc* system of investor-state dispute settlement that are provided for.[26] Whether they can rely on consistency, certainty or stability the rule of law continues to guide investment law and other regimes in global economic governance

23. *See, e.g*, Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *opened for signature* Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (entered into force Oct. 14, 1966) [hereinafter ICSID Convention] (noting that "[t]he tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties" including the rules of international law).

24. *See, e.g.*, Consistency of Certain Danzig Legislative Decrees with the Constitution of Free City, Advisory Opinion, 1935 P.C.I.J. (ser. A/B) No. 65, ¶ 54 (Dec. 4) (holding that certain decrees implemented by Danzig amending its criminal code violated its Constitution as guaranteed by the League of Nations under the Treaty of Versailles).

25. *See* Kenneth J. Keith, *John Dugard Lecture – 2015: The International Rule of Law*, 28 Leiden J. Int'l L. 403, 406 (2015) (discussing the 2005 World Summit Outcome).

26. *See* Stoll, *supra* note 15; *see also* Ernst-Ulrich Petersmann, *International Rule of Law and Constitutional Justice in International Investment Law and Arbitration*, 16 IND. J. GLOB. LEGAL STUD. 513 (2009).

such as trade.[27]

As part of the move towards the capture of the rule of law in an international (agenda) and institutional context, the UN proposed a definition of the rule of law that includes a reference "to a principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws . . . ."[28] This is clearly a welcome attempt to refine and define the rule of law for an international context. The UN conception of the rule of law takes into account how the numerous actors in (global) governance can be accountable.

Privatization also captures the idea of accountability as part of the economic governance structure in which state-like entities behave like states. The idea and account of privatization in this Article and the international efforts, such as the UN Report of 2004, provide ways of approaching the idea of the rule of law where multiple actors are accountable to law.[29] The approach and development of privatization in this Article, therefore, captures private actors and epistemic communities in (global) governance as accountable to the (rules of international) law, i.e., the principle of legality.[30]

The international legal system consists of diverse actors and normative eco-systems in which competition for dialogue is often focused on the more *exotic* or the *popular*. Privatization and the rule of law fall into these two categories and their dynamics can only survive where there is a convergence of their internal message and practical application (or perhaps appreciation). Naturally, those versed in the debate on global legal norms will favour the popular — the rule of law, while those with a sense of curiosity might pose further questions on the exotic — privatization. Naturally, there are distinctions to be made between the two, but at the same time, there are some concrete questions that must be asked to determine their legal worth for the international legal system. Given that a debate on the rule of law can be as exhaustive as trying to negotiate if the egg or the chicken came first in the UNGA, we must focus our attention to understand the concept of privatization in broader context of the narratives below and how the concept fits into the dialogue on the rule of law. So, in a Hartian sense, we can

27. *See* Petersmann, *supra* note 26.

28. U.N. Secretary General, *The Rule of Law and Transitional Justice in Conflict and Post-Conflict Societies: Report to the Security Council*, ¶ 6, U.N. Doc. S/2004/616 (Aug. 23, 2004); *accord.* G.A. Res. 61/39, The Rule of Law at the National and International Level (Dec. 18, 2006).

29. *The Rule of Law and Transitional Justice in Conflict and Post-Conflict Societies: Report to the Security Council*, *supra* note 28, ¶ 6.

30. *See generally* Morris, *supra* note 17 (developing and discussing the idea and notion of privatization more broadly).

explore further privatization as part of the normative standards in the international legal system where the notion of *rule* requires how much we also are able to view the international legal system from the "governance of rules" when considering the meaning of *the rule of law*.[31]

A. The Extraterritorial Jurisdiction of Private Trademark Law

The link between trademark law and extraterritoriality, has been and remains a complex issue. At its heart, is the question of jurisdiction, or, to put it another way, to what extent can the trademark law of a nation state be applied to the private activities conducted in another nation for alleged trademark infringement? Can the nation of United Apologia assert jurisdiction over the Republic of Utopia in private regulatory matters, and what is the role of international law in such circumstances?

The issue of the extraterritoriality of trademark law often arises in U.S. trademark infringement cases, and recently, a federal court found that a Canadian grocery store that operated under the name Pirate Joe infringed the eponymous U.S. supermarket chain Trader Joe's trademark and goods.[32] That court, with a degree of caution, observed that there was a need "to avoid unreasonable interference with other nations' sovereign authority where possible[,]"[33] but also affirmed the extraterritorial reach of the Lanham Act.[34] It was not the first time the courts in the United States have affirmed the extraterritorial reach of the Lanham Act, as the Supreme Court has done so in *Steele v. Bulova Watch Co.*[35]

The extraterritorial doctrine has fascinated legal scholars over the decades and continues to perplex the mind.[36] One can reasonably argue that the extraterritorial application of US trademark law supports the claim that the privatization of international law is a natural occurrence. This is because the

---

31. Sean Coyle, *Positivism, Idealism and the Rule of Law*, 26 OXFORD J. L. STUD. 257, 259 (2009).

32. Trader Joe's Co. v. Hallatt, 835 F. 3d 960, 977–78 (9th Cir. 2016).

33. *Id.* at 972 (quoting RJR Nabisco, Inc. v. Eur. Comm., 136 S. Ct. 2090, 2106–07 (2016)).

34. *Id.*

35. 344 U.S. 280 (1952).

36. *See, e.g.*, William Luney, *Trademarks — Extraterritorial Application of the Lanham Act*, 55 MICH. L. REV. 887 (1957); Paul Garner, *Extraterritorial Application of the Trademark Laws of the United States*, 4 HARV. INTERNAL L. CLUB J. 48 (1962); Joshua Clowers, *On International Trademark and the Internet: The Lanham Act's Long Arm*, 13 RICH. J.L. & TECH. 1 (2006); Dariush Keyhani, Bulova *Wrongly Decided: A Case Against Extraterritoriality of Trademark Law*, 7 CHI.-KENT J. INTELL. PROP. 33 (2007); Xuan-Thao N. Ngyuyen, *The Digital Trademark Right: A Troubling New Extraterritorial Reach of United States Law*, 81 N.C. L. REV. 483 (2003).

extraterritorial reach relates to private conduct and questions on the interaction of public international law and international private law *vis-à-vis* trademark law. In addition, the new system of global law where private economic actors are more aggressive in terms of regulatory expansion have pursued the *rule of law* to the full extent to protect their private rights — and the state has been the major toolkit in that endeavour to reflect globalization, extraterritoriality, and international trademark norms.[37]

But, despite how perplexing it might be, whether a nation state can apply its laws extraterritorially, for intellectual property rights matters a lot, and the *Trader Joe's* court said that the Lanham Act applied to the infringer's extraterritorial conduct in Canada:

> We resolve two questions to decide whether the Lanham Act reaches Hallatt's allegedly infringing conduct, much of which occurred in Canada: First, is the extraterritorial application of the Lanham Act an issue that implicates federal courts' subject-matter jurisdiction? Second, did Trader Joe's allege that Hallatt's conduct impacted American commerce in a manner sufficient to invoke the Lanham Act's protections? Because we answer "no" to the first question but "yes" to the second, we reverse the district court's dismissal of the federal claims and remand for further proceedings.[38]

Although on the one hand, the court applied U.S. law extraterritorially, on the other hand, the court said that reasonable steps should be taken as to not interfere in the sovereign authority of Canada.[39] It is this duelling approach that further complicates what was already an *invalid question* under the realm of international law. However, U.S. trademark law has provisions that

37. *See, e.g.*, Curtis A. Bradley, *Territorial Intellectual Property Rights in an Age of Globalism*, 37 VA. J. INT'L L. 505 (1997); Morris, *From Territorial to Universal*, *supra* note 4; Graeme Dinwoodie, *Trademarks and Territory: Detaching Trademark Law from the Nation-State*, 41 HOUS. L. REV. 885 (2004); Dan Burk, *Trademark Doctrines for Global Electronic Commerce*, 49 S.C. L. REV. 695 (1998); Marshall Leaffer, *The New World of International Trademark Law*, 2 MARQ. INTELL. PROP. L. REV. 1 (1998); Paul Berman, *From International Law to Globalization*, 43 COLUM. J. TRANSNAT'L L. 485 (2005); Graeme Dinwoodie, *Developing a Private International Intellectual Property Law: The Demise of Territoriality*, 51 WM. & MARY L. REV. 711 (2009); Shontavia Johnson, *Trademark Territoriality in Cyberspace: An Internet Framework for Common-Law Trademarks*, 29 BERKELEY TECH. L.J. 1253 (2014); James Darnton, *The Coming of Age of the Global Trademark: The Effect of TRIPS on the Well-Know Marks Exception to the Principle of Territoriality*, 20 MICH. STATE INT'L L. REV. 11 (2011).

38. *Trader Joe's Co.*, 835 F.3d at 966.

39. *Id.* at 972–73 (describing the factors used in evaluating whether to apply U.S. law extraterritorially).

broadly cover *commerce* and that have in the past been applied extraterritorially, thus, the *Trader Joe's* court rationalized:

> We determine whether any statute, including the Lanham Act, reaches foreign conduct by applying a two-step framework. At step one we ask "whether the statute gives a clear, affirmative indication that it applies extraterritorially." The Supreme Court settled this question with regard to the Lanham Act when it held that the Act's "use in commerce" element and broad definition of "commerce" clearly indicate Congress's intent that the Act should apply extraterritorially. Where, as here, Congress intended a statute to apply extraterritorially, we proceed to step two and consider "the limits Congress has (or has not) imposed on the statute's foreign application."[40]

One of the court's most interesting reasonings, for my purposes, has to do with the doctrine of international comity, and how the court construed its reasoning as to whether alleged infringing activities in Canada had any impact of *commerce* in the United States that warranted the application of the Lanham Act.[41]

Thus, after a lengthy analysis of the *Timberlane* doctrine (where the Federal court set out three steps to fulfill in order to warrant the application of the Lanham Act as either a merits question or jurisdictional one)[42] — the court stated that Trader Joe's, met "*Timberlane* prongs one and two, at least at this early stage of the proceedings."[43] However, it was the third criteria of *Timberlane* that the court would use to assess international comity[44] and cautiously explain that due to the doctrine of international comity, unreasonable interference in other nations' sovereignty must be avoided as much as possible. But, it was only a cautious statement, as the *Trader Joe's* court then set out seven factors that should also be taken into consideration

40. *Id.* at 966 (internal citations omitted).

41. *Id.* at 972–74.

42. *Id.* at 969; *see also Timberlane Lumber Co. v. Bank of America National Trust & Savings Association*, 549 F.2d 597 (9th Cir. 1976). The Timberlane test provides for the extraterritoriality of the Lanham Act providing that: "(1) the alleged violations . . . create some effect on American foreign commerce; (2) the effect [is] sufficiently great to present a cognizable injury to the plaintiffs under the Lanham Act; and (3) the interests of and links to American foreign commerce [are] sufficiently strong in relation to those of other nations to justify an assertion of extraterritorial authority." *Trader Joe's Co.*, 835 F.3d at 969 (citing Love v. Associated Newspapers, Ltd., 611 F.3d, 613 (9th Cir. 2010)).

43. *Id.* at 972.

44. *Id.*

when applying the third test of *Timberlane.*[45] The court then ruled that, the third test of *Timberlane* was also met, and therefore, justified the extraterritoriality of the Lanham Act.

What we've seen from the *Trader Joe's* court is that the court is comfortable "wearing two hats"[46] — one, as the guardian of American domestic law, that is the Lanham Act, and the other hat, as the "peacemaker," relating to how far it can stretch the boundaries of international law in relation to the extraterritorial application of the Lanham Act in a sovereign country.

The court's particular ease, albeit cautious, discussion on the exercise of jurisdiction of the Lanham Act, that is to apply it extraterritorially, comes from both previous applications of international private law instruments such as the Sherman Antitrust Act and the Lanham Act.[47] It is through the application of international private law instruments in which extraterritorially raises more questions as to how public international law *should* or *can* respond. For scholars such as Kratochwil, there is no reason why public international law should not permit extraterritorial application of domestic law:

> As public international law permits concurrent jurisdiction (e.g., over nationals abroad) and also, according to the "protective principle," the exercise of jurisdictional power whenever conduct abroad has foreseeable and direct effects on the domestic order, courts must utilize "conflict-of-law" rules. The principle of international "comity" is likewise often invoked in order to reach a decision as to which of the (conflicting) national norms shall be the governing one.[48]

---

45. *Id.* at 972–73 ("(1) the degree of conflict with foreign law or policy, (2) the nationality or allegiance of the parties and the locations or principal places of business of corporations, (3) the extent to which enforcement by either state can be expected to achieve compliance, (3) the relative significance of effects on the United States as compared with those elsewhere, (5) the extent to which there is explicit purpose to harm or affect American commerce, (6) the foreseeability of such effect, and (7) the relative importance to the violations charged of conduct within the United States as compared with conduct abroad.").

46. *See* Friedrich Kratochwil, *The Role of Domestic Courts as Agencies of the International Legal Order*, in INTERNATIONAL LAW: A CONTEMPORARY PERSPECTIVE 247 (Richard Falk, Friedrich Kratochwil & Saul Mendlovitz eds., 1985) (explaining that the duality of "wearing two-hats" refers to "institutions of the domestic as well as the international order").

47. *Cf. id.* at 248 (quoting Judge Learned Hand's holding in *United States v. Aluminum Co. of America*, 148 F.2d 416, 433 (2d Cir. 1945), that "any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends").

48. *Id.* at 247–48.

If the *Trader Joe's* decision is an indication that *territorial trademark law* has extraterritorial effect, then it is clear that the *winners* are private rights holders, who can invoke domestic trademark law for infringing activities in a globalized world.

But the broader picture is that there is an emerging pattern on how the private rights of economic actors, backed by the rules of international private law, are diluting the operations of public international law. The private regulatory laws on trademarks enforce legal relationships within territorial borders, and their ability to also enforce private conduct in a sovereign state reclassify how to deal with public international law on the relations of states when they are somehow in conflict.

But such a reclassification may be too optimistic at this stage, and what is actually taking place during convergence in a conflict situation is that both international private law and the public international law systems are one and the same — and no proper distinction can be made. Yet, clearly in contemporary times, where extraterritoriality of domestic laws represents acceptable behavior, "the concerns, the actors, and the process of 'public' international law have been expanded — 'privatized'"[49] and it is this privatization, that represents a new convergence of epistemic communities and investor-state disputes reality of what is *international law*.

B. Intellectual Property Investment Function

Some of the major investment decisions in recent years such as, *Philip Morris v. Australia*[50], *Phillip Morris v. Uruguay*[51], and *Eli Lilly v. Canada*[52] involve the investment function of intellectual property rights such as trademark protection and patent rights. The WTO Panel ruling in the Australia plain packaging dispute, suggest that there is a construction or emergence of a new global judicial order that takes into account the

49. Ralph G. Steinhardt, *The Privatization of Public Law*, 25 GEO. WASH. J. INT'L L. & ECON. Econ 523, 544 (1991); *see* Morris, *From Territorial to Universal*, *supra* note 4, at 77–81 (discussing extraterritoriality and trademark law as part of the privatization of international law). *See generally* GUNTHER HANDL ET AL., BEYOND TERRITORIALITY: TRANSNATIONAL LEGAL AUTHORITY IN AN AGE OF GLOBALIZATION (2012).

50 *See* Philip Morris Asia Ltd. v. Commonwealth of Australia, PCA Case Repository No. 2012-12 (Perm. Ct. Arb. 2012)

51 *See* Philip Morris Brand Sàrl v. Republic of Uruguay, ICSID Case No. ARB/10/7 (2010).

52 *See* Eli Lilly & Co. v. Government of Canada, ICSID Case No. UNCT/14/2 (2012).

international legalization of intellectual property rights.[53]

One of the questions that arise from these judicial developments of intellectual property rights in global tribunals is how to frame the correlation between intellectual property rights and investment. In this Section, I argue that such correlation fits into the narrative on the privatization of international law, or, to put it another way, the essence of global intellectual property rights is to function as an investment under international law. For the purposes of such investment, international investment agreements and other *like treaties* are one limb of the international legal structure in which the investment function can be deduced.

Another limb is, how such agreements are interpreted in international tribunals, such as ISDS tribunals, the WTO Dispute Settlement Body ("DSB"), or the International Court of Justice ("ICJ"). These limbs or different structures of the international legal system serve as the ultimate determinants on the investment function of intellectual property rights. Not only do intellectual property rights and investment protection overlap at the international level,[54] they also both seek to enhance how private economic rights are *distributed* on a global reach and for the *rule* of international law to provide protection for *such* distribution. But despite the existence of an investment function of intellectual property in the international legal system — its justification can be compared to that of the *social function of law*[55] —

53. *See* Panel Report, *Australia—Certain Measures Concerning Trademarks, Geographical Indications and Other Plain Packaging Requirements Applicable to Tobacco Products and Packaging*, WTO Doc. WT/DS467/1/R (June 28, 28 June 2018) [hereinafter Plain Packaging Panel Report]; Tania Voon, *Acquisition of Intellectual Property Rights: Australia's Plain Tobacco Packaging Dispute*, 35 EUR. INTELL. PROP. REV. 113 (2013); Jonathan Griffiths, *"On the Back of a Cigarette Packet": Standardised Packaging Legislation and the Tobacco Industry's Fundamental Right to (Intellectual) Property*, 2015 INTELL. PROP. Q. 343;. *But see* Andrew Lang, *The Role of the International Court of Justice in a Context of Fragmentation*, 62 INT'L & COMPAR. L.Q. 777, 806 (discussing how the ICJ could develop a "toolbox" to intervene in the maize on plain-packing and international legal contestations).

54. *See* Susy Frankel, *Interpreting the Overlap of International Investment and Intellectual Property Law*, 19 J. INT'L ECON. L. 121 (2016) (analyzing how to address intellectual property and investment at the international level).

55. The literature on jurisprudence extrapolates the social function of law; however, some of the works consulted during the writing of this section — or rather, to emphasise the point on the social function of law, see Roscoe Pound, *Legislation as a Social Function*, 18 AM. J. SOCIO. 755 (1913); Hans Kelsen, *The Law as a Specific Social Technique*, 9 U. CHI. L. REV. 75 (1941); Edward Rogers, *The Lanham Act and the Social Function of Trademarks*, 14 L. & CONTEMP. PROB. 173 (1949); Glanville Williams, *The Aims of the Law of Tort*, 4 CURRENT LEGAL PROBS. 137 (1951); David Funk, *Major Functions of Law in Modern Society*, 23 CASE W.L. REV. 257 (1972); D. J. GALLIGAN, LAW IN MODERN SOCIETY (2007).

or the Hartian[56] use of *function* in relation to legal rules.[57]

What makes the proposition of intellectual property investment function attractive is that the modern protection of intellectual property rights and the rise of international investment agreements and *like-treaties* in the global legal system has created both "law-making operations"[58] of epistemic communities in unison with the state. The law-making operations are, in turn, interpreted by private-like judicial bodies under a system of investor-state dispute settlement. The result of these judicial activities in the global system is that they've become the center of the international legal system and thereby creates a *social function* in addition to their *legal functions*.

Thus, both the mixture of social and legal functions of the law-making operations of epistemic communities and interpretation of intellectual property provisions under international investment treaties reflects rules as both having a social function and "rules of adjudication".[59] Moreover, a social function approach to develop the investment function of intellectual property may absolves the state of any responsibilities for private actors' activities in international legal relations, where there exists "primary and secondary rules."[60] Therefore, in the context where law-making operations of international treaties involves private actors, their existence, and interpreting such treaties via *quasi* private tribunals such as *ad hoc* investor-state dispute settlement elevates the social and legal functions. Moreover, the emerging functional standards would suggest that states have no responsibility of private activities within international law.

The best, although not conclusive definition of social function that I can propose — so that it fits my broader approach to *investment function* — is that a social function arises as a result of societal advancement and other social goals in the aims of innovation and the realization of rules for intellectual property rights. This is a flexible description that can allow various maneuvers at interpretation and analysis of the international legal structure of intellectual property and investment.

Although this definition of social function is a narrow one — to be applied

56. HART, *supra* note 7 (discussing function per legal rules are tools to help achieve social goods including the protection of property). *See generally* GALLIGAN, *supra* 53, at 68–80.

57. HART, *supra* note 7; GALLIGAN, *supra* 53, at 68–80.

58. *See* HART, *supra* note 7, at 99 (deploying this terminology).

59. *See* Note, *The Distinction Between the Normative and Formal Functions of Law in H.L.A. Hart's the Concept of Law* 65 VA. L. REV. 1359, 1379 (1979).

60. HART, *supra* note 7, at 86 (discussing the union of primary and secondary rules and that social pressure helps to bring conformity to rules but also notes "no centrally organized system of punishments for breach of the rules . . . .").

to intellectual property rights,[61] it can also be used to examine law as a social phenomenon. Furthermore, in my example, of *social*, it can be used to determine a wide array of instrumental means and activities that are relevant to different actors in the international system. For instance, the social aims of the state can be associated with my use of *social*, as, the social activities and aims of the private entities active in the international economic system. Thus, whether my definition of social function is appropriate or not, it helps to determine how to accurately portray *function* as a form of *utilitarian activity* where the merchants of global commerce seek the rule of law within a public choice space.[62]

In explaining the meaning of certain expressions, an abundance of caution is always necessary, in order not to fall into automatically pinned down static interpretations that may prove difficult to abandon in light of new developments or alternative views. It is that same caution that I am using, in framing what *function* actually means in my quest to paint a picture of the investment function of intellectual property.

The global community of intellectual property players include the coalition of epistemic communities, the state and occasionally tribunals. All the actors have different functions to perform, and thus, a conception of *function* that includes all their activities would not be ideal. Nor, would a conception of function that ultimately relies only on *all* international legal rules that coordinates the scope and protection of economic activities. Thus, I am therefore left to frame *function* in a different paradigm.

Therefore, to construe a conception of function, we must see intellectual property rights as, to quote Dworkin, "sufficiently complex and structured"[63] utilitarian activities exercised by private rights owners, or, what I prefer to

61. What I have in mind here, is that the treatment of social function should be seen in the light of how intellectual property rights are used as, what Pound refers to in a different context, the "preservation of the rights of private property" as a fundamental object of the law. Pound, *supra* note 55, at 760; *see also* Rogers *supra* note 54; CATERINA SGANGA, PROPERTIZING EUROPEAN COPYRIGHT: HISTORY, CHALLENGES AND OPPORTUNITIES 191–232 (2018); Christophe Geiger, *The Social Function of Intellectual Property Rights, Or How Ethics Can Influence the Shape and Use of IP Law*, *in* INTELLECTUAL PROPERTY LAW: METHODS AND PERSPECTIVES (Graeme B. Dinwoodie ed., 2013).

62. My usage of utilitarian *activities* in this section mainly alludes to the utilitarian theory on the justifications of intellectual property rights as a form of social good. For general readings on the utilitarian doctrine, see, for example, Russel Hardin, *The Utilitarian Logic of Liberalism,* 97 ETHICS 47 (1986); JAMES WOOD BAILEY, UTILITARIANISM, INSTITUTIONS, AND JUSTICE (1997); FREDERIK ROSEN, CLASSICAL UTILITARIANISM FROM HUME TO MILL (2003).

63. Ronald Dworkin, *My Reply to Stanley Fish: Please Don't Talk About Objectivity Any More*, *in* THE POLITICS OF INTERPRETATION 287, 293 (W.J.T. Mitchell ed., 1983).

call the merchants of global commerce. To pursue their global utilitarian activities, the merchants of global commerce are also active norm makers in the international legal system that regulates their utilitarian activities. In other words, there is a "functional essence"[64] of normative rules that emerges from the utilitarian activities in intellectual property. And, in this regard, a part of utilitarian activities give rise to norms, and where such norms lead to the global rule of law — then *law* as such, must be seen, as serving "the goals of liberty . . ., equality . . ., substantive fairness . . ., procedural fairness . . ., [and] utility . . . ."[65] It is difficult to deny that the global system of intellectual property rights doesn't reflect economic activities in a liberal fashion, and at the same time endorses the utilitarian approach of economic rights. Hence, the prototype of the culture of privatization of international law can also be found in these global economic situations.

But, by keeping in mind these definitions of social function and the idea of *utilitarian conception of function*, further discussions should help to illuminate the issues raised in this Article, rather than providing a complete satisfactory result. In order to ascertain the proper intellectual property investment function, I examine two types of relationships: the first being the union of *rights* and *property* (to include intellectual property rights) by examining how HLA Hart developed his own arguments. Secondly, I am concerned with what the tribunals can tell us about the concept of *investment function* proposed in this Article. And in this latter, I am interested in the interaction of both intellectual property rights and the concept of investment as a function that privatize international law by keeping stability and legal certainty in the global economic order. These arguments are explored in the next sections below and then linking the explosion of intellectual property investments in international treaties. This latter, being the *lex cosmopolis* paradigm.

III. HART: (INTELLECTUAL) PROPERTY FUNCTIONS AND THE GLOBALIZING OF "RIGHTS"

I want to turn to Hart and his *Concept of Law* to support my proposition on intellectual property investment function as constituting part of the culture of privatization of international law.[66] It might be somehow safe to turn to established legal thought to aid and abet such a proposition and to help situate the arguments and complexities that I discuss throughout the Article.

64. Michael S. Moore, *The Interpretive Turn in Modern Theory: A Turn for the Worse?,* 41 STAN. L. REV. 871, 887 (1989).

65. *Id.*; *see also* ANDREI MARMOR, INTERPRETATION AND LEGAL THEORY 74 (2d ed. 2005) (discussing Dworkin and Moore's take on the law).

66. *See* HART, *supra* note 7.

I should also point out, that another reason for selecting Hart, to support my arguments, is that Hart, when read in its proper context, is also about private law ("property"). In this regard, Hart provides a good point of departure *back to basics* and contextualizes, what I hope, is a compelling argument, on the private economic *property* function in intellectual property. Moreover, one can further argue that the globalization of rights when seen as part of the privatization culture of international law allows additional insights into the nexus between private property rights and rules of international law.

Hart, in his now classic work, has argued, among other things, that primary and secondary rules have both distinctive elements and can be unified.[67] For Hart, the existence of "primary rules of obligations" can be supplanted "by further secondary rules."[68] Although, there are endless interpretations of Hart's primary and secondary rules *vis-a-vis* obligations, let me quote him directly, to offer my own contextual view. Hart writes:

> Under the simple regime of primary rules the internal point of view is manifested in its simplest form, in the use of those rules as the basis of criticism, and as the justification of demands for conformity, social pressure, and punishment. . . . With the addition to the system of secondary rules, the range of what is said and done from the internal point of view is much extended and diversified. With this extension comes a whole set of new concepts and they demand a reference to the internal point of view for their analysis.[69]

Now, there is a lot to be taken in from the above passage alone, and this brings me to my main question — as per this section — *what does Hart have to do with intellectual property rights*?

Indirectly, Hart's connection to intellectual property rights can be determined in part, firstly, by his treatment of "property" and "rights," and secondly, an "internal" point of view for global intellectual property rights. I am more concerned with the "internal point of view"[70] argument, the broad

67. *Id.* at 99 (noting "the union of primary and secondary rules is at the centre of a legal system)."

68. *Id.* at 97.

69. *Id*. at 98.

70. This has been eloquently explained by one academic in the following: "The internal point of view is the practical attitude of rule acceptance — it does not imply that people who accept the rules accept their moral legitimacy, only that that there are disposed to guide and evaluate conduct in accordance with the rules." Scott Shapiro, *What is the Internal Point of View?*, 75 FORDHAM L. REV. 1157, 1157 (2006).

arguments of "property", and I want to link, the *internalization* argument to intellectual property rights. There are few literature resources that I came across during the writing of this Section that explicitly connects Hart to intellectual property rights.[71]

Given that Hart also explains his primary and secondary rules as "the justification of demands for conformity," this argument can be applied to intellectual property rights as investments, or at least to justify intellectual property investments.[72] Given that Hart actively promoted the idea that "obligations" derive as a result of the laws' ability to influence behaviour (in individuals) — one can deduce that different *rule systems* such as trademark law, patent laws, or copyright laws — comprise an internal viewpoint (*internalization*)[73] as obligations given that they are seen as *law*.

Intellectual property rules impose obligations (on individuals): an obligation not to infringe, counterfeit, etc., and the obligation that an investment under treaties is also of an intellectual property nature. The consequences of breaking these obligations are sanctions (such as heavy financial fines) such as when a U.S. court awarded Apple a substantial sum due to patent infringement by rival Samsung Electronics.[74] The other, in the context of the investment function of intellectual property, is a financial award through an ISDS tribunal.

But for Hart, the internal point of view of the law should not merely be seen from sanctions[75] only, but rather from *the internal point of view*. Let's, for the sake of illustration, go back to the *Apple Inc. v. Samsung Electronics Co.*[76] case to look at the significant players and extrapolate the Hartian internal point of view.

Both Apple and Samsung are major global players in the electronics industry and both firms are the owners of thousands of intellectual property rights such as patents and trademarks. Equally, given that both firms pass on their products to consumers — who, for my purposes, comprise a social group — naturally, it is quite possible that this social group may either be

71. *But see* XAVIER SEUBA, THE GLOBAL REGIME FOR THE ENFORCEMENT OF INTELLECTUAL PROPERTY RIGHTS 16 (2017).

72. HART, *supra* note 57, at 98.

73. *See id.*

74. Apple Inc. v. Samsung Electronics Co., 888 F. Supp. 2d 976 (N.D. Cal. 2012).

75. For a rebuttal to Hart's view that legal obligations can exist even without sanctions through the "gunman situation," see Danny Priel, *Sanction and Obligation in Hart's Theory of Law*, 21 RATIO JURIS 404 (2008). For a general analysis of Hart, of which there are many, see, e.g., Mehrdad Payandeh, *The Concept of International Law in the Jurisprudence of H.L.A. Hart*, 21 EUR, J. INT'L L. 967 (2011).

76. 888 F. Supp. 2d 976 (N.D. Cal. 2012).

confused by the "similarity," "design," "functional elements," and/or aspects of a Samsung product, to an Apple product — which intellectual property laws exists to protect.[77]

At the same time, there is also an obligation on Samsung not to infringe the patents of its rivals as guaranteed under the rules of patent protection. Thus, if infringement on the part of Samsung forms a pattern, then inevitably, (1) consumers as a social group will come to realize that Samsung often employs a particular conduct, and (2) Samsung does not accept the patent rules as they are, therefore finding it acceptable to engage in infringing behavior.[78] The point of this argument (hopefully clear) is that from a Hartian perspective — an internal point of view signifies certain normative conduct (the consumers who accept the patent rules) and the infringers who also accept the rules (after a judicially imposed duty to do so).

But Hart is perhaps better equipped to explain what he actually meant by internal point of view:

> When a social group has certain rules of conduct, this fact affords an opportunity for many closely related yet different kinds of assertion; for it is possible to be concerned with the rules, either merely as an observer who does not himself accept them, or as a member of the group which accepts them and uses them as guides to conduct. We may call these respectively the "external" and the "internal points of view."[79]

Hart further explains that the acceptance of rules also depends on multiple factors such as "the calculations of long-term self-interest"[80] and therefore, can be influenced by standard of conduct.[81] Of course, standard of conduct varies from social groups or individuals — and what the actual determinants of their conduct are cannot be explained only from legal theory. A good example is perhaps the widespread use of intellectual property infringement mechanisms over the internet by various "social groups," i.e., individuals of different calibers or organizations and states that engage in intellectual property theft.[82] But that argument is not for here.

But let me ask, given that we are talking about intellectual property as an investment function, or at least, I am trying to make that argument: is there

77. *Id*.

78. *Id*. (claiming that Samsung infringed Apple's patents).

79. *See* HART, *supra* note 55, at 89.

80. *Id.* at 203; *see also* Shapiro, *supra* note 72, at 1162.

81. Shapiro, *supra* note 72, at 1162.

82. As a social group — the partially defunct piraratebay.com comes to mind, but classic case include, A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004 (2001).

a possible unison between intellectual property rules and investment rules and how are they distinguished, when confronted as "investments" in international tribunals? Again, where does Hart come in?

Here we must look at the private legal structure of international investment agreements. By private legal structure I am referring to the fact that (1) intellectual property imply private rights regulated by private law, (2) international investments are carried out by private economic entities under international treaties, and (3) disputes are adjudicated by "hybrid" tribunals for private investors against the state.

What is at the center of private legal structure are "rules," and as Hart develops, "whatever the rules are"[83] they impose obligations and confer some form of "power-sharing." And in the context of primary and secondary rules, Hart notes: "Rules of the first type impose duties; rules of the second type *confer powers, public or private* . . . [and lead] to the creation or variation of duties or obligations."[84] Hart's style of argumentation is simple, often non-technical, and can also be misunderstood.

Assuming that I am correctly interpreting Hart, arguably then, Hart's variations of duties or obligations that emanate from the law also point to a concept of *function* (as I framed it earlier) and hence, intellectual property law and investment law functions in a general way that Hart sees as obligation-imposing. Moreover, given Hart's description of "power-conferring" as a form of public-private hybrid legal system where private actors benefits from "the course of the law within the sphere of his contracts" there is some comfort in the notion of intellectual property investment as a form of dynamic legal structure.[85]

The point is, as Hart argues, law functions in "society as the invention of the wheel"[86] and to exclude intellectual property law or investment law from this invention would be counterintuitive. Given that for Hart, rules operate with "purposive activities"[87] and hence contain different functions, whether normative, social, coercive or obligations-imposing,[88] then the hybridity of private-public law is no different.

From this perspective then, we have to (1) look at intellectual property investments and their treatment by *hybrid* tribunals as some form of power-

83. HART, *supra* note 57, at 89.

84. *Id*. at 81 (emphasis added).

85. *Id*. at 41.

86. *Id.* at 42.

87. *Id.* at 41.

88. *See also* John Finnis & H.L.A. Hart, *A Twentieth-Century Oxford Political Philosopher*, 54 AM. J. JURIS. 161, 165–66 (2009).

sharing for dissecting international rules between the state and private actors, and (2) the broader implications on the globalization of "rights" to include those of intellectual property. The first I will examine in more detail in the next sub-section, but now, I want to examine globalization of rights in the Hartian context. These two observations are one way of interpreting what Hart meant by conferring "powers, public or private."[89]

The significance of Hart's analysis of "rights" is also important as it also directly relates to another diagnosis by Hart — *international law* — and as such, I can now attempt to frame Hart from the context of intellectual property to the globalization of rights in the rest of the discussion here.

Let me be subjective, and illustrate from a single quotation from Hart, to capture his meaning of "rights" in the context of the private rules, as I understand it. Hart's treatment of rights is complex and varied, so there is no point in trying to elucidate "rights" in its entirety from the Hartian perspective. Hart develops a theory of legal rights that emanates from how the legislator-imposed rights: "Legislation is an exercise of legal powers 'operative' or effective in creating legal rights and duties," Hart writes.[90] Now, we must interpret this Hartian conception of legal rights as having a legislative imposing (obligatory) function where it concerns law.

Hart, again, in simple and clear language explains the purpose of the law as to exclude optional human conduct: "The most prominent general feature of law at all times and places is that its existence means that certain kinds of human conduct are no longer optional, but in *some* sense obligatory."[91]

What Hart is really aiming for is that law, in particular, private law, is separate from any form of morality, and no better place can this separation be found than in the all-imposing ways of private law. Thus, Hart observes of contracts, wills, and property:

> Without such private power-conferring rules society would lack some of the chief amenities which law confers upon it. For the operations which these rules make possible are the making of wills, contracts, transfers of property, and many other voluntarily created structures of rights and duties

89. HART, *supra* note 7, at 81. For a similar view in relation to copyrights, see Shyamkrishna Balganesh, *The Obligatory Structure of Copyright Law: Unbundling the Wrong of Copying*, 125 HARV. L. REV. 1664, 1671 (2012); *see also* Jeremy Waldron, *From Authors to Copiers: Individual Rights and Social Values in Intellectual Property*, 68 CHI.-KENT L. REV. 841, 843 n.5 (1992) (quoting Hart, on "liberty-rights and their protective perimeter[,]" an argument that I believe firmly captures the utilitarian justification of intellectual property rights).

90. HART, *supra* note 7, at 31.

91. *Id.* at 6 (emphasis added).

> which typify life under law.[92]

Hart argues, in essence, that legal rights, in property for example, are legally significant and the law provides for a relationship that is a form of legal right-duty.[93] In other words, rights and duties are similar to conjoined twins and in international intellectual property and the investment rule system — a *legal-duty right* exists to be exercised as an obligation.

Thus, in a sense, the Hartian conception of rights, or at least how I tried to interpret it in this Section of this Article, is that it allows for a utilitarian justification of intellectual property rights to flourish. When this interpretation is viewed from a utilitarianism perspective, such as, in the Bentham tradition, as the law creating legal relations (granting) of private property rights to economic actors and individuals with the aim of promoting welfare in society (and the global economy), the *legal-right duties* in international private law provide for the other laws to flourish, where such laws can aid global economic commerce.[94]

The last point to consider is Hart's approach to international law and how it relates to the global system of rules in intellectual property and investments. Hart famously asked whether "international law is really law" and posited that in "the absence of an international legislature, courts with compulsory jurisdiction, and centrally organized sanctions have inspired misgivings . . . ."[95] The modern international intellectual property rights system and of the international investment agreements are without a doubt a legal system. However, given that their origins lie with private epistemic forces, from a theoretical point of view, then, whether they are really "law" is always up for debate.[96] I use a rules-based system here to conjecture the thought that the form and content of law is better explained from international private laws. Certainly, the international intellectual property rights system via the TRIPs Agreement enjoys the WTO DSB as a court that can enforce its rules, and similarly, the rise of arbitral tribunals in

92. *Id.* at 96.

93. For a similar argument, but in a different context, not relating to Hart, see R.B. Grantham & C.E.F. Rickett, *Property Rights as a Legally Significant Event*, 62 CAMBRIDGE L.J. 717, 719 (2003).

94. For corresponding views, see Waldron, *supra* note 87; Richard Armitage, *Globalizing Jeremy Bentham*, 32 HIST. POL. THOUGHT 63 (2011); Jennifer Pitts, *Legislator of the World? A Rereading of Bentham on Colonies*, 31 POL. THEORY 200 (2003); Philip Schofield, *Jeremy Bentham and HLA Hart's Utilitarian Tradition in Jurisprudence*, 1 JURIS. 147 (2010).

95. HART, *supra* note 7, at 214.

96. The international intellectual property system in this context originated from the Vienna Patent Congress of 1873. *See* EDITH TILTON PENROSE, THE ECONOMICS OF THE INTERNATIONAL PATENT SYSTEM 46 (1951).

international investment agreements have also contributed to a growing sense that some form of "enforceability" of the international law of intellectual property rights and investments have reduced the misgivings about international law.

Given that it is rather difficult to interpret which side of the fence Hart is on regarding the existence of international law, or more correctly, is it *really* law, let me propose that, for the purposes of the modern international intellectual property system and the new wave development in international investment law, that a combination of these two fields *makes* them *international law*. For the sake of brevity let's call that combination *regulatory international law*.

By moving away from Hart's misgivings on international law to that of regulatory international law that concerns private actions in the global economy, then, similar to say, *sovereignty* — regulatory international law is a system of construction of rules necessary for the globalizing nature of private rights.[97] Thus, unlike Hart, who is rather ambiguous on sovereignty, regulatory international law takes the form of both the normative rules and the rules for private rights that are specifically set out in treaties relating to intellectual property and/or investment. Those treaties acknowledge the importance of private rights not as municipal related issues only (domestic private law), but also their significance beyond the State to that of the global economy.

In this regard, regulatory international law also leads to conformity in the international system so that "private interests" can realize their "obligations or duties" within the rules-based system of regulatory international law. This is a point that Hart seems to appreciate.[98] Thus, the point of my proposition on the *existence* of regulatory international law is that (as combined) (1) regulatory international law demonstrates how changes in legal relations at the global level have occurred as a result of economic activities driven by private rights holders, and (2) the target of regulation — intellectual property rights and (contractual rights) in international investment agreements are two important mechanisms of the international order that necessarily provide part of the answer that international law *is* really law. In other words, regulatory international law is unique, as it forms part of the "needs" of the international

97. For Hart's depiction of sovereignty, see *id*. at 223–24 (noting, for instance, that there is "no way of knowing what sovereignty states have, till we know what the forms of international law are . . . .").

98. HART, *supra* note 7, at 218 ("It is true that not all rules give rise to obligations or duties; and it is also true that the rules which do so generally call for some sacrifice of private interests, and are generally supported by serious demands for conformity and insistent criticism of deviations.").

system (a society), where it at least, goes beyond "minimum forms" to actual "indispensable features" of law in the global society.[99]

Thus, the real value of regulatory international law from the Hartian perspective for globalizing of private property rights is that it provides the legal "minimum forms of protection for . . . property [rights]"[100] as a need of the international community (or society) to say "[i]f you wish to do this, this is the way to do it . . . ."[101] As such, we must view the system of "public international law" as lacking the uniformity to regulate private rights. On the other hand, we must also view "international private law" as a system that contains the principles for private rights in the global economic system, and its *validity* to determine how public international law is privatized.[102]

This exercise, into the Hartian conception of functions, primary and secondary rules, internal point of view (of the law), power-sharing nature of (private rules) — and the linkage to intellectual property law, rights, and international law, is all but to affirm that modern intellectual property and investment rules in the global system are *positivist* law and therefore, have many facets including how to reinvent the wheel. Moreover, for the privatization thesis that this Article advances — the modern system of international intellectual property rules and investment rules must be seen in light of the rulemaking and norm-making capacity of private rights holders and actors (epistemic communities) of these systems; they are the ones who exercise *private power* through possession.[103]

A. "Fair and Equitable Treatment" and Plain Packaging of Intellectual

99. *Id.* at 199 (arguing that some form of description "is needed" to reflect the minimum form of international law as a rule of law system; "to convey the status of the minimum forms of protection for persons, property, and promises which are similarly indispensable features of municipal law").

100. *Id.*

101. *Id.* at 28.

102. Here I am paraphrasing an interpretation of Hart, as developed by Kingsbury and Donaldson, see Benedict Kingsbury & Megan Donaldson, *From Bilateralism to Publicness in International Law*, *in* FROM BILATERALISM TO COMMUNITY INTEREST: ESSAYS IN HONOUR OF BRUNO SIMMA 88 (Ulrich Fastenrath et al. eds., 2011) ("Hart had envisaged that, in any legal system, the rule of recognition may become a technical instrument used primarily or exclusively by the elite of officials within the system . . . ."). Thus, international private law can be seen as a technical instrument, whilst being used by those designated with private rights — private rights holders.

103. *See* HART, *supra* note 7, at 41 ("Rules conferring private powers must, if they are to be understood, be looked at from the point of view of those who exercise them. . . . [P]ossession of these legal powers makes of the private citizen, who, if there no such rules, would be a mere duty-bearer, a private legislator.").

Property Investments

Where intellectual property, and specifically trademarks have been successful, as private rights for over a century beginning with the Paris/Bern System, they have shaped the trajectory of international intellectual property law so much so that success is also leading to the demise of trademarks in the global economic system. At least, that is one way of looking at the global movement for the regulation of tobacco and plain packaging in cigarettes where trademarks are the hallmarks of identification and market niche.

In the context of international law, the plain packaging disputes decided by the WTO are important to gain further insight on how private rights collide in international law.[104] The initial complaints concerned primarily the *Tobacco Plain Packaging Act 2011* in Australia that is designed to limit the use and visibility of trademarks on tobacco products.[105] In order to do this, the Australian Plain Packaging law regulates "the retail packaging and appearance of tobacco products in order to: (a) reduce the appeal of tobacco products to consumers . . . ."[106] Those measures were challenged at the WTO, and in addition to the WTO challenge, the Permanent Court of Arbitration ("PCA") also looked into a claim that the plain packaging law in Australia constituted an expropriation of investments[107] under the *Australia*

104. *See* Panel Report, *Australia—Certain Measures Concerning Trademarks, Geographical Indications and Other Plain Packaging Requirements Applicable to Tobacco Products and Packaging*, WTO Doc. WT/DS435/AB/R; WT/DS441/R; WT/DS458/R; WT/DS467/R (adopted June 28, 2018) [hereinafter Panel Rulings of 2018]. A series of other complaints had also been initiated at the WTO, and for context, they are also important, given that in some instances, the Panel lapsed. *See* Request for Consultations by Ukraine, *Australia—Certain Measures Concerning Trademarks and Other Plain Packaging Requirements Applicable to Tobacco Products and Packaging*, WTO Doc. WT/DS434/1 (Mar. 15, 2012). After this complaint by Ukraine, a Panel was composed on March 15, 2012 and lapsed on May 30, 2016, with a mutually agreed solution on the same day. In the Cuba complaint, the Panel circulated its report in 2018. *See* Complaint by Cuba, *Australia—Certain Measures Concerning Trademarks, Geographical Indications and Other Plain Packaging Requirements Applicable to Tobacco Products and Packaging*, WTO Doc. WT/DS458/R (June 28, 2018). In the Indonesia complaint, the Panel also circulated its report in 2018. Panel Report, *Australia—Certain Measures Concerning Trademarks, Geographical Indications and Other Plain Packaging Requirements Applicable to Tobacco Products and Packaging*, WTO Doc. WT/DS467/R (June 28, 2018).

105. *Tobacco Plain Packaging Act 2011* (Cth) s 3(2)(a)(i) (Austl.). ("The objects of this act are: (a) to improve public health by: (i) discouraging people from taking up smoking, or using tobacco products.") In addition to the Act, Regulations have been implemented entitled the Tobacco Plain Packaging Regulations 2011.

106. *Id.* s 3(2)(a).

107. Philip Morris Asia Ltd. (Hong Kong) v. Australia, PCA Case No. 2012-12,

— *Hong Kong BIT*.[108] In the Panel Rulings of 2018, Australia was able to demonstrate that its plain packaging laws did not breach international law.[109]

These litigations in plain packaging are important, as they can give insights into both domestic and international approaches to intellectual property regulations. At the national level, various laws regulating tobacco were enacted in countries such as Australia, Canada, Peru, Indonesia and others.[110] As a reaction to those laws, tobacco manufacturers challenged those laws in courts as well as the effect of those laws on the *dilution* of their trademarks.[111] At the international level, several arbitrations occurred regarding the investments by multinational cigarette manufacturers.[112] All these developments regarding tobacco regulation touch upon a number of issues from public health, politics, intellectual property, trademarks, investments, and international law.

One of the most important questions regarding the global regulation of tobacco, is whether this regulatory trend is one form of halting the expansion and power of private rights that are represented in intellectual property. Conversely, one may also inquire whether such development is to stop the influence and expansion of international intellectual property law. In this Section of this Article, this and other questions are examined against the backdrop of a culture of privatization that has been developed in previous papers,[113] and inquires about the extent intellectual property (trademarks) influence or shape international law as private actors.

There are three main questions addressed in this Part of this Article. The first, is to ascertain the current state of intellectual property in international investment law. The second, should intellectual property investments be assessed as fair and equitable. In that regard, parts of this section of the paper critically examine the nature of fair and equitable treatment in international

---

Award on Jurisdiction and Admissibility (Dec. 17, 2015).

108. Agreement between the Government of Hong Kong and the Government of Australia for the Promotion and Protection of Investments, H.K.-Austl., Sept. 15, 1993, 1748 U.N.T.S. 385 (entered into force Oct. 15, 1993) [hereinafter H.K.-Austl. BIT].

109. Panel Rulings of 2018, *supra* note 103, at 271.

110. *See, e.g.*, *Tobacco Plain Packaging Act 2011* (Cth) (Austl.); An Act to Amend the Tobacco Act and Non-Smokers Health Act to Make Consequential Amendments to Other Acts, S.C. 2018, c 9 (Can.).

111. *See, e.g.*, British Am. Tobacco UK Ltd. v. Secretary of State for Health [2016] EWHC (Admin) 1169 (Eng.); JTI Ir. Ltd. v. Minister for Health [2015] IEHC 481 (Eng.).

112. *See, e.g.*, Philip Morris Asia Ltd. (Hong Kong) v. Austl., PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (Dec. 17, 2015).

113. *See, e.g.*, Morris, *supra* note 4; P. Sean Morris, *To What Extent Do Intellectual Property Rights Drive the Nature of Private Law in the Era of Globalism?,* 28 TRANSNAT'L L. & CONTEMP. PROBS. 455 (2019).

investment law and its implication for international intellectual property law. The third question is considering plain packaging laws enacted on national levels and their impact on international law, and how to find solutions to such an impact. Thus, the primary goal in this Section of this Article is to demonstrate the culture of privatization by examining the impact of tobacco regulation on international law from the perspective of trademark law, investment, and the TRIPs Agreement.

B. On the Nature of International Investment Law in the System of Public International Law

The collision of the private nature of international law is also reflected heavily in current international investment law. International investment law,[114] like international intellectual property law, is part of the corpus of international economic law, which in turn drives public international law outside of the more *vocal realms* such as international human rights law or the law of war and peace.

In the last five decades or so, international investment law has become a significant regime in international law. The global economic and investment climate has elevated legal issues pertaining to investments deeper into the core of public international law. And in doing so, international investment law, or, broadly, international economic law, has risen to the glass ceiling of the international legal system. In that ascent, international investment law and international intellectual property law forms two of the main pillars that holds the foundation of the current system of international law. Nowadays international financial law is also rising to the upper echelons of the ceiling, but that argument is for elsewhere.

Generally, international investment law has been able to support the rise of international intellectual property law through the various intellectual property clauses and provisions that are found in investments agreements

---

114. While it is not prudent to go into the semantics and scope of international investment law, there is plenty of academic literature that have covered this discipline. My concern is rather one of the principle that has been at the heart of international investment law — fair and equitable treatment. For general reading on international investment law, see, e.g., IOANA TUDOR, THE FAIR AND EQUITABLE TREATMENT STANDARD IN THE INTERNATIONAL LAW OF FOREIGN INVESTMENT (2008); RAINER HOFFMAN & CHRISTIAN TAMMS, INTERNATIONAL INVESTMENT LAW AND GENERAL INTERNATIONAL LAW: FROM CLINICAL ISOLATION TO SYSTEMATIC INTEGRATION? (2011); ANDREW NEWCOMBE & LLUÍS PARADELL, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT (2009); ROLAND KLÄGER, 'FAIR AND EQUITABLE TREATMENT' IN INTERNATIONAL INVESTMENT LAW (2011); MARTINS PAPARINSKIS, THE INTERNATIONAL MINIMUM STANDARD AND FAIR AND EQUITABLE TREATMENT (2013).

that are governed under international investment law.[115] For one academic scholar — intellectual property issues in international investments were, at one point, likened to a sleeping giant.[116] I, however, submit that this is no longer the case, given the *Eli Lilly*[117] decision has changed the dynamics regarding the issue of intellectual property as investments.

One crucial element (or principle) of international investment law that has an impact on international intellectual property law is the notion of "fair and equitable treatment" ("FET") — a doctrine that the United States actively promoted from 1949.[118] This ubiquitous doctrine in international investment law not only presents a paradox for both international intellectual property law and international investment law, but also goes to the heart of the relationship between international private law and public international law. For private economic operators, the primary vehicle in the international legal system that is advantageous to their "investments" is international economic law as broadly defined. Yet, at the same time, international economic law is part of the state's arsenal of public international law. Hence, the paradox lies in part between the normative conflicts for both sets of laws — as they, technically address, different regulatory aims.

The rise of international investment law as a discipline is largely a result of the proliferation of global *ad hoc* investor state dispute settlement (ISDS) tribunals, which give private parties a means of recourse to litigation in disputes that normally involve private and government parties.[119] The most

115. This argument is explored in more detail below where I discuss "Lex Cosmopolis." *See infra* Section 5.D.

116. *See* Bryan Mercurio, *Awakening the Sleeping Giant: Intellectual Property Rights in International Investment Agreements*, 15 J. INT'L ECON. L. 871 (2012).

117. Eli Lilly v. Gov't of Can., ICSID Case No. UNCT/14/2, Final Award (Mar. 16, 2017). See also, postscript to this text.

118. Through United States' initiatives in the 1940s and 1950s, the principle of fair and equitable treatment began as part of the International Code of Fair Treatment for Foreign Investors, through the International Chamber of Commerce, targeting private investments per se, but as part of public international law. *See* Mona Pinchis-Paulsen, *The Ancestry of Equitable Treatment in Trade: Lessons from the League of Nations During the Inter-War Period*, 15 J. WORLD INV. & TRADE 13 (2014).

119. *E.g.*, Alpha Projektholding GmbH v. Ukraine, ICSID Case No. ARB/07/16, Award (Nov. 8, 2010). The first known arbitration case is the Alabama Claims concerning the U.S. and the UK, see Tom Bingham, *The Alabama Claims Arbitration*, 54 INT'L & COMP. L.Q. 1 (2005) (describing the award rendered in 1872 by the Tribunal of Arbitration established by the Treaty of Washington); O. Thomas Johnson Jr. & Jonathan Gimblett, *From Gunboats to BITs: The Evolution of Modern International Investment Law*, *in* YEARBOOK ON INTERNATIONAL INVESTMENT LAW AND POLICY 649 (Karl P. Sauvant ed. 2012) (giving a general account of the history of international investment law); *see also* SURYA P. SUBEDI, INTERNATIONAL INVESTMENT LAW: RECONCILING POLICY AND PRINCIPLE (2008); KATE MILES, THE ORIGINS OF

prominent of these tribunals — the International Centre for the Settlement of Investment Disputes ("ICSID") — has seen plenty a many investment disputes settled via arbitration awards. These investment arbitrations, in general, often refer to public international law; however, the impact they have on the nature of international law itself is another matter.

The fair and equitable treatment principle has been of great concern to both the legal scholarly debate[120] and arbitral tribunals.[121] It is a doctrine that since the 1920s has been controversial, even though its origins, lie in "international criminal law,"[122] for a better sense of the term, and not international economic law. The FET principle is seen as part of the core minimum international protection afforded to investments. This doctrine of international investment law does not stop there.[123] It creeps, or rather, it has a strong foothold on anything that can be deemed as "investments," even intellectual property rights, which are heavily reflected in a number of bilateral treaties or mega-bilateral treaties such as the CETA[124] or the U.S. — Australia FTA.[125]

There is no doubt the FET principle has been more exposed in international investment law as opposed to say, international intellectual property law, where since the 1960s, it has taken up a prominent part of the academic debate in international economic law. Moreover, given that the

---

INTERNATIONAL INVESTMENT LAW: EMPIRE, ENVIRONMENT AND THE SAFEGUARDING OF CAPITAL 2015); INTERNATIONAL INVESTMENT LAW AND COMPARATIVE PUBLIC LAW (Stephan W. Schill ed., 2010).

120. *See supra* note 115 and accompanying text.

121. *E.g.*, PSEG Global Inc. v. Republic of Turk., ICSID Case No. ARB/02/5, Award, ¶ 238–39 (Jan. 19, 2007) ("The standard of fair and equitable treatment has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate. This is particularly the case when the facts of the dispute do not clearly support the claim for direct expropriation, but even there are notwithstanding events that need to be assessed under a different standard to provide redress in the event that the rights of the investor have been breached. Because the role of fair and equitable treatment changes from case to case, it is sometimes not as precise as would be desirable. Yet, it clearly does allow for justice to be done in the absence of the more traditional breaches of international law standards. This role has resulted in the concept of fair and equitable treatment acquiring a standing on its own, separate and distinct from that of other standards, albeit many times closely related to them, and thus ensuring that the protection granted to the investment is fully safeguarded.").

122. *See* L. F. H. Neer (U.S. v Mex.), 4 R.I.A.A. 60 (Gen. Claims Comm'n 1926).

123. *See* discussion *infra* Section .B.

124. Comprehensive Economic and Trade Agreement Between Canada of the One Part, and the European Union and its Member States, of the Other Part, Can.-E.U., Oct. 30, 2016, http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf .

125. Free Trade Agreement, U.S.-Austl., May 18, 2004, 118 Stat. 919 These are discussed in more detail in the paper below. *See infra* Section IV.B.

WTO has changed the nature of public international law to a more purely economic driven one as opposed to the pre-WTO conception of public international law — an instrument of war and peace in broad terms — the FET principle must also be examined in the context of international intellectual property law and the international legal implications for the relationship between international private law and public international law.

The FET umbrella of ensuring private economic operators can manuever public international law without too much entanglement with the state, reflecting the paradox of the relationship of international private law and public international law. In whose interest must these laws operate? The state or the private investor? How is FET determined, and what does FET really entail? How does FET as a principle *fare* when it comes to trademarks and international intellectual property law, especially, if such trademarks concern cigarettes and the public health effects of branded cigarette advertising? At the international level, do such questions affect the relationship between different international law regimes?

In this vein, the next section offers a critical examination of the FET principle with the intention of identifying its impact on the relationship of international private law and public intentional law in light of tobacco regulation with its broader implication of intellectual property as investments. Moreover, the discussions also frame the FET principle as part of a culture of privatization that punctuates the discussion in this paper. The discussion in the next section focuses on international investment rules that governs FET and how those rules cross over to international intellectual property.

The FET principle in general, creates the roadmap of determining how it is also seen within the context of international intellectual property law, and subsequently, shapes investment arbitration and disputes settlement at the international level. Thus, the significance of the FET principle in both international investment law and international intellectual property law gives a clearer picture of rules in public international law that are of an economic nature. But more importantly, one will be able to ascertain if such rules create tension or allow public and international private law to operate in harmony.

A subsequent discussion in the following sections is the use of trademarks and plain packaging regulations, where trademarks are seen as intellectual property investments for the purposes of international investment law. This controversial issue raises significant questions on the use of trademarks by private economic operators and the efforts of states to prevent such use of trademarks against public health grounds. This discussion will serve as the main basis to determine the paradox in the relationship between public and international private law and also the legal intricacies that the policy objectives of those laws must address.

C. "Fair and Equitable Treatment" in International Investment Law

i. Legal Characteristics of Fair and Equitable Treatment

Although the principle of fair and equitable treatment is synonymous with international investment law and arbitration, its origins are more copious — a sort of off-the cut claim, when one believes that justice is not being served. And it was in this manner, when an American widow in the 1920s sneered at the Mexican legal system for not affording her "fair and equitable treatment" in the judicial system.[126] For the widow, the Mexican justice system failed to properly investigate the wrongful death of her husband and bring those responsible to justice in which the FET principle emerged.[127] According to the *Neer Claims Commission*, customary international law provides for minimum standards for the treatment of foreign nationals if there had been a denial of justice.[128]

This approach to the denial of justice by the Neer Commission, as a form of unfair treatment, has since been seen in international investment law as "a high threshold for government treatment of foreign investors".[129] What the *Neer Claims Commission* effectively did was to acknowledge the *minimum standards requirement* as a broad principle within customary international law, anchoring the FET principle as well.

As part of customary international law, international economic lawyers and scholars were able to rely on the anchorage of the international minimum standard principle to transpose it to other areas, such as the protection of investments. I am also guilty in this approach. Because, in this Article, I am also making an attempt to make a similar or at least confirm that that approach is right — at least in part to prove my privatization thesis. In any case, the trouble with the *Neer* minimum standards is that it is rather broad, and requires a number of criteria to be met, including those unexpected or

126. *See Neer*, 4 R.I.A.A. at 61 (mentioning how the Mexican authorities might have "acted in a more vigorous and effective way than they did").

127. *See id.*

128. *Id.* at 61–62.("[I]t is in the opinion of the Commission . . . that the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognise its insufficiency. Whether the insufficiency proceeds from deficient execution to an intelligent law or from the fact that the laws of the country do not empower the authorities to measure up to international standards is immaterial.").

129. *See* Subedi, *supra* note 120, at 63.

unwarranted.[130] This broad approach, has also, left some roadblocks along the way — including a precise understanding of what FET actually entails.[131]

For international investment treaties (including multilateral, regional and bilateral), they have adopted or made reference to customary international law in their provisions. The Havana Charter[132] for instance, in Article 11(2)(a)(i), incorporates FET into its provisions, similar to many predecessors of contemporary BITs — Freedom, Commerce and Navigation ("FCNs") treaties. Contemporary treaties such as NAFTA expressly refer to "fair and equitable treatment" in accordance with international law[133] — echoing the *Neer Claims* Commission minimum standards test.

Similarly, in the Canada-Peru BIT,[134] Article 5(1) is also a direct recognition of customary international law as the applicable law, even though such reference alone cannot determine the outcome of cases under those BITs.[135] There is no doubt, that the FET principle, is, nowadays, seen as the *language* of promoting and protecting investments[136] — as opposed to foreign nationals, according to the *Neer Claims* Commission. In any event, the FET principle reflects the protection of foreigners in customary international law, and also a sense of *fairness* in the distribution and administration of justice.[137]

---

130. *See, e.g.*, Pope & Talbot, Inc. v. Gov't of Can., NAFTA Ch. 11 Arb. Trib., Interim Award (2000); *see also infra* note 138 and accompanying discussion.

131. *See* MTD Equity v. Chile, ICSID ARB/01/07, Award, ¶ 109 (May 25, 2004) ("[T]he meaning of what fair and equitable is defined when that standard is applied to a specific set of facts . . . .").

132. Havana Charter for an International Trade Organisation art. 11(2)(a)(i), March 24, 1948, 62 U.N.T.S. 26 (calling for assurance that "just and equitable treatment for the enterprise, skills, capital, arts and technology brought from one Member country to another").

133. *See* North American Free Trade Agreement art. 1105, Dec. 8, 1993, 32 I.L.M. 670 ("Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.")

134. Agreement between Canada and the Republic of Peru for the Promotion and Protection of Investments, Can.-Peru, November 14, 2006.

135. *See, e.g.*, Glamis Gold, Ltd. v. United States, Award (NAFTA Arb. Trib. June 8, 2009) (devoting a substantial amount of analysis on the nature and scope of FET in customary international law and finding that expropriation did not occur and dismissed the claims of the investor).

136. *See MTD Equity*, ICSID ARB/01/07, ¶ 113 ("[F]air and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. Its terms are framed as a proactive statement — 'to promote,' 'to create,' and 'to stimulate' — rather than prescriptions for a passive behaviour of the State or avoidance of prejudicial conduct to the investors.").

137. *See* Elihu Root, *The Basis of Protection to Citizens Residing Abroad*, 4 AM. J.

ii. Fair and Equitable Normative Standards: Thou Shalt Not Alter Thy (Intellectual Property) Investments

The FET principle has given rise to a number of standards[138] including unexpected and unwarranted legislations that may jeopardize investments.[139] These standards, including those mentioned here,[140] are still evolving, but for the purposes of the discussions here I am concerned with how states alter investments through legislative actions that can be deemed as unexpected or unwarranted. The classic example is tobacco legislations affecting trademarks[141] with some of those cases arbitrated in ICSID tribunals and at the dispute settlement body of the WTO.

The ICSID, one could argue, is by far the most important international tribunal, that, in principle, is responsible for the evolution and interpretation of fair and equitable standards. Thus, it is not surprising that it is those ICSID cases that are responsible for these standards when confronted with the

INT'L L. 517, 521–22 (1910) ("There is a standard of justice, very simple, very fundamental, and of such general acceptance by all civilised countries as to form a part of the international law of the world. The condition upon which any country is entitled to measure the justice due from it to an alien by the justice which it accords to its own citizens is that its system of law and administration shall conform to this general standard. If any country's system of law and administration does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment of its citizens."); *see also* Rudolf Dolzer, *Fair and Equitable Treatment: Today's Contours*, 12 SANTA CLARA J. INT'L L. 7 (2014).

138. The standards that states must ensure to the investor include the unnecessary revocation of investment permit; the state must not renege on representations made to the investor; ensuring all legal requirements for the operation of the investment are accessible to the investor; freedom from bias in conduct towards an investor by the administrative apparatus of the state; ensuring that administrative requirements placed at the state of the investment project are not made more onerous during its operation; freedom from unexpected and unwarranted conduct by the host state; application of strands of public law liability to courts; and freedom from discriminatory conduct by the host state or state bodies. *See, e.g.*, Metaclad Corp. v. United Mexican States, ICSID Case No. ARB/(AF)/97/1, Award (Aug. 30, 2000); Incesya Vallisoletana S.L. v. Republic of El Sal., ICSID Case No. ARB/03/26, Award (Aug. 2, 2006); Champion Trading Co. v. Arab Republic of Egypt, ICSID Case No. ARB/02/9, Award (Oct. 27, 2006); Waste Mgmt. Inc. v. United Mexican States, ICSID Case No. ARB(AF)/98/2, Award (Apr. 30, 2004). For a discussion on these standards, see Abhijit P.G. Pandya, INTERPRETATIONS AND COHERENCE OF THE FAIR AND EQUITABLE TREATMENT STANDARD IN INVESTMENT TREATY ARBITRATION (2011). *See also* Kenneth J. Vandevelde, *A Unified Theory of Fair and Equitable Treatment*, 43 N.Y.U. J. INT'L L. & POL. 43 (2010); Stephen Vasciannie, *The Fair and Equitable Treatment in International Investment Law and Practice*, 1999 BRIT. Y.B. INT'L L. 99 (2000).

139. Pope & Talbot, Inc. v. Gov't of Can., Interim Award (NAFTA Arb. Trib. 2000).

140. *See supra* note 138.

141. *E.g. Tobacco Plain Packaging Act 2011* (Cth) (Austl.).

interpretation of fair equitable treatment. One such standard — an obligation by the state to protect investments through domestic legislations without altering the regulatory regime to negatively affect the investor — has been addressed in *Tecmed,*[142] where that tribunal noted that it was the onus of the host state to protect investments through legal means.[143] One of the principal issues in *Tecmed* was whether Mexico violated Tecmed's right to receive fair and equitable treatment, and the tribunal held that *Tecmed* did not get such fair and equitable treatment from Mexico.[144]

Arguably, investment agreements are contracts in the broad sense of the term, and litigations often arise due to breach of contract. Taking this same argument to investment agreements, if a host-state breaches its obligations under an investment agreement, or fail to provide adequate legal protection for the investor, the host state can be deemed to have acted in bad faith. A legislation that expropriate investor's property is an example where a state can act in bad faith. States, however, often enact legislation or engage in other arbitrary conduct that unexpectedly affect the investments.[145] The negative effects of such legislation that affects investments gives rise to breach of contract, or the investment agreement, in this instance. Furthermore, such actions signal to other investors that the business environment in the host state is not stable.

This was the view taken in *PSEG v. Turkey*, where that tribunal explained that it was "not only the law that kept changing but notably the attitudes and

142. Tecnicas Medioambientales Tecmed S.A. *v.* United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, (May 29, 2003), 10 ICSID Rep. 130 (2004).

143. *Id.* ¶ 154 ("The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments . . . . The foreign investor also expects the host State to act consistently, i.e.[,] without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to use the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments, and not to deprive the investor of its investment without the required compensation.").

144. *Id.* ¶¶ 60, 152–60, 198.

145. *See* Metalclad Corp. v. United Mexican States, ICSID Case No. ARB/(AF)/97/1, Award, ¶¶ 74–76 (Aug. 30, 2000) (noting that that arbitrary conducts may lead to a breach of fair and equitable treatment); *see also Tecmed*, ICSID Case No. ARB(AF)/00/2, ¶ 154; Waste Mgmt., Inc v. United Mexican States, ICSID Case No. ARB(AF)/00/3, Award, ¶ 98 (Apr. 30, 2004); Pope & Talbot, Inc. v. Government of Canada, Interim Award (NAFTA Arb. Trib. 2000) (noting conduct that interferes with the investment is unexpected and unwarranted).

polices of the administration."[146] As laws keep changing based on government policies, the fair and equitable treatment of the investor are contractually interfered with. In order to prevent such scenarios, domestic laws must be enacted to give adequate level of protection to investors, in the event that unexpected and unwarranted legislations are introduced by the host state.[147]

When States fail to enact legislation to protect investors or enact legislation that interferes with the fair and equitable treatment of foreign investors, such legislations are often aimed at "expropriating" the property of foreign investors. Although such actions are sometimes unwarranted or arbitrary, the property focus has always been on real (physical) property. What often goes unnoticed is the concern for intellectual property. Any interference with the intellectual property rights of the investor by the host state can lead to the loss of economic benefits to the investor, and such interference can come in the form of taking of contract rights or the imposition of unreasonable regulatory measures. Such actions are in essence, the expropriation of intellectual property rights.

Intellectual property rights form a significant part of the investor's contractual rights, and therefore, are factored into the equation when compensations are being sought for expropriation of investments. Article I(1)(c)(iv) of the BIT in *PSEG v. Turkey* defines investment to include "intellectual and industrial property, including rights with respect to copyrights, patents, trademark, trade names, industrial designs, trade secrets and know-how, and goodwill."[148] With this definition, all assets including industrial property rights are covered under the BIT,[149] and unexpected or unwarranted regulatory measures, that favor only the host state, can be seen as expropriation[150] of the investor's intellectual property rights or breaching the investor's fair and equitable treatment.

From this account, intellectual property investments fall within the public/private international law divide and are essential to the economic

146. PSEG Global Inc. v. Republic of Turk., ICSID Case No. ARB/02/05, Award, ¶ 254 (Jan. 19, 2007).

147. *See* Enron Corp. v. Arg. Republic, ICSID Case No. ARB/01/3 (July 30, 2010), ¶¶ 236, 268–69, 286 (noting that regulatory measures taken by the state were unreasonably interfering with the investor's property rights, and as such, breached the fair and equitable treatment of the investor).

148. *PSEG Glob. Inc.*, ICSID Case No. ARB/02/05, Award, ¶ 66.

149. Treaty between the United States of America and the Republic of Turkey Concerning Reciprocal Encouragement and Protection of Investments, U.S.-Turk., Dec. 3, 1985, T.I.A.S. No. 90-518 (entered into force May 18, 1990).

150. Expropriation in this context, also means the same as when describing expropriation for other forms of property, such as physical property.

benefits of nation states. But because intellectual property rules are propelled from the domestic law of the nation state to the international paradigm, and in particular here, where intellectual property is seen as investments under international investment law, the global rule-making content of public and private international law are expanding in which it is hard to make a distinction.

iii. Intellectual Property Investments as Sources of Fair and Equitable Treatment

Are intellectual property investments sources of fair and equitable treatment? Given that in some bilateral investment treaties an investment is defined as including intellectual property, then it is safe to argue that intellectual property rights are in fact sources of fair and equitable treatment.[151] We can gain further insight into this question apart from the *PSEG v. Turkey* decision by taking a further look at other ISDS decisions where the object of intellectual property was mentioned in the decision as per the BIT.

Using the ICSID database, forty-six cases (46) were selected from a total of 176 that were based on the search criteria: where the case has been (1) concluded; and (2) published materials, (a) award and (b) decision.[152] The

151. *See, e.g.*, PSEG Glob. Inc. v. Republic of Turk., ICSID Case No. ARB/02/05, Decision on Jurisdiction (June 4, 2004).

152. The cases points mostly to the BIT provision where intellectual property forms part of the definition of an investment: El Paso Energy Int'l. v. Argentine Republic, ICSID Case No. ARB/03/15, Award, ¶ 143 (Oct. 31, 2011); ADC Affiliate v. Hung., ICSID Case No. ARB/04/16, Award of the Tribunal, ¶ 295 (Oct. 2, 2006); SGS Société Générale de Surveillance S.A. v. Republic of the Phil., ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, ¶ 62 (Jan. 29, 2004); *PSEG Glob. Inc.,* ICSID Case No. ARB/02/05, Award, ¶ 292; Tradex Hellas S.A. v. Republic of Alb., ICSID Case No. ARB/94/2, Award, ¶ 105 (Apr. 29, 1999); Fireman's Fund Ins. v. United Mexican States, ICSID Case No. ARB(AF)/02/1, Award, ¶ 170 (July 17, 2006); Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1, Award, ¶ 170 (Dec. 16, 2002); Cont'l Cas. Co. v. Argentine Republic, ICSID Case No. ARB/03/9, Award, ¶ 240 (Sept. 5, 2008); MCI Power v. Republic of Ecuador, ICSID Case No. ARB/03/6, Decision on Annulments, ¶ 72 (Oct. 19, 2009); Siemens v. Argentine Republic, ICSID Case No. ARB/02/8, Decision on Jurisdiction, ¶ 150 (Aug. 3, 2004); Bureau Veritas , Inspection, Valuation, Assessment & Control, BIVAC B.V. v. Republic of Para., ICSID Case No. ARB/07/9, Decision of the Tribunal on Objections to Jurisdiction, ¶¶ 15, 80 (May 29, 2009); Minnotte v. Republic of Pol., ICSID Case No. ARB(AF)/10/1, Award, (May 16, 2014); Swisslon DOO Skopje v Former Yugoslav Republic of Macedonia, ICSID Case No. ARB/09/16, Award, ¶ 104 (July 6, 2012); Alpha Projektholding GmbH v. Ukr., ICSID Case No. ARB/07/16, Award, ¶¶ 255, 304–06 (Nov. 8, 2010); Burimi SRL v. Republic of Alb., ICSID Case No. ARB/11/18, Award, ¶¶ 94–95 (May 3, 2012); Aguaytia Energy, LLC, v. Republic of Peru, ICSID Case No. ARB/06/13, Award, ¶ 44 (Dec. 11, 2008); Malaysian Hist. Salvors , SDN, BHD v. Gov't of Malay., ICSID Case

sample cases were then searched using the separate keywords "property" and "intellectual" and concerned or contained references to "intellectual property" are discussed.[153] The search was carried out May 10 2016. Nine of those cases are also significant and the relevant BIT they correspond to.[154] Only the English language cases were selected for this sample.

"Property" as a term turned up in almost all the searches, and variably referred to immovable/intangible/physical property. However, where "intellectual property" was referred to, was mostly in relation to a provision in the BIT. The result is that the intellectual property provisions are modelled off "Model BIT" agreements.

No. ARB/05/10, Award on Jurisdiction, ¶ 139 (May 17, 2007); Phoenix Action Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Award, ¶ 56 (Apr. 15, 2009); Bayview Irrigation v. United Mexican States, ICSID Case No. ARB/(AF)/05/1, Award, ¶ 50 (June 19, 2007); Desert Line Projects LLC v. Republic of Yemen, ICSID Case No. ARB/05/17, Award, ¶ 92 (Feb. 6, 2008); Daimler Fin. Servs. AG v. Argentine Republic, ICSID Case No. ARB/05/1, Award, ¶ 82 (Aug. 22, 2012); Glob. Trading Res. Corp. v. Ukr., ICSID Case No. ARB/07/11, Award, ¶ 47 (Dec. 1, 2010); Rompetrol Grp. N.V. v. Rom., ICSID Case No. ARB/06/3, Award, ¶ 106 (May 6, 2013); Occidental Petroleum v. Ecuador, ICSID Case No. ARB/06/11, Award, ¶ 867 (Oct. 5, 2012); Electrabel S.A. v. Republic of Hung., ICSID Case No. ARB/07/19, Award, (Nov. 25, 2015); Biwater Gauff Ltd. v. Un. Repuiblic of Tanz., ICSID Case No. ARB/05/22, Award, ¶ 242 (July 24, 2008); AES Summit v. Republic of Hung., ICSID Case No. ARB/07/22, Award, ¶ 6.2.5 (Sept. 23, 2010); Pantechniki v. Republic of Alb., ICSID, Case No. ARB/07/21, Award, ¶ 33 (July 30, 2009); GEA Grp. v. Ukr., ICSID Case No. ARB/08/16, Award, ¶ 138 (Mar. 31, 2011); KT Asia Inv. Grp. v. Republic of Kaz., ICSID Case No. ARB/09/8, Award, ¶ 89 (Oct. 17, 2013); CEMEX Caracas Invs. B.V. v. Bolivarian Republic of Venez., ICSID Case No. ARB/08/15, Decision on Jurisdiction, ¶ 150 (Dec. 30, 2010); Levy v. Republic of Peru, ICSID Case No. ARB/10/17, Award, ¶ 62 (Feb. 26, 2014); Arif v. Republic of Mold., ICSID Case No. ARB/11/23, Award, ¶¶ 326, 361 (Apr. 8, 2013); Tamimi v. Sultanate of Oman, ICSID, Case No. ARB/11/33, Award, ¶ 277 (Nov. 3, 2015); Malicorp Ltd. v. Arab Republic of Egypt, ICSID Case No. ARB/08/18, Award, ¶ 108 (Feb. 7, 2011); Rafat v. Republic of Indon., ICSID Case No. ARB/11/13, Award on Jurisdiction, ¶ 43 (July 16, 2013); Caratube v. Republic of Kaz., ICSID Case No. ARB/08/12, Decision on the Annulment Application of *Caratube Int'l Oil Co.*, ¶ 56 (Feb. 21, 2014).

153. *See supra* note 153.

154. These are: Emmis et Al v Hungary, ICSID Case No. ARB/12/2 (16 April 2014), ¶¶ 135, 178; Accession Mezzanine Capital L.P et al v Hungary, ICSID Case No. ARB/12/3 (Jurisdiction) (17 April 2015), ¶ 24; ATA Construction, et al v Jordon, ICSID Case No. ARB/08/2) 18 May 2010, ¶ ¶, 59, 96; Ambiente Ufficio S.p.A and others v Argentine Republic, ICSID Case No. ARB/08/9 (Jurisdiction) 8 February 2013), ¶ 418; Bosh International, et al v Ukraine, ICSID Case No. ARB/08/11 (25 October 2012), ¶ 102; OKO Pankki Oyj and Others v Republic of Estonia, ICSID Case No. ARB/04/6 (17 November 2007), ¶ 178; OKO Pankki Oyj and Others v Republic of Estonia, ICSID Case No. ARB/04/6 (17 November 2007); Corn Products International, Inc., v United Mexican States, ICSID Case No. ARB(AF)/04/1 (Decision on Responsibility) (15 January 2008), ¶ 113; Plama Consortium Limited v Republic of Bulgaria, ICSID Case No. ARB/03/24 (27 August 2008); Industria Nacional de Alimentos, S.A et al v Republic of Peru, ICSID Case No. ARB/03/4 (7 February 2005), ¶ 25.

The survey and cases classify intellectual property as "investments." Furthermore, such classification follows a standard definition in all the BITs, with only a few definitions of intellectual property as investments went beyond the standard definition to include explicit categories.

In *El Paso Energy* for instance, the Tribunal notes that the type of investments that the BIT defines concern those "having economic value," and in the case of intellectual property this is important, given that "any right conferred by law or contract, and any licenses and permits pursuant to law" amount to investment.[155] In other words, investments under BITs cover any economic input, and intellectual property is significant economic input in any investment.[156]

Thus, in *SGS v. Philippines*, one of the core claims in relation to intellectual property was the transfer of knowledge (know-how), which was considered as an investment: "The said activities are considered by SGS as 'an investment within the definitions of Article I(2)(d) of the BIT: 'copyrights, industrial property rights, know-how and goodwill,' as well as within the BIT's general catch-all definition of investments as every kind of asset.' "[157]

The Tribunal did not consider further this claim; however, it is important because within the paradigm of international law, property can be construed broadly[158] even if "property" also involves intellectual property, and such interpretation does not explicitly refer to international or national intellectual property instruments.

States that resort to discrimination in terms of intellectual property investments, such as protection of the intellectual property rights in relationships between producer and reseller, violate international law.[159] Thus, under such circumstances, intellectual property investments are not accorded fair and equitable treatment within the meaning and purpose of investments under international investment law and broader protection of

155. *El Paso Energy Int'l Co.*, ICSID Case No. ARB/03/15, Award, ¶ 201; *see also* El Paso Energy Int'l Co. v. Argentine Republic, ICSID Case No. ARB/03/15, Decision on Jurisdiction, ¶ 50 (Apr. 27, 2006).

156. *See Swisslon DOO Skopje*, ICSID Case No. ARB/09/16, Award., ¶¶ 104, 284; *see also Aguaytia Energy*, *LLC*, ICSID Case No. ARB/06/13, Award, ¶ 44 (citing a stabilization clause that lists the right to repatriate earnings as a result of an intellectual property, such as transfer of technology, licensing, and trademarks).

157. *See SGS*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, ¶ 62.

158. *See Tradex Hellas S.A.*, ICSID Case No. ARB/94/2, Award, ¶ 106.

159. *See* Karpa v. United Mexican States, ICSID Case No. ARB(AF)/99/1, Award, ¶ 170 (Dec. 16, 2002).

aliens under international law. The *Draft Convention on the International Responsibility of States for Injuries to Aliens* refers to the "unreasonable interference with the use . . . of property" — and this also includes intellectual property.[160]

The linkage and inclusion of intellectual property as part of the definition of investments in the BITs, as seen through the cases in this section, confirms that within the broader context of international law, any deprivation of property, broadly construed to include intellectual property, violates international law and the obligation of states to "foreign investors."[161]

The fair and equitable treatment of intellectual property investments in BITs forms part of the broader non-discriminatory obligations of national treatment and MFN principles under international law. The ICSID cases such as *Tecmed*, *EDF*,[162] and *Waste Management*,[163] have confirmed that, in light of the good faith principle established by international law, fair and equitable treatment requires the State to "provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment."[164] Furthermore, in *Saluka*,[165] the fair and equitable treatment have also been elaborated on as to include "an assessment of the state of the law,"[166] and as such, the investments also include intellectual property laws.

Although majority of the cases reveal that intellectual property was merely included in the BITs as a general clause, as part of the definition of investments, the survey shows that that has been the trend in most of the older BITs. However, newer BITs, in particular, the post-1990 BITs, tend to go beyond the general intellectual property model clause and include full provisions on the protection of intellectual property. Thus, for instance, the *US — Poland Treaty* contains a full provision on the protection of

160. Louis B. Sohn & R. R. Baxter, *Responsibility of States for Injuries to the Economic Interests of Aliens: II. Draft Convention on the International Responsibility of States for Injuries to Aliens*, 55 AM. J. INT'L L. 548, 553 (1961).

161. Tokelés v. Ukr., ICSID Case No. ARB/02/18, Award, ¶ 111 (Jul. 26, 2007); *see also* Genin v. Republic of Est., ICSID Case No. ARB/99/2, Award, ¶ 368 (June 25, 2001).

162. EDF (Servs.) Ltd. v. Rom., ICSID Case No. ARB/05/13, Award, ¶ 216 (Oct. 8 2009).

163. Waste Mgmt., Inc. v. United Mexican States, ICSID Case No. ARB(AF)/00/3, Award, ¶ 98 (Apr. 30, 2004).

164. Tecnicas Medioambientales Tecmed S.A. v. United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, ¶ 154 (May 29, 2003).

165. Saluka Invs. B.V. v. Czech Republic, Partial Award, ¶ 301 (Perm. Ct. Arb. Mar. 17, 2006), available at http://ita.law.uvic.ca/documents/Saluka-PartialawardFinal.pdf.

166. *Id*.

intellectual property.[167] And as will be seen later in the Article, the emergence of super-BITS, such as the *US — Australia FTA* have substantial intellectual property provisions that provide more clarity on the meaning and texture of intellectual property as investments.[168]

An interesting observation from the survey findings above is that outside of NAFTA members, almost all the other disputes involved states that are outside of Western Europe, that is, mostly former Eastern Bloc European states, South American states and occasionally an African or Asian state. The involvement of these states often relies on the invocation of international law for fair and equitable treatment by the investor where the outcome was always a violation of international law and/or, the host state did not provide fair and equitable treatment to the investor.[169] In other words, traditional capitalist states often triumphed over emerging capitalist states.

Although the ICSID case law has not convincingly developed international normative standards on intellectual property, they have, however, shown that the linkage between fair and equitable treatment and intellectual property investments are emerging global norms. Taken in this light, then, arguably intellectual property investments are sources of fair and equitable treatment under international law.

The practice of the ICSID in one breadth embodies the sources of public international law,[170] as the tribunal interprets international conventions in as much as they relate to international investments.

The ICSID tribunals also recognizes customary international law and the general principles of international law. Moreover, the ICSID tribunal engages and recognizes judicial decisions and teachings of qualified publicists, and in this way, the ICSID is quicker to respond to the changing dynamics of contemporary international law, which is increasingly shaped by investments. Taking into account Article 38(1)(d) of the ICJ Statute, ICSID tribunals generate sources of international law as it refers to "judicial

167. *Treaty between the United States of America and the Republic of Poland concerning Business and Economic Relations*, art. IV, U.S.-Pol. Mar. 21, 1990, T.I.A.S. No. 94-806 (entered into force Aug. 6, 1994).

168. Free Trade Agreement, U.S.-Austl., May 18, 2004, U.S.T.R., ch. 17 (entered into force Jan.1, 2005).

169. *See, e.g.*, Occidental Petroleum Corp. v. Republic of Ecuador, ICSID Case No. ARB/06/11, Award, ¶ 876 (Oct. 5, 2012) (finding that Ecuador breached the investment treaty by failing to provide fair and equitable treatment and national treatment as per required under intentional law).

170. *See* Statute of the International Court of Justice art. 38, June 26, 1945, 59 Stat. 1031, 33 U.N.T.S. 993.

decisions" as "subsidiary means for the determination of rules of law."[171] Furthermore, Article 42(1) of the ICSID Convention, in the same vein, acknowledges ICSID international law making as sources of international law. That provision reads:

> The Tribunal shall decide in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and *such rules of international law as may be applicable*.[172]

The reference to international law in the ICSID Convention, and ICSID tribunals as sources of international law, has to some extent been clarified by ICSID's own case law, such as *Liman Caspian Oil*[173] and an early report by the ICSID Directors in 1965.[174] This is not an explicit reference of the existence of sources of ICSID as sources of international law per se, yet there is no contention that this is not the case, and as the ICSID acknowledges in *AWG v Argentina*,[175] like cases that determines the outcome and process of international law, should be decided alike.

D. Tobacco Regulation: Fair and Equitable Treatment

i. Legislative Development Regarding Tobacco Regulation

The rise in the consumption of cigarettes and attempts to regulate tobacco have been more than a hundred years in the making according to one observer.[176] Questions regarding tobacco regulation are always controversial

---

171. *See id.* art. 38(1)(d).

172. ICSID Convention, *supra* note 24, art. 42 (emphasis added).

173. Liman Caspian Oil BV v. Republic of Kaz., ICSID Case No. ARB/07/14, Award, ¶ 172 (June 22, 2010); *see also* Alian Pellet, *The Case Law of the ICJ in Investment Arbitration*, 28 ICSID REV. 223 (2013).

174. Pellet, *supra* note 173, at 227 n.21 (citing Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ¶ 40 (Mar. 18, 1965), compiled in ICSID CONVENTION, RULES AND REGULATIONS, at 47, ICSID/15 (Apr. 2006), available at http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf) ("The term 'international law' as used in this context should be understood in the sense given to it by Article 38(1) of the Statute of the International Court of Justice, allowance being made for the fact that Article 38 was designed to apply to inter-State disputes.").

175. *See* AWG Grp. Ltd. v. Argentine Republic, ICSID Case No. ARB/03/19, Decision on Liability, ¶ 189 (July 30, 2010).

176. *See generally* Heather Wipfli & Jonathan M. Samet, *One Hundred Years in the Making: The Global Tobacco Epidemic*, 37 ANN. REV. PUB. HEALTH 149 (2016)

because they touch all sides of society, including policy and politics at the domestic and international level, health and safety, and naturally legal regulation.[177] The most divisive aspect of tobacco regulation concerns plain packaging — that is, legislation enacted requiring manufacturers to conceal or minimize their trademarks on cigarette packs.[178]

There are two primary reasons why tobacco regulations have been enacted. The first is that early tobacco legislation was concerned about fire hazards, and such legislation was prevalent in the nineteenth and early twentieth century (mostly in the developed world).[179] Some countries also had legislation that made it illegal to sell cigarettes to minors.[180] The second reason is that of health. The year 1964 marked a pivotal role in the efforts to regulate tobacco, because it was in that year that the Surgeon General of the United States issued a report detailing with the adverse health consequences of smoking.[181] As a result of that report, various efforts to regulate the tobacco industry were launched in a number of U.S. states.[182] However, it is Canada and Uruguay that hold the record for introducing the first tobacco control regulations via plain packaging laws in their domestic legal setting.[183]

But with the Australia Plain Packaging Act of 2011, several other countries followed suit and implemented plain packaging legislation. These include Indonesia, Chile, and Ireland.[184] In the EU, a Directive has also been enacted.[185]

(describing how the tobacco epidemic began in latter half of the nineteenth century while efforts at regulation did not begin until the latter half of the twentieth century).

177. See HOLLY JARMAN, THE POLITICS OF TRADE AND TOBACCO CONTROL (2015) (giving a concise and practical discussion on tobacco regulation in a global context). Other notable works include, PUBLIC HEALTH AND PLAIN PACKAGING OF CIGARETTES: LEGAL ISSUES (Tania Voon et al. eds., 2012); LAWRENCE O. GOSTIN, GLOBAL HEALTH LAW (2014); THE GLOBAL TOBACCO EPIDEMIC AND THE LAW (Andrew D. Mitchell & Tania Voon eds., 2014); and LUKAS VANHONNAEKER, INTELLECTUAL PROPERTY RIGHTS AS FOREIGN DIRECT INVESTMENTS: FROM COLLISION TO COLLABORATION (2015).

178. *See* Mark Davison, *Plain Packaging of Tobacco and the "Right" to Use a Trade Mark*, 34 EUR. INTELL. PROP. REV. 498, 498 (2012) (noting Australia's controversial plain packaging legislation).

179. Wipfli & Samet, *supra* note 176, at 150–51.

180. *See, e.g.,* Tobacco Restraint Act, S.C. 1908, c. 73 (repealed 1994).

181. Wipfli & Samet, *supra* note 176, at 150.

182. *See id.*

183. *See* JARMAN, *supra* note 177, at 31.

184. *Id.*

185. Directive 2014/40, of the European Parliament and of the Council of 3 April 2014 on the approximation of the laws, regulation and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC, 2014 O.J. (L 127) [hereinafter Directive

Since the 1960s in Australia, several attempts have been made to restrict tobacco advertising, and it was in 1992 that Australia began serious efforts through the passage of the *Tobacco Advertising Prohibition Act*[186] concerning the restrictions on tobacco advertising or use of tobacco products.

The Tobacco Plain Packaging Act of 2011 crystallized the previous efforts on the restriction and use of tobacco.[187] Part 2 of the Act set out the various restrictions that are placed on the retail packaging of the tobacco products and the products contained within that packaging.[188] These allow for the restricted use of trademarks when placing on the tobacco product package and to place health warnings on the product, which are designed to affect the appeal of the product, and in doing so, limit the use of trademarks on the product. In other words, the Act prohibits the use of non-word signs with some exceptions to certain prescribed signs,[189] and the size, font and shape of the mark is also regulated.

From an economic investment point of view, a negative effect of the Tobacco Plain Packaging Act is that it diminishes the use of trademarks and the ability of those trademarks to distinguish goods or services that are dealt within the course of trade by the trademark owner.[190]

The EU's Tobacco Products Directive has also been subjected to court action regarding its legality because of its restrictions on intellectual property in particular trademarks, but the CJEU has found that it to be valid.[191] One of the main points in the Tobacco Products Directive is that it mandates member states to offer "standardization of the packaging of tobacco products" providing there are sufficient justifications, such as on public health.[192]

There are slightly different approaches by the EU and Australia to plain packaging despite pursuing the same policy objectives: the legal instruments use different language between "standardisation" and "restrictions" (or

2014/40].

186. *Tobacco Advertising Prohibition Act 1992* (Cth) (Austl.).

187. *Tobacco Plain Packaging Act of 2011* (Cth) (Austl.).

188. *See id.* ch 2 pt 2 div 1 s 20.

189. *See id.* ch 2 pt 2 div 1 ss 19(2)(ii), 20(2).

190. *See generally* Voon, *supra* note 53 (offering context and overview of the developments in Australia); Davison, *supra* note 179 178 (situating the debate and impact on trademark ownership).

191. *See, e.g.*, Case C-547/14, Philip Morris Brands SARL v. Sec'y of State for Health, ECLI:EU:C:2016:325 (May 4, 2016); Case C-358/14, Poland v. European Parliament, ECLI:EU:2016:323 (4 May 2016); Case C-477/14, Pillbox 38 (UK) Ltd. v. Sec'y of State for Health*,* ECLI:EU:C:2016:324 (May 4, 2016).

192. Directive 2014/40, *supra* note 185, arts. 1, 24(2).

"requirements" as used by the Act) that ought to be met.[193] In any event, despite varying degree of approaches, the ultimate impact is on trademarks for cigarettes, and plain packaging clearly risks obscuring or eliminating trademarks on cigarettes packages. This in turn can affect one of the central function of trademarks — an indication of origin.[194]

At the international level, the treaties and WTO disputes have had an impact on the trajectory of plain packaging laws. For instance, are treaties such as the Framework Convention on Tobacco Control ("FCTC") the main reason why countries are implementing plain packaging laws?

Countries that enacted plain packaging legislations cannot be entirely to blame for the regulated demise of cigarettes trademarks. In fact, most of the blame, if there is to be any, lie with the Framework Convention on Tobacco Control administer by the World Health Organization (WHO).[195] Countries that signed on to the convention, including Australia, are obliged under Articles 11 & 13 to take legislative measures designed to minimize the appeal of tobacco products.[196]

In this regard, international treaties, such as the Tobacco Convention, have a direct hand in how trademarks are used — even if such treaties do not concern intellectual property rights as a subject matter. What this demonstrates is that international treaties often do not seek a unified or harmonised system of norms. This is because on the one hand, investment, trade or intellectual property treaties, promote the use and innovation of intellectual property rights due to their economic value, while on the hand, treaties such as the Tobacco Convention interfere with such objectives by limiting intellectual property use.

These conflicting treaty norms at the international level are not new; however, they could be minimised with special provisions that allows for conflict diffusion. Furthermore, when the terms or obligations in a treaty are ambiguous, states are able to exercise their sovereignty in interpreting treaty

193. *Compare id.* art. 24(2), *with Tobacco Plain Packaging Act of 2011* (Cth) ch 2 pt 2 div 1 s 20 (Austl.), *and* Voon, *supra* note 53.

194. Although these are fundamental arguments, they are not addressed fully here. For further analysis of the EU tobacco products directive through discussion of a number of critical questions, see generally Christian Pitschas, *The New EU Tobacco Products Directive in the Light of TRIPS: Trademarks and the Protection of Public Health*, 9 GLOB. TRADE & CUST. J. 356 (2014).

195. WHO Framework Convention on Tobacco Control, June 29, 2004, 2303 U.N.T.S. 166 (entered into force Feb. 27, 2005).

196. *E.g.*, *id.* art. 11(1)(a) (noting that countries must adopt measures to ensure that "tobacco product packaging and labelling do not promote a tobacco product . . . to create an erroneous impression about its . . . health effects").

ambiguities.[197]

Although plain packaging laws are depicted as a form of victory for public health advocates, it is detrimental for cigarette manufacturers. The objective of plain packaging laws is forcing the removal of trademarks from the products they are meant to identify the source and origin. Furthermore, plain packaging laws are in effect, mandating that trademarks are to be avoided from use during the course of trade or commerce. Where a compromise is found in plain packaging laws to allow the trademark to remain on the cigarette products — such trademark is watered down to block letters without any graphical appeal.[198] In one sense, plain packaging laws allows for the whittling away of trademarks and trademark investments.

Advocates of plain packaging laws also have pointed to the TRIPs Agreement Article 2.1 as a legal basis for the compatibility of such laws. Article 2.1 provides that trademarks can be denied registration if they are contrary to morality, public order, or deceive the public.[199] That provision however refers to registration and not use. The difference cannot be clearer. Plain packaging laws are not seeking to deny registration, rather their purpose is to restrict the use of trademark during the course of trade. As such, Article 2.1 of TRIPs does not relate to use of trademark in the course of trade and cannot be the sound legal reasoning for the justification of plain packaging laws.

ii. Trademarks as Intellectual Property Investments

How does one consider trademarks as investments and especially for the purposes of international treaties that governs investments? Going by any example of the intellectual property provisions in some of the bilateral

197. *See, e.g.*, Appellate Body Report, *European Community — Measures Concerning Meat and Meat Products (Hormones),* ¶ 165, n.154, WTO Doc. WT/DS26/AB/R (adopted Feb. 13, 1998) (quoting OPPENHEIM'S INTERNATIONAL LAW 1278 (9th ed. 1992) ("The interpretative principle of *in dubio mitius*, widely recognised in international law as a 'supplementary means of interpretation,' has been expressed in the following terms: 'The principle of *in dubio mitius* in interpreting treaties, in deference to the sovereignty of the states. If the meaning of a term is ambiguous, that meaning is to be preferred which is less onerous to the part assuming an obligation, or which interferes less with the territorial and personal supremacy of a party, or involves less general restrictions upon the parties.' "); *see also* Nuclear Tests (Austl. v. Fr.), Judgment, 1974 I.C.J. 267, ¶ 44 (Dec. 20).

198. *See, e.g.*, *Tobacco Plain Packaging Act 2011* (Cth) ss 20-25 (Austl.) (restricting the appearance of trademarks and brand names on the outer packaging of tobacco products to specifications designed to mitigate marketing appeal).

199. Agreement on Trade-Related Aspects of Intellectual Property Rights art. 2.1, Apr. 15, 1994, 1869 U.N.T.S. 299, 33 I.L.M. 1197 [hereinafter TRIPS Agreement] (incorporating Article 6 *quinquies* (b) of the Paris Convention).

investment treaties mentioned in the previous section,[200] and elsewhere in this paper, intellectual property, including trademarks forms part of the definition of investments, and as such, the matter is crystal clear. But, for example, in *Alpha Projektholding v. Ukraine*, the Tribunal only mentioned that under the *Austria-Ukraine BIT* (UABIT), certain types of "know-how" or assistance, does not meet the criteria of "intellectual or industrial property rights that qualify as investments under the UABIT."[201]

The intellectual property provision of the UABIT in Article 1(1)(d) defines investment to include "intellectual and industrial property rights, in particular but not exclusively: copyrights, trademarks, patents for inventions, industrial designs and models, technical processes, know-how, trade secrets, trade names and goodwill."[202] Here, again, we can see that concerning the BIT, this is a generic definition. However, the reference to trademarks is thin, and forms part of the meaning of intellectual property for the purposes of the definition of an investment. Therefore, trademarks as mentioned in the UABIT (and most other BITs provisions on intellectual property follow this standard definition) does not leave much for interpretation in the broadest sense.

Apart from WTO disputes regarding plain packaging, especially the June 2018 Panel report, along with *Eli Lily*, some other cases have emerged that touches upon intellectual property investments.[203] In the past, to adequately address the low level of disputes that specifically addressed intellectual property as investments, tribunals were faced with two options. The first was to define investments that include intellectual property within terms of the investment treaty; the second, turned to the tenets of treaty interpretation in international law to ascertain the purpose of treaties that are both related to investments and intellectual property. This latter approach represents a seamless overlap of both areas of law, that is, international intellectual property law and international investment law.[204]

Furthermore, tribunals have engaged in several exercises on defining

---

200. See treaties cited *supra* note 152.

201. Alpha Projektholding GmbH v. Ukr., ICSID Case No. ARB/07/16, *Agreement for the Promotion and Reciprocal Protection of Investments between the Republic of Austria and Ukraine* (UABIT), Award, ¶ 306 (Nov. 8, 2010).

202. *Id*. ¶ 255.

203. *But see* Malaysian Hist. Salvors, SDN, BHD v. Malay., ICSID Case No. ARB/05/10, Investment-An Objective Criterion Under the ICSID Convention, Award, ¶ 54–56 (May 17, 2007); Eli Lilly v. Can., ICSID Case No. UNCT/14/2, Final Award, ¶ 105 (Mar. 16, 2017). See also, postscript.

204. *But see* Susy Frankel, *Interpreting the Overlap of International Investment and Intellectual Property Law*, 19 J. INT'L ECON. L. 121, 122 (2016).

various terms, and the word investment, is no different, in going through such polemic (dictionary) exercise. For the ICSID, it generally turns to the bilateral treaty for a definition of an investment in relation to the dispute under consideration.[205] This approach is more practical and allows for flexibilities when addressing the question of investment for the purposes of international investment norms. This was explicitly acknowledged by the ICSID in *Biwater v. Tanzania*[206] where it noted that "'over the years, many tribunals have approached the issue of the meaning of 'investment' by reference to the parties' agreement, rather than imposing a strict autonomous definition . . . ."[207]

Although, through the ICSID cases, a rigid definition of investments has been avoided, this does not mean that this has always been the case. In fact, various ICSID decisions have revealed a sort of fragmented approach to the definition of investments.[208] For example, the *Salini* test[209] for investments sets five criteria that must be met,[210] and other ICISID decisions, have noted the inflexibilities[211] that a rigid definition of investments, such as in the *Salini*

205. *See, e.g.*, Malaysian Hist. Salvors SDN, BHD v. Malay., ICSID Case No. ARB/05/10, Annulment, ¶ 61 (Apr. 16, 2009) (stating that an investment is as defined in the agreement, and as such, the claim did not relate to an investment within the meaning of Article 25(1)).

206. Biwater Gauff (Tanz.) Ltd. v. United Republic of Tanz., ICSID Case No. ARB/05/22, Award (July 24, 2008).

207. *Id.* ¶ 313, 317 ("[I]t is doubtful that arbitral tribunals sitting in individual cases should impose one such definition which would be applicable in all cases and for all purposes.").

208. *See, e.g.*, Phoenix Action, Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Award (Apr. 15, 2009) (building slightly on the *Salini* test); *Malaysian Hist. Salvors*, ICSID Case No. ARB/05/10, Annulment, ¶ 16. What is responsible for part of the fragmentary approach to investment in the ICSID Tribunals, is in large part, due to the fact that, there is a lack of precedent, and as such, different tribunals enjoy a level of flexibility to apply tests or investment criteria specific to their case. *See* Cristoph Schreur & Matthew Weiniger, *Conversations Across Cases – Is There a Doctrine of Precedent in Investment Arbitration?*, 3 TRANSNATIONAL DISPUTE MGMT (2008).

209. Salini Construttori S.P.A. v. Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction (July 23, 2001) (finding that an international construction contract qualified as an investment for the purposes of the ICSID Convention); *see also* Alex Grabowski, *The Definition of Investment under the ICSID Convention: A Defense of Salini*, 15 CHI. J. INT'L L. 287 (2014).

210. These are (1) duration; (2) regularity of profit and return; (3) assumption of risk; (4) substantial commitment; and (5) significance for the host State's development. *See Salini Construttori*, ICSID Case No. ARB 00/4, Decision on Jurisdiction, ¶ 52; Grabowski, *supra* note 209, at 290

211. *Biwater Gauff Ltd.*, ICSID Case No. ARB/05/22, Award, ¶ 314 ("[T]he Salini test itself is problematic, if as some tribunals have found, the 'typical characteristics' of an investment as identified in that decision are elevated into a fixed and inflexible

test, requires. Moreover, the ICSID Convention itself is silent on the meaning of investment.[212] The Convention avoided giving a definition of the term, despite various attempts during the negotiating process.[213]

Outside of bilateral investment treaties, the definition of investments has also been a source of debate from the perspective of the law of treaties. But such an examination first requires examining the ICSID Convention and in particular Article 25, which states that the Convention is only applicable to "any legal dispute arising directly out of an investment . . . ."[214] This broad term that the Convention simply refers to allows for any commercial activities with economic value to be deemed as investments (and this is certainly true for intellectual property in general), but also opens the definition to be subjected to scholarly ruminations[215] in addition to fragmentary definitions in ICSID decisions.

There is however another silver lining for interpreting the term "investment" that Article 25(1) left hanging in the air: that is, it should be interpreted within its ordinary meaning. The term "investment" is, for all purposes, an economic term, hence, an ordinary meaning should be applied.

According to the Vienna Convention on the Law of Treaties,[216] Article 31, treaties are to be interpreted within their ordinary meaning. This position was endorsed by *Ambiente*, where that Tribunal noted that the:

---

test . . . .").

212. *See* ICSID Convention, *supra* note 24, art. 25(1).

213. Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ¶ 27 (Mar. 18, 1965), compiled in ICSID CONVENTION, RULES AND REGULATIONS, at 47, ICSID/15 (Apr. 2006), available at http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf ("No attempt was made to define the term 'investment' given the essential requirement of consent by the parties, and the mechanism through which Contracting States can make known in advance, if they so desire, the classes of disputes which they would or would not consider submitting to the Centre (Article 25(4))."); *see also Biwater Gauff Ltd.*, ICSID Case No. ARB/05/22, Award, ¶ 312.

214. ICSID Convention, *supra* note 24, art. 25(1).

215. The academic literature is full of various strands, theories, and definitions of investments for the purposes of international law. *See, e.g.*, Julian Davis Mortenson, *The Meaning of Investment: ICSID's Travaux and the Domain of International Investment Law*, 51 HARV. INT'L L.J. 257 (2010); Mavluda Sattorova, *Defining Investment under the ICSID Convention and BITs: Of Ordinary Meaning, Telos, and Beyond*, 2 ASIAN J. INT'L L. 267 (2012); Pia Acconici, *Unexpected Development-Friendly Definition of Investment in the 2013 Resolution of the Institut de Droit International*, 23 ITALIAN Y.B. INT'L L. 69 (2013).

216. Vienna Convention on the Law of Treaties art. 31(1), *opened for signature* May 23, 1969, art. 60, 1155 U.N.T.S. 331 [hereinafter Vienna Convention].

> [R]eliance on the *travaux preparatoires* and the intentions of the parties must not lead to an outcome deviating from the interpretation of Article 25 "in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."[217]

The ordinary meaning approach that *Ambiente* acknowledges, is only one part of a three-part approach to treaty interpretation that the VCLT endorses. Two being the *object* and *purpose* of the treaty, and the third, a contextual approach.

The treaty approach to the definition of investment was the preferred approach in *Malaysian Historical Salvors* by confirming that the meaning of investment emanates from the ordinary meaning given in the treaty,[218] and that, the sole arbitrator did not take into consideration, among other things that the definition of an investment also involves interpreting the *travaux* of the ICSID Convention where the drafters intended to allow investment under Article 25(1) to be defined.[219] For all intents and purposes, the dispute in *Malaysian Historical Salvors* was about intellectual property rights and other non-traditional investments. The company in the dispute signed a contract with the Malaysian government to salvage a shipwreck, and one sticking point was whether the contract and the *process of salvaging* — "know-how" in the language of intellectual property — constituted an investment.[220]

Although the company is registered under Malaysian laws, it is owned by a British national — and hence, the UK-Malaysia BIT ("UKMAB")[221] was invoked. Under the contract — the findings of the shipwreck would constitute historical heritage, and for the purposes of intellectual property, cultural heritage, is to an extent, an allied property right.[222] In any event, the contract states that "[t]he Government and the Salvor 'shall have ownerships of publications and intellectual rights . . . . However the GOVERNMENT

217. Ambiente Ufficio S.p.A v. Argentine Republic, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, ¶ 455 (Feb. 8, 2013) (quoting Vienna Convention, *supra* note 216, art. 31(1)).

218. Malay. Hist. Salvors SDN BHD v. Gov't of Malay., ICSID Case No. ARB/05/10, Decision on the Application for Annulment, ¶ 14 (Apr. 16, 2009).

219. *Id.* ¶ 69

220. *See id.*

221. Agreement for the Promotion and Protection of Investments, U.K.-Malay., May 21, 1981, 1579 U.N.T.S. 11 [hereinafter UK-Malaysia BIT].

222. *See* Justin S. Stern, *Smart Salvage: Extending Traditional Maritime Law to Include Intellectual Property Rights in Historic Shipwrecks*, 68 FORDHAM L. REV. 2489 (2000); Valentina S. Vadi, The *Challenge of Reconciling Underwater Cultural Heritage and Foreign Direct Investment: A Case Study,* 17 ITALIAN Y.B. INT'L L. 143 (2007).

shall not commercially exploit such rights except in so far as to propagate education, tourism, museums, culture and history.' "[223]

Article 59 of the UK-Malaysia BIT defines investments to include "intellectual property rights" without any elaboration.[224] According to the Tribunal, the right granted to salvage can be treated as a business concession under the contract that also involve intellectual property rights: "what is precisely at issue between the Government and the Salvor is a claim to money and to performance under a contract having financial value; the contract involves intellectual property rights . . . ."[225] In other words, the Tribunal in its annulment decision, made it clear that the salvaging contract was an investment, for the purposes of the BIT, and it constituted an economic activity.[226] The sole arbitrator originally found that the salvaging contract was not an investment contract.[227] In light of this, the Tribunal concluded that the contract was an investment — and there can be hardly any room for a different conclusion.[228] Thus, in *Malaysia Historical Salvors*, it has been demonstrated that intellectual property are investments.

Although intellectual property rights are investments, BITs traditionally do not effectively represent intellectual property as investments *per se* in detail. Rather, intellectual property constitutes part of the broad notion of investments; and in some cases, intellectual property too — as a term, is also left undefined, or in-adequate explanation of what it entails. Nevertheless, contemporary super BITs such as the *US — Australia FTA*, have substantive provisions on intellectual property rights, and thereby, change the dynamics on the question of intellectual property as investments when compared to the older type BITS discussed above.[229]

In any event, to adequately address some of the issues raised regarding

223. *Malaysian Hist. Salvors*, , ICSID Case No. ARB/05/10, Decision on the Application for Annulment, ¶ 2 (quoting the salvage contract).

224. UK-Malaysia BIT, *supra* note 221, art. 1, ¶ (1)(iv).

225. *Malaysian Hist. Salvors*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment, ¶ 60; Malaysian Hist. Salvors SDN, BHD v. Gov't of Malay., ICSID Case No. ARB/05/10, Award on Jurisdiction, ¶ 139 (May. 17, 2007) (noting that intellectual properties are investments).

226. *See Malaysian Hist. Salvors*, Decision on the Application for Annulment, ICSID Case No. ARB/05/10, ¶ 61.

227. *Id.*

228. *Id.* ¶¶ 60–61.

229. *See* United States – Australia Free Trade Agreement art. 17.1–17.12, U.S.-Austl., May 18, 2004, 43 I.L.M. 1248 (including provisions regarding remedies to intellectual property right violations, increasing the duration of copyright protection, and establishing the protection of encrypted program-carrying satellite signals under intellectual property rights).

intellectual property investments in the older type BITS, one solution is to go narrower into the specific elements of intellectual property and what they entail especially for investments. Take the case of trademarks for example, which are seen as sign and symbols representing the origin of goods and the economic reach of manufacturers (investors): trademarks, as one court argues, perform an investment function, as the CJEU acknowledges in *Interflora v. Marks and Spencer*,[230] noting that the investment function of trademarks is essential to the economic operator.

According to the CJEU, in order for an infringement to take place, the investment function — one of several functions of trademarks — must be compromised.[231] That investment function the court said, entails the use of the trademark by its economic operator "to acquire or preserve a reputation capable of attracting consumers and retaining their loyalty."[232] Although the CJEU was dealing with specific regional trademark law, the implication of this finding on a global scale is undeniable. This is even more so for investment contracts that can potentially define in broader terms the meaning of intellectual property as investments and how trademarks form part of the core investment.

Another implication of this definition of investment function of trademarks relates to questions of jurisdiction and applicable law, and contracts, involving European companies may potentially refer to the applicable law for intellectual property disputes as that of the national's law home state. But, when the investment function of trademarks is interpreted in the broad economic term associated with investments, it is clear that if trademarks as defined as investments in contracts, then international law has an important role to play by interpreting such contracts in accordance with their meaning.

Furthermore, BITs in general allow the owners of trademarks access to international arbitral tribunals in the event any adverse effect on the investment of trademarks may occur such as expropriation.[233] Given the global nature of goods and services, the functions of trademarks cannot be separated from the protection of trademarks, and BITs often emphasize the need for protection and enforcement of intellectual property rights. The

230. Case C-323/09, Interflora v. Marks & Spencer Plc, ECLI:EU:C:2011:604, ¶ 60–61 (Sep. 22, 2011).

231. *See id*.

232. *Id*. ¶ 60.

233. *See generally* Valentina S. Vadi, *Trade Mark Protection, Public Health and International Investment Law: Strains and Paradoxes*, 20 EUR. J. INT'L L. 773 (2009) (analyzing the protection of trademarks in international investment law).

TRIPs for instance sets out the international legal norms for the protection of trademarks and investors are generally confident that they can rely on international law in this instance to protect their investment rights.[234]

But there are also drawbacks which the investment function of a trademark can lead to. How to reconcile the promotion of investments through intellectual property rights while regulating products such as tobacco that may cause adverse health reactions.

iii. Trademark Use, Plain Packaging Encumbrances and the Law of International Investment

The protection of trademarks under the TRIPs Agreement has afforded trademarks a coveted spot in international law — elevating trademark protection to greater legal certainty. And although TRIPs protection of trademarks are minimum standards — the TRIPs provisions represent established laws that offer protection of trademarks on a regional or national level. Furthermore, the existence of intellectual property provisions in investment treaties also ensures that trademark protection or recourse to arbitral tribunals is available in the event of a breach of treaty terms highlights how significant trademark protection have become in international law.

But despite the importance of trademarks in international law — some states have enacted legislations that affect the very existence of trademarks in global commerce — albeit in relation to certain products that may affect public health. The problem with such regulations is that they go against the very obligation of states in international law in relation to treaties governing investments and intellectual property.

Take Article 20[235] of the TRIPs Agreement as an example. According to this provision, the use of a trademark in the course of trade should not be interfered with.[236] This provision in the TRIPs Agreement imposes an obligation on states not to unnecessarily or unjustifiably encumbered trademarks that forms part of an economic activity.[237] In other words, Article

234. *Id*. at 776–77; TRIPS Agreement, *supra* note 199.

235. TRIPS Agreement, *supra* note 199, art. 20 ("The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as use with another trademark, use in a special form or use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings. This will not preclude a requirement prescribing the use of the trademark identifying the undertaking producing the goods or services along with, but without linking it to, the trademark distinguishing the specific goods or services in question of that undertaking.").

236. *Id*.

237. *See id.*

20 is about government regulation and its limits[238] in investments that concern intellectual property.

The language is strong, clear and blunt, yet states do not appear perturbed by this provision of the TRIPs. Article 20 of the TRIPs Agreement incorporates the language of investment by providing a legal channel of certainty to investors that their intellectual property investment in a host country will not encounter any roadblocks.

Article 20 of the TRIPs Agreement therefore acts like a stabilization clause in investment contracts, and as such, legislations that requires investors to *obscure* their trademarks on cigarettes breaches this obligation of the TRIPs. This is because plain packaging laws are generally justified as special requirements for the purposes of public health, and hence, in principle, are not compatible with Article 20 of the TRIPs Agreement. Plain packaging legislation, in effect unjustifiably encumbered the use of trademarks.

The main concern of Article 20 TRIPs Agreement in relation to trademarks is use — and not the actual protection. A trademark is used in the *course of commerce* when it is able to distinguish the origin of goods and services by a visible affixed sign. Thus, it is vital that trademarks are displayed visibly in order to fulfil the use requirement.

Between the two most powerful trading nations, the United States and the European Union (counted as a nation for the sake of argument), the difference in their trademark laws on trademark use appears only during litigation,[239] despite the similar language. Under U.S. trademark law — the semantics of trademark use is described as "use in [the course of] commerce"[240] whilst in the EU, it is a matter of "trademark use" or "using in the course of trade."[241] For the purposes of trademark use in the course of

---

238. *See* NUNO PIRES DE CARVALHO, THE TRIPS REGIME OF TRADEMARKS AND DESIGNS 417–18 (2d ed. 2011) (describing Article 20 as the most controversial provision of the TRIPs Agreement as regards to trademarks). For Carvalho, the prohibition of use of trademarks via national legislations is in fact "the ultimate encumbrance." *Id.* at 418.

239. The CJEU has, for instance, addressed use in the course of trade as being used in the course of a commercial activity. Case C-17/06, Celine SARL v Celine SA, ECLI:EU:C:2007:39 (2007), ¶ 17. For cases that have different approaches to "use" in both the EU and the United States, the Google AdWord litigations demonstrate this well. *See* Joined Cases C-236/08, C-237-08, C-238/08, Google France, ECLI:EU:C:2009:569, ¶ 57; Rescuecom Corp. v Google Inc., 562 F.3d 123 (2d Cir. 2009) (holding that Google fulfilled the requirement of use in commerce but not the use of in the course of trade).

240. Lanham Act § 1, 15 U.S.C. § 1051(a).

241. This was the language that previous versions of the Trademark Directives in Europe applied. *See e.g.*, Directive 2008/95/EC of the European Parliament and of the Council of 22 October 2008 to approximate the laws of the Member States relating to Trade Marks, 2008 O.J. (L 299/25), art. 5(1), 6(1). The trade mark directives have gone through several modifications, but with little or no changes, the latest being, Directive

trade under EU law, such use is also applicable to external countries which the EU trades with, and where EU law is applicable.

The situation is clearer in the United States, in terms of international trade, and the "use in commerce" provision of the Lanham Act, in the sense that the meaning of "commerce" also involves trade between the United States and another country.[242]

The provisions of the TRIPs Agreement adopt the same language as EU trademark law — "use of a trademark in the course of trade," as set out in Article 20 and Article 16 of the TRIPs Agreement.[243] What is interesting is that Article 20 of the TRIPs Agreement is further supported by several provisions dealing with legitimate interests, such as Articles 13 and 17 on copyright and trademarks respectively.[244]

Article 17 for instance,[245] technically says that laws, such as plain packaging, are not compatible with the TRIPs. Furthermore, according to Article 13 (dealing with copyright in general) limitations and exceptions to exclusive rights of intellectual property (trademarks for the purposes of this section), although allowed, should "not conflict with a normal exploitation" nor "unreasonably prejudice the legitimate interests of the right holder."[246] This powerful reference to legitimate interests acts as a defensive mechanism in treaty conflicts within the international economic and legal treaty system.

As early as in 2000, a WTO Panel endorsed the notation of legitimate interests as a normative claim.[247] Taking this reasoning of *Canada — Patents* — that legitimate interests are normative claims, then, when Article 17 of the TRIPs covering trademarks is factored into the equation, any claims concerning trademarks are also a reflection of the legitimate interests of the trademark owners.[248]

(EU) 2015/2436 of the European Parliament and of the Council of 16 December 2015 to approximate the laws of the Member States relating to trade marks, 2015 O.J. (L 336).

242. Lanham Act § 1, 15 U.S.C. § 1051(a); *see also* Trader Joe's Co. v. Hallatt, 835 F. 3d 960, 972 (9th Cir. 2016).

243. TRIPS Agreement, *supra* note 199, arts. 16, 20.

244. *Id.* arts. 13, 17.

245. *Id.* art. 17 ("Members may provide limited exceptions to the rights conferred by a trademark, such as fair use of descriptive terms, provided that such exceptions take account of the legitimate interests of the owner of the trademark and of third parties.").

246. *Id.* art. 13.

247. Panel Report, *Canada – Patent Protection of Pharmaceutical Products*, WTO Doc. WT/DS114/R (adopted Mar. 17, 200) (explaining that the term "legitimate interests . . . must be defined in the way it is often used in legal discourse — as a normative claim calling for protection of interests that are 'justifiable' . . . .").

248. TRIPS Agreement, *supra* note 199, art. 17.

Article 17 is even more important than the other provisions given that Article 17 provides for exceptions (as what public health tobacco regulations general based their premise) and as such, ought to be seen in a different context.[249] Under no circumstances are trademarks rights (and use) to be compromised. The case for a special circumstance to compromise the rights in trademarks and their use during the course of trade has not been envisaged.

From a purely doctrinal perspective — trademark laws in a domestic context do prescribe that certain trademarks cannot be registered or registration for previously registered marks may be revoked if such marks are offensive among other things. For instance, REDSKINS — formerly used by a U.S. football (not soccer) team is one such mark.[250] But this example does not link with the use in the course of trade requirement in the TRIPs or for that matter, the Plain Packaging Act.[251]

In the Panel Report of June 2018 on the Australian Plain Packaging requirements — the WTO endorsed the notion that it was the prerogative of a nation to enact legislations that intend, as a matter of public policy, to protect public health.[252] At the heart of the dispute, as the claimants maintained, was whether Australia breached international law obligations under the WTO treaty, specifically, the TBT Agreement and TRIPs Agreement.[253] Thus, in relation, to the claims under the TBT Agreement, the Panel agreed that Australia's Plain Packaging law constituted a "technical regulation" and hence, did not breach the TBT Agreement.[254] This *positive* assessment was also upheld in relation to the TRIPs Agreement, as the Panel opined that the plain packaging laws were within the boundaries of the TRIPs

249. *See id.* For an analysis of Article 17, see Katja Weckstrom, *When Two Giants Collide: Article 17 and the Scope of Trademark Protection Afforded under the TRIPs Agreement*, 29 Loy. L.A. Int'l & Comp. L. Rev. 167 (2007); Haochen Sun, *The Road to Doha and Beyond: Some Reflections on the TRIPS Agreement and Public Health*, 15 EUR. J. INT'L L. 123 (2004).

250. After decades of use, the mark was abandoned due to concerns over race. But for some of the legal discussions leading up to the cancellation of the mark see, e.g., Victoria F. Phillips, *Beyond Trademark: The Washington Redskins Case and the Search for Dignity*, 92 CHI. KENT L. REV. 1061 (2017); Jeffrey Lefstin, *Does the First Amendment Bar Cancellation of REDSKINS*, 52 STAN. L. REV. 665 (2000).

251. *Tobacco Plain Packaging Act 2011* (Cth) (Austl.).

252. *See* Panel Rulings of 2018, *supra* note 103, at 162.

253. Agreement on Technical Barriers to Trade, Apr. 15, 1994, 1868 U.N.T.S. 120 [hereinafter TBT Agreement].

254. Panel Rulings of 2018, *supra* note 103, at 162. It should be noted that Article 1 of the TBT Agreement stipulates that technical regulations including packaging "do not create unnecessary obstacles to international trade." TBT Agreement, *supra* note 253, rec. 5.

Agreement.[255] This, "in combination with other tobacco-control measures maintained by Australia, are capable of contributing, and do in fact contribute, to Australia's objective of improving public health by reducing the use of, and exposure to, tobacco products . . . ."[256] For the complainants, Australia, could have in principle adopted different measures to the plain packaging legislations, such as higher taxes or social marketing campaigns to get its message across. The Panel however, disagreed, and made the following observation especially relating to the question of encumbrance:

> [W]e conclude for the purposes of our analysis under Article 20 of the TRIPS Agreement that the complainants have not shown that any of the proposed alternative measures alone or in combination would be manifestly better in contributing towards Australia's public health objective, operating in a manner comparable to the TPP [Tobacco Plain Packaging] measures as an integral part of Australia's comprehensive tobacco control polices and at the level desired by Australia. In light of our analysis under Article 2.2 of the TBT Agreement, we are not persuaded that the proposed alternatives call into question the sufficiency of the reasons Australia has given to the TPP trademark restrictions, bearing in mind the contribution that the TPP measures, including their trademark-related requirements, make, as part of its comprehensive tobacco control polices, to Australia's objective of improving public health.[257]

Thus, with this argument and its lengthy analysis of Article 20 of the TRIPs Agreement, the Panel concluded that the TPP did not violate the TRIPs Agreement, as was raised by the claimants.[258] The Panel, established three criteria, to make its assessment: (a) "the existences of 'special requirements'" that "encumber" the use of trademarks; [259] (b) and, if such "requirements 'encumber' '[t]he use of a trademark in the course of trade,'"[260] and, (c), "whether the TPP measures 'unjustifiably' encumber the use of trademarks . . . ."[261] The panel's finding was succinct, in relation to

255. Panel Rulings of 2018, *supra* note 103, at 229 ("We conclude that the complainants have not demonstrated that the TPP measures are inconsistent with Australia's obligations under Article 20 of the TRIPS Agreement.").

256. *Id.* (addressing in particular the question of encumbrance).

257. *Id.* ¶ 7.2601

258. *Id*.

259. *Id.* ¶ 7.3.5.3.

260. *Id.* ¶ 7.3.5.4.

261. *Id*. ¶ 7.3.5.5.

"special requirements" and "encumber":

> T[]he term "special requirements" refers to a condition that must be complied with, has a close connection with or specifically address the "use of a trademark in the course of trade", and is limited in application. This may include a requirement not to do something, in particular a prohibition on using a trademark.[262]

In relation to the question of "unjustifiably," the Panel set out a series of determinants that would provide some insights but decided against examining those determinants.[263]

There is no novelty in the application of the arguments that the Panel used in its analysis of *Australia Plain Packaging*. Rather the dispute must be looked at from a different lens: whether it was a challenge to the fabric of international law in that an international tribunal would be responsible or have a say in domestic sovereign right of a state to enact legislations for public policy. In this context, the WTO could not challenge legislation that invokes the protection of public health on public policy grounds, as this is a tenet in part of the GATT exceptions.

Crucially, however, the Panel report is an indication that the WTO endorses the continuity of international law, where states are the primary actors, and that despite the existence of epistemic and private economic forces objections to such restrictive statist legislations, it is states that are the main actors in international law. Hence, from this perspective, the panel of *Australia — Plain Packaging* was not a ruling that private economic actors can count on as part of their power-function in international law. Yet, the Panel report reveals one thing — that regardless of being a *negative* rule, it shows the extent the privatizing culture of international law has permeated the judicial halls of tribunals, and specifically, does provide some important questions for the development of international legal scholarship.

iv. The Public and Private International Law Dimension: an Analytical Discussion

At the turn of the twenty-first century when legal scholars began to *return* to the public and private international law divide, one argument was that the distinction has blurred given that both fields of law cross-integrate.[264] The

262. *Id.* ¶¶ 7.2231, 7.2236 (discussing the panel's finding on encumbering).
263. *Id.* ¶¶ 7.2430–7.2431.
264. *See* Edith Brown Weiss, *The Rise of the Fall of International Law?*, 69 FORDHAM

return[265] to the private and public international law dimension in the twenty-first century academic literature has been, as a result of globalization – the common vehicle of capitalism that drives trade and global commerce — and hence, that vehicle is equipped with a hybrid engine in which legal norms are somewhat difficult to distinguish.

The result of this legal hybridization of globalization is that international law is further *commodified*[266] — in which intellectual property rights play a significant role in the commodification process of international law.[267] The subject matter of intellectual property is universal or global, and this is especially noticeable given that nation states regulate intellectual property through domestic international private law (intellectual property law). The universalist nature of intellectual property also includes public international law, and as such, this hybridization contributes to a culture of privatization.

Apart from *hard* international intellectual property laws such as the TRIPs Agreement, other public international law instruments that cover the private nature of intellectual property subject matter include the Universal Declaration of Human Rights[268] and several external regimes ranging from climate change/environmental law to mega-regional and bilateral treaties.[269] However, in terms of the human rights regime and intellectual property, the former has in a sense a strong presence in intellectual property law, even if it means private rights holders relying on human rights norms to protect their (intellectual) property. The broader significance is that human rights as a regime has fortified the pillars of international law so much so that it is inescapable of not linking human rights to any area of international law.

L. REV. 345, 352–53 (2000) ("Public international law has become increasingly concerned with areas that used to be viewed as entirely within the purview of private international law, just as private international law is more often addressing issues that used to be viewed as the primary province of governments.").

265. *See, e.g.*, Carla Hesse, *The Rise of Intellectual Property, 700 B.C. – A.D. 2000: An Idea in the Balance*, 131 DAEDALUS 26 (2002).

266. *See, e.g.*, Jan Klabbers, *The Commodification of International Law*, *in* 1 SELECT PROCEEDINGS OF THE EUROPEAN SOCIETY OF INTERNATIONAL LAW 341 (Hélène Ruiz-Fabri et al. eds., 2006).

267. *See* Rochelle Dreyfuss & Susy Frankel, *From Incentive to Commodity to Asset: How International Law is Reconceptualising Intellectual Property*, 36 MICH. J. INT'L L. 557 (2015).

268. *See* G.A. Res. 217 (III) A, Universal Declaration of Human Rights, art. 27(2) (Dec. 10, 1948) (noting that everyone is entitled "to the protection of the moral and material interests resulting from any scientific, literary or artistic production of which he is the author."); *see also* G.A. Res. 2200A (XXI), International Covenant on Economic, Social and Cultural Rights, art. 15(1), (Dec. 16, 1966).

269. *See generally* HENNING GROSS RUSE-KHAN, THE PROTECTION OF INTELLECTUAL PROPERTY IN INTERNATIONAL LAW (2016) (exploring different agreements, treaties, and regimes related to international intellectual property).

Within the domain of private international law, as it relates to intellectual property, it has become increasingly evident that the norms of global intellectual property rules originated from the domestic sphere and created a global system of rules which relies on both domestic norms and global norms.

This inter-reliance of norms does not necessarily pose regulatory challenges for intellectual property, or the development of either private or public international law, but rather how to enable a more intensive system of norm-generation to accurately reflect the role of intellectual property within a system that has become less one-sided. The challenge is to reflect a global system of rules in which heterogeneous law is more flexible and eliminating homogeneity of either international private law or public international law.

Naturally, to add a label such as "the culture of privatization" to the hybridization of international private law and public international law, only creates one more layer to the existence of other systems of law that operate at the international level such as "global law," "transnational law," or even "economic constitutionalism." In any event, we need to legitimize the new function of intellectual property norms at the international level beyond the legal schisms. One of way doing so is appreciating the norm generating and rule-content shaping function of intellectual property rights at the global level from international private law and public international law perspectives.

It is in that spirit that this Article so far explored the meaning and context of fair and equitable treatment in international law and how it is linked to intellectual property rights. This Article so far has discussed how recent developments in international tribunals interpreted BITs and made attempts to offer some form of discussions relating to intellectual property investments. Moreover, this Article explored other developments in international dispute settlements, such as the context of plain packaging and how these developments help to create or contribute to the aura of a culture of privatization in international law. Thus, this Article has provided evidentiary material as how the culture of privatization in international law emerges as a result of private rights in international intellectual property and investment adjudication. There is, however, the need to recalibrate the Hartian approach to private adjudication and its linkage to public international as established in earlier parts of this Article, and the next Section does that.

IV. THE AUTHORITY-RIGHTS NEED OF ADJUDICATING PRIVATE RIGHTS IN

PUBLIC INTERNATIONAL LAW

For holders of intellectual property rights, who are also actively engaged in investments in a second country where investment agreements provide legal protection, both their "property rights" and "investment rights" have created legal relations that gives them some of form authority over states. At the heart of these authority-rights is how to effectively, in the event of a dispute, adjudicate their private rights under the rules of public international law. This complicated trifecta of "authority-rights," "adjudication," and "private-rights" culminates in the privatization culture of international law as developed in this paper and my previous iterations elsewhere.

There is no hierarchal difference among authority-rights, adjudication, and private-rights: they all accomplish the same goal of privatizing international law. In short, the adjudication narrative represents a positivist engagement with international law (when the Hartian view primary and secondary rules are considered). For authority-rights, it presents me with an opportunity to infuse the debate with how the authority of creating international rules by epistemic communities are significant, given that, those epistemic communities represent private rights holders. And the third, the concept of private rights, can best be explained from how the WTO DSB interprets the concept when faced with the role of intellectual property rights in international law. All three components will have to be explained separately in order demonstrate the continued occurrence of the privatization culture of international law, before showing how new "super-BITS" are slowly manifesting the privatization narrative as *lex-cosmopolis*.

A. Adjudication – A Hartian View in Light of the Australia - Certain Measures and Trademark Basic Treaty Function

One of Hart's arguments in the *Concept of Law* is that law should be seen within the context of "adjudication" — that is, the power "to make authoritative determinations of the question whether, on a particular occasion, a primary rule has been broken."[270] In essence, Hart is speaking about how rules and procedures are applied in front of a judicial body such as courts or tribunals when such rules are violated. As Hart posited, a legal system comprises of rules where the players of that system, *private citizens* and *officials* accepts the "legal validity" of rules and as "common

270. HART, *supra* note 57, at 94. For theoretical arguments on adjudication in general, see Timothy Endicott, *Adjudication and the Law* 27 OXFORD J. LEGAL STUD. 311 (2007); Ralf Poscher, *The Common Error in Theories of Adjudication: An Inferentialist Argument for a Doctrinal Conception, in* THE PRAGMATIC TURN IN LAW. INFERENCE AND INTERPRETATION IN LEGAL DISCOURSE 307 (Janet Giltrow & Dieter Stein eds., 2017).

standards."[271] Perhaps, it is best, to let Hart, explain this, in his own words:

> There are therefore two minimum conditions necessary and sufficient for the existence of a legal system. On the one hand, those rules of behaviour which are valid according to the system's ultimate criteria of validity must be generally obeyed, and, on the other hand, its rules of recognition specifying the criteria of legal validity and its rules of change and adjudication must be effectively accepted as common public standards of official behaviour by its officials. The first condition is the only one which private citizens *need* satisfy: they may obey each "for his part only" and from any motive whatever; though is a healthy society they will in fact often accept these rules as common standards of behaviour and acknowledge an obligation to obey them, or even trace this obligation to a more general obligation to respect the constitution. The second condition must also be satisfied by the officials of the system. They must regard these as common standards of official behaviour and appraise critically their own and each other's deviations as lapses.[272]

It is possible to interpret from this extract that intellectual property rights and their protection at the international level impose duties and obligations as a matter of *law*. Such duties and obligations, along with developments in international investment protection (for intellectual property investments), creates a legal system that requires the *authority* of adjudication. In this context, *regulatory international law*, when being adjudicated by an international tribunal, will allow for "discretion" when interpreting, or at least consideration of the "standards" of regulatory international law, should conflict arise. Again, it is best to quote Hart in his own words in order to avoid any distortion of his views:

> In every legal system a large and important field is left open for the exercise of discretion by courts and other officials in rendering initially vague standards determinate, in resolving the uncertainties of statutes, or in developing and qualifying rules only broadly communicated by authoritative precedents.[273]

The above quoted passage contains a lot that only be best unpacked in its own article. However, in summary, from my point of view, what Hart is telling us is that no matter the condition, existence or language of the law —

271. HART, *supra* note 57, at 113.
272. *Id*.
273. *Id.* at 132.

the adjudicators (judges) can interpret the law as they see fit to match reality (current standards) and remove any cloud of uncertainty. A court may not necessarily revise[274] a treaty — but it can interpret a treaty in accordance with international law standards.[275]

This begs the question: how does an international tribunal interpret general terms such as "use of a trademark," "trademark basic treaty function,", or "investment" when confronted in light of conflicts arising from an international investment agreement in general or one relating to intellectual property rights? In *Australia — Plain Packaging* the WTO Panel was also faced with similar questions, and for example, explains that the use of a trademark is essential to its basic treaty function of distinguishing goods:

> [T]he treaty text shows that "[t]he use of a trademark" is a *protected interest* under Article 20 that must be considered in assessing justifiability. As a result, the legal standard for "justifiability" must be developed in light of the role and importance of "[t]he use of a trademark," as the interest protected by the provision. "The use of a trademark" is essential to a trademark's ability to fulfil its basic treaty function of distinguishing goods or services in commerce in terms of their quality, characteristics, and reputation. Against that background, the object and purpose of Article 20 in protecting "[t]he use of a trademark" is to safeguard the ability of a trademark to full its basic treaty function of distinguishing a good or service as far as possible, while permitting a Member to achieve other legitimate objectives. It adds that "[t]he object and purpose of safeguarding the ability of a trademark to fulfil its basic treaty function as far as possible unquestionably furthers the object and purpose of the TRIPs Agreement as a whole." There is no parallel to Article 20 to protect the use of other forms of IP covered by the TRIPS Agreement.[276]

From the above passage, we could for example, deduce that the Panel's reference to "legitimate objectives" could also mean that of intellectual property as investments, as set out in international investment treaties.

The Panel's treatment of "use of a trademark" is interesting for the fact that, this is a doctrine, that, primarily relates to private law — that is the

274. *See* Rights of Nationals of the United States of America in Morocco (Fr. v. U.S.), Judgment, 1952 I.C.J. 176, 196 (noting that "the Court can not adopt a construction by implication . . . . It is the duty of the Court to interpret the Treaties, not to revise them").

275. *See* Understanding on Rules and Procedures Governing the Settlement of Disputes art. 3.2, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401.

276. Panel Rulings of 2018, *supra* note 106, ¶ 7.2314.

domestic trademark law of states, and the elevation of this doctrine, in international law goes to show how important private rights are at the global level (or at the domestic level in relation to its immersion as part of "public rights"[277]).

Another deduction that one can draw from the Panel's treatment of "basic function" is that other forms of treaty interpretation, for example, the principles set out under Articles 31 and 32 VCLT are necessary for the interpretation of "basic function of a trademark" in treaties.[278]

Yet, it is how, what is arguably, a direct reference to private rights holders — "protected interest," that is most notable, of the Panel's treatment of trademarks, significant for the all-important element in the privatization[279] of international law. After all, it is Australia that made the first move to regulate how international corporations *should* represent their goods on the Australian market, where the use of a trademark was no longer able to distinguish tobacco goods due to "plain packaging."[280] Thus, from the point of view of Australia, tobacco products were a public health issue that requires the state to take action, even if such actions would be deemed as the expropriation of intellectual property rights and WTO members can, as a matter of legitimate policy, expropriate private trademarks as a public health concern.

If we invoke the Hartian approach to adjudication as earlier discussed there are two important takeaways from the above assessment. First, international tribunals adjudicate domestic laws that seemingly expropriate intellectual property rights as a matter of interpreting those provisions within the international treaties they are part of. In other words, a WTO Panel discussing TRIPs will only refer to domestic laws if they form part of the litigation. Secondly, international tribunals will attempt to offer some legitimate interpretation on the authority of states to regulate matters such public health grounds as legally valid. The point is, from the Hartian perspective, as set out in this section of the Article, it is the existence of *law*

277. *See, e.g.*, Oil States Energy Servs. v. Green's Energy Grp., 138 S. Ct. 1365 (2018) (showing how the Supreme Court decided after *inter partes* review that patents are public rights in that they do not violate the U.S. Constitution).

278. Vienna Convention, *supra* note 216, arts. 12–13.

279. *See Oil States Energy Servs.*, 138 S. Ct. at 1365–86 (showing how the Supreme Court examined the concept of public rights and private rights and found that *inter partes* patents are public rights). The Court acknowledges that patents are private property rights but "the decision to grant a patent is a matter involving public rights —specifically, the grant of a public franchise." *Id.* at 1373. Hence, this is also one form of privatization I develop in this work, albeit at the domestic level.

280. *Tobacco Plain Packaging Act of 2011* (Cth) ss 18–26 (Austl.).

and its interpretation within cases such as *Australia — Plain Packaging* that represents the importance of adjudication.

Law, in this situation, was the international law of intellectual property protection, as per the TRIPs Agreement. But, nevertheless, *that* law, also states that "[m]embers may, in formulating or amending their laws and regulations, adopt measures necessary to protect public health . . . ."[281] Thus, adjudication should be seen as interpreting and applying the law and finding the right answers to questions posed. And decisions such as *Australia — Plain packaging* show how adjudication is critical to determining international law in light of how private rights are protected (or expropriated) under international law.[282]

Nevertheless, when Hart on a general level is factored into the assessment of the *obligation* that Australia has under international law (under Article 8(1) of the TRIPs Agreement), and the obligations of other complainants under international law, the adjudication process can further reveal different *conflicts of norms* and the tools to resolve them.[283]

B. Authority-Rights: The Meaning of "Authority" in China – Enforcement

In *China — Enforcement*, the Panel in part of its analysis of the term "shall have the authority"[284] also linked the meaning of "authority" to private rights holders.[285] The Panel construed "authority" to mean the "power or right to enforce obedience; moral or legal supremacy; right to command or give a final decision"[286] and it is from this meaning that the Panel explained that sections of the TRIPs Agreement also include the authority of private rights holders.

The Panel was particularly concerned about Part III of the TRIPs Agreement and its relation to private rights holders "given the potential importance"[287] of interpreting authority beyond state or other designated officials. Thus, for the Panel, private rights holders "shall have the authority" to initiate procedures under the TRIPs Agreement.[288] The

281. TRIPS Agreement, *supra* note 199, art. 8(1).

282. Panel Reports of 2018, *supra* note 119, ¶7.2314.

283. *See* TRIPs Agreement, *supra* note 199, art. 8(1)–(2); *see also* Pauwelyn, *supra* note 1 (developing and setting out conflict of norms tools in international law).

284. Panel Report, *Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, ¶ 7.234-7.254, WTO Doc. WT/DS362/R (adopted Apr. 13, 2010).

285. *Id.* ¶ 7.247.

286. *Id.* ¶ 7.236.

287. *Id.*¶¶ 7.238–7.241.

288. *Id.* ¶ 7.247

incursion by the Panel into the notion of "authority" is significant as it recognizes intellectual property as private rights but authorizes the private rights holders to take initiatives under international law (the TRIPS Agreement) to enforce the rights. It is akin to the recognition that individuals have standing in international law similar to states and non-state actors, such as international institutions.

Beyond, the legal semantics in the Panel, it would be hard to argue whether, if there was an appeal, that argument would have been discarded. Thus, in principle, the mere "fact that intellectual property rights are private rights"[289] gives credence that private rights holders enjoy the authority to the right to enforce and create a space to advance the debate on how privatization of international law occurs. This is a result of intellectual property rights in the international system. But beyond *China — Enforcement*,[290] there is also a lesson in domestic case law to also support this thesis due to the public rights and private rights debate within international law and intellectual property rights.

C. Private-Rights in Privatizing Public Law – The Lesson from Oil States Energy

We have seen that, at the domestic level, courts have confirmed that intellectual property are private rights (and can also be public rights),[291] but what about the concept of private rights in international tribunals? Do tribunals believe that private rights are also a matter of public rights under international law, and if they do, does this mean the privatization of international law has come full circle? In *Australia — Plain Packaging*, the Panel also confirmed that intellectual property are private rights[292] and indeed, as also stated in the preamble of the TRIPs Agreement. The majority of the DSBs cases on intellectual property rights have confirmed that the TRIPs Agreement recognizes the private rights of intellectual property.[293]

289. *Id.*¶ 7.530.

290. Panel Report, *China – Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, WTO Doc. WT/DS362/R (adopted Jan. 26, 2009).

291. *See, e.g.*, Oil States Energy Servs., L.L.C. v. Greene's Energy Grp., 138 S. Ct. 1365 (2018).

292. *See* Panel Report, *Australia – Plain Packaging*, ¶ 7.1924, 7.1966, 7.1971, 7.2000 n.4472, WT/DS435/R (June 28, 2018) ("Article 16 imposes an obligation on Members to guarantee a minimum level of private rights to trademark owners that allows them to successful protect the distinctiveness and source-indicating function of their marks . . . .").

293. *See, e.g.*, *Canada — Patent Protection of Pharmaceutical Products*, ¶ 5.18, WTO Doc. WT/DS114/R (Mar. 17, 2000); *EC — Protection of Trademarks and*

However, it is not only as enumerated in the preamble of the TRIPs Agreement, but the DSB has made it clear that private rights exist in intellectual property.

The enforcement of intellectual property rights is also clearly linked to the authority of private rights holders. It is a point that the Panel in *China — Enforcement* would explain in great detail:

> The Panel also observes that a common feature of Sections 2, 3 and 4 of Part III of the TRIPS Agreement is that the initiation of procedures under these Sections is generally the responsibility of private rights holders. [A] condition that authority shall only be available upon application or request seems to be assumed in much of Sections 2, 3 and 4 of Part III. This is consistent with the nature of intellectual property rights as private rights, as recognised in the fourth recital of the preamble of the TRIPS Agreement. Acquisition procedures for substantive rights and civil enforcement procedures generally have to be initiated by the right holder and not *ex officio*.[294]

This passage emphasized the notion of private rights in intellectual property, not merely as those set out in the substantive text of the TRIPs Agreement, but also the enforcement procedures are, as a matter of point, the responsibility of "private rights holders." In a Hartian context, then, the enforcement of intellectual property rights as private rights in international law subscribe to adjudication[295] where the authority of the private rights holders helps to determine how infringement (or rules violation) occur, and where the correct remedies in the law are (the TRIPs Agreement and WTO Covered Agreement).

Thus, what should be emphasized is that the adjudication of intellectual property rights under public international law manifests both private rights as the centre of action for interpreting the public nature of international law. This process helps to form a culture of privatization that emanates from the publicness of international law. This observation is similar to what the *Oil States Energy* court said of the process of reviewing patents *inter partes*:

Geographical Indicators for Agricultural Products and Foodstuffs, ¶ 7.742, WT/DS174/R (Mar. 15, 2005); *China — Measures Affecting the Protection and Enforcement of Intellectual Property Rights*, ¶ 7.247, WT/DS362/R (Jan 26, 2009); *India — Patent Protection for Pharmaceutical and Agricultural Chemical Products*, ¶ 48, WT/DS50/AB/R (Dec. 19, 1997).

294. *China – Enforcement*, WTO Doc. WT/DS362/R, ¶ 7.257.

295. *See* Seuba, *supra* note 72, at 16–17.

public rights is "between the government and others"[296] and hence, the privatization of international law is similarly between private rights holders of intellectual property rights in the international system and the states that enforce international law.

D. Lex Cosmopolis: Private Hard Law Beyond TRIPS?

The move towards superBITs or other types of FTAs with strong intellectual property rights provisions have to some extent, represented a form of convergence of strong private rights rules, or hard law beyond TRIPs. Let me briefly outline some of those developments to show how private rights and the regulatory needs of private actors converges as part of a cosmopolitan system of rules (*lex cosmopolis*) that contributes to the privatisation of international law.

In essence, *lex cosmopolis* represents the universality of international legal norms and the rule of law for the functioning of intellectual property rights in the global economic system due to the extent strong intellectual property rules are influenced by private actors and or reflects private law norms.

One way of illustrating the idea of *lex cosmopolis* is through the proliferation of "TRIPs-plus" (sometimes referred to as "superBITS) type free trade agreements[297] between the United States and partner States, where such agreements, contain substantial intellectual property provisions. I should also, point out, that the idea of *lex cosmopolis* is also evident in the mega-regional trade agreements such as TPP or CETA, European Partnership Agreements (EPAs) or BITS with intellectual property chapters, some of which has been discussed in previous parts of this work. Hence, my arguments here, is limited to early FTAs that have been signed between the United States and partner countries, as they can/have *globalize* intellectual property rules. Samples of these FTAs are illustrated below.

---

296. *See Oil States Energy*, 137 S. Ct. at 1378 (highlighting other implications of different aspects of privatization). For other implications of different aspects of privatization, see, e.g., Laura Dickinson, *Public Law Values in a Privatized World*, 31 YALE J. INT'L L. 383 (2006).

297. For an overview of TRIPs-plus agreements, see Bryan Mercurio, *TRIPs-Plus Provisions in FTAs: Recent Trends, in* REGIONAL TRADE AGREEMENTS AND THE WTO LEGAL SYSTEM (Lorand Bartels & Federico Ortino, eds., 2006); Pedro Roffe, Christoph Spennermann & Johanna von Braun, *Intellectual Property Rights in Free Trade Agreements: Moving Beyond TRIPS Minimum Standards*, *in* RESEARCH HANDBOOK ON THE PROTECTION OF INTELLECTUAL PROPERTY UNDER WTO RULES (Carlos M. Correa, ed., 2010); Thomas Cottier et al., *The Prospects of TRIPs-Plus Protection in Future Mega-Regionals, in* MEGA-REGIONAL TRADE AGREEMENTS (Thilo Rensmann, ed., 2017).

- U.S. — Australia Free Trade Agreement (entered into force on 1 January 2005);[298]
- U.S. — Bahrain Free Trade Agreement (entered into force on 1 January 2006;[299]
- U.S. — Dominican Republic/Central America Free Trade Agreement (entered into force on 1 January 2005);[300]
- U.S. — Chile Free Trade Agreement (entered into force on 1 January 2004);[301]
- U.S. — Colombia Trade Promotion Agreement (entered into force on 15 March 2012);[302]
- U.S. — Jordan Free Trade Agreement (entered into force on 17 December 2001);[303]
- U.S. — Korea Free Trade Agreement (entered into force on 15 March 2012);[304]
- U.S. — Morocco Free Trade Agreement (entered into force on 1 January 2006);[305]
- U.S. — North American Free Trade Agreement (entered into force on 1 January 1994);[306]
- U.S. — Oman Free Trade Agreement (entered into force on 1 January 2009);[307]
- U.S. — Panama Trade Promotion Agreement (entered into force on 31 October 2012);[308]

---

298. United States – Australia Free Trade Agreement, May 18, 2004, 43 I.L.M. 1248.

299. United States – Bahrain Free Trade Agreement, Sept. 14, 2004, 44 I.L.M. 544

300. Dominican Republic – Central America – United States Free Trade Agreement (CAFTA-DR)..

301. United States – Chile Free Trade Agreement, June 6, 2003, 42 I.L.M. 1026.

302. United States – Colombia Trade Promotion Agreement, Pub. L. No 112-42 (2011)

303. *Agreement Between the United States of America and the Hashemite Kingdom of Jordan on the Establishment of a Free Trade Area*, Jordan-U.S., Oct. 24, 2000, 41 I.L.M. 63.

304. Free Trade Agreement Between the United States of America and the Republic of Korea, Korea-U.S., June 30, 2007,49 I.L.M. 642.

305. *United States – Morocco Free Trade Agreement* art. 15.9(2), Morocco-U.S., June 15, 2004, 44 I.L.M. 544 (providing patent protection for "new uses of a known product . . . for the treatment of humans and animals"). Prior to this, Morocco did not provide for such protection under its intellectual property laws or international obligations.

306. The North American Trade Agreement, Dec.17, 1992, 32 I.L.M. 605 (entered into force Jan. 1, 1994).

307. Office of the United States Trade Representative, *Oman Free Trade Agreement* (Feb. 6, 2022, 5:00 pm)

308. Office of the United States Trade Representative, *U.S.-Panama Trade Promotion Agreement* (Feb. 6, 2022, 5:02 pm)

- U.S. — Peru Trade Promotion Agreement (entered into force on 1 February 2009);[309]
- U.S. — Singapore Free Trade Agreement (entered into force 1 January 2004).[310]

The above examples of U.S. — FTAs, were mostly negotiated and signed in around the same time frame of the TRIPs Agreement or, after the TRIPs Agreement came into force. One of the commonalities about these FTAs, is that they have identical intellectual property provisions that follow a particular template, and the intellectual property provisions are generally set out in chapters fourteen through to eighteen.[311] However, when compared to the protection of intellectual property under the TRIPs Agreement, it is evident that the minimum standards under the TRIPs are surpassed by the provisions in these FTAs. Thus, as "TRIPs-plus" agreements, they establish higher standards for intellectual property protection than the TRIPs Agreement, and they extend protection to more categories of "intellectual property rights"[312] (such as pharmaceutical data, test data protection, or the extension of patent terms).[313] A selective examination of the scope of some

309. Office of the United States Trade Representative, *The Peru Trade Agreement* (Feb. 6, 2022, 5:04 pm),

310. *United States – Singapore Free Trade Agreement,* May 6, 2003, 42 I.L.M. 1026 (2003).

311. While most of the intellectual property chapters are lengthy, normally 30 to 40 pages, the *US — Israel FTA* of 1985 contains only a single general provision, in Article 14, providing MFN and the need to uphold obligations under bilateral and multilateral agreements on intellectual property rights. However, this was a pre-TRIPS Agreement. *See US – Israel Free Trade Agreement* art. 14, Apr. 22, 1985, 24 I.L.M. 657 (1985). Also, the *US – Jordan FTA* intellectual property provisions are set out in Article 4 and do not command the same number of pages compare to the other FTAs mentioned above. *See Agreement Between the United States of America and the Hashemite Kingdom of Jordan on the Establishment of a Free Trade Area*, Jordan-U.S., Oct. 24, 2000, 41 ILM 63.

312. *See, e.g.*, Henning Grosse Ruse-Khan, *The International Law Relation Between TRIPs and Subsequent TRIPs-Plus Free Trade Agreements: Towards Safeguarding TRIPS Flexibilities?*, 18 J. INTELL. PROP. L. 325 (2011); Susy Frankel, *Challenging TRIPs-Plus Agreements: The Potential Utility of Non-Violation Disputes*, 12 J. INT. ECON. L. 1023 (2009); Beatrice Lindstrom, Note, *Scaling Back TRIP-Plus: An Analysis of Intellectual Property Provisions in Trade Agreements and Implications for Asia and the Pacific*, 42 N.Y.U. J. INT'L L. & POL. 917 (2010); Sandeep Mittal, *Effects of TRIPs Plus Provisions in International Trade Agreements upon Access to Medicines in Developing Countries*, 22 J. INTELL. PROP. RTS. 295 (2018).

313. *See* Wael Armouti & Mohammad Nsour, *Data Exclusivity for Pharmaceuticals in Free Trade Arrangements: Models in Selected United States Free Trade Agreements*, 40 HOUS. J. INTL. L. 106, 107 (describing patent linkage as "a decision by regulatory authorities to grant marketing approval for drugs that enjoy patent protection" based on

of the FTAs, and their "TRIPs-plus" standards, as a matter of illustrative purposes only, shows that such higher standards were purely to assist other norms in building a relationship for the advancement of international intellectual property law.

The *US — Singapore FTA*, for example, as well as the TRIPs Agreement, provides for the opposition of a trademark during registration: "Each party shall afford an opportunity for the registration of a trademark to be opposed."[314] The TRIPs Agreement, for its part, provides that "members may afford an opportunity for the registration of a trademark to be opposed."[315] To the untrained eye, the subtle difference in language does not appear immediately; however, the semantics of the wording of each provision clearly highlights a difference: "shall" versus "may." Thus, in this regard, one must see this subtle difference as mandatory.[316]

In the *US — Chile FTA*, the bar was raised for the protection of undisclosed information.[317] Whereas the TRIPs Agreement provides measures to be taken to protect undisclosed information "against unfair commercial use,"[318] in the *US — Chile FTA* it appears to prohibit third parties in a broad sense, as it states that "the party shall not permit third parties not having the consent of the person providing the information . . . ."[319] What this seems to suggest is that third parties should look elsewhere should they require access to undisclosed information and not the public authorities where such information is being held.[320]

Furthermore, the issue of compulsory licensing seems to be one of the most restrictive, which is common in most of the FTAs that goes beyond what the TRIPS provides. For instance, the *US — Australia FTA*[321] provides that compulsory licensing is prohibited, but can be granted in exceptional

the consent of the patent holder).

314. *US – Singapore FTA*, *supra* note 310, art. 16.2(1).

315. TRIPS Agreement, *supra* note 199, art. 15(5).

316. *See* Wee Loon Ng-Loy, *IP and FTAs of Singapore: Ten Years On*, *in* INTELLECTUAL PROPERTY AND FREE TRADE AGREEMENTS IN THE ASIA-PACIFIC REGION 342 (Christoph Antons & Reto Hilty eds., 2015).

317. *See* Free Trade Agreement, Chile-U.S., *supra* note 306, art. 17.10(1) ("[T]he Party shall not permit third parties not having the consent of the person providing the information to market a product based on this new chemical entity, on the basis of the approval granted to the party submitting such information.").

318. *See* TRIPS Agreement, *supra* note 199, art. 39(3).

319. Free Trade Agreement, Chile-U.S., *supra* note 306, art. 17.10(1).

320. *See* Elisa Walker Echenique, *Implementing the IP Chapter of the FTA Between Chile and the USA: Criticisms and Realities from a Developing Country Perspective*, 9 SCRIPTED 234, 239 (2012).

321. United States – Australia Free Trade Agreement, 18 May 2004, 43 I.L.M. 1248.

circumstances that haveto do with "anticompetitive," "public non-commercial use," or "national emergency."[322] Similar provisions can be found in the *US — Singapore FTA*[323] and the *US — Jordan FTA*.[324] There are certain conditions for a compulsory licence under the TRIPs Agreement, but no "restrictions on the circumstances in which a compulsory license may be issued"[325] hence, the FTAs' restrictions on compulsory licensing can create difficulties for governments and third parties to gain access to the commercial data of pharmaceutical companies.[326] Thus, based on the restrictions on compulsory licensing in FTAs, the real reasons for TRIPs-plus agreements emerges: to circumvent how governments were *appropriating* the intellectual assets of private rights holders.

What some of the academic papers on TRIPs-Plus agreements have found is that they promote the interests of private rights holders at a greater rate than the TRIPs Agreement.[327] This finding should not be surprising, given that international intellectual property negotiations have always been driven by private interests.[328] But the proliferation of TRIPs-plus agreements helps to shape the *lex cosmopolis* by mandating compliance to other intellectual property treaties that are not within the confines of the TRIPs. For example, under the *US — Australia FTA*, Australia was required to accede to the WCT, WPPT before the entry into date of the agreement.[329] And similarly, under the *US — Singapore FTA*, Singapore was required to ratify a number of treaties such as the International Convention for the Protection of New Varieties of Plants (1991) UPOV Convention,[330] the Patent Cooperation Treaty (PCT), WIPO Copyright Treaty (WCT), which offers protection for works in the digital world, and WIPO Performances and Phonograms Treaty (WPPT), giving public performers protection for works and producers of

322. *Id.* art. 17.9(7)(a)–(b).

323. Free Trade Agreement, Singapore-U.S., supra note 310, at art. 16.7(6)(b).

324. Agreement Between the United States of America and the Hashemite Kingdom of Jordan on the Establishment of a Free Trade Area, Jordan-U.S, art. 4(20).

325. Peter Drahos et al., *Pharmaceuticals, Intellectual Property and Free Trade: The Case of the US-Australia Free Trade Agreemen*t, 22 PROMETHEUS 244, 249 (2004).

326. *Id.*

327. *See, e.g.*, Lindstrom, *supra* note 312.

328. *See* SUSAN SELL, PRIVATE POWER, PUBLIC LAW: THE GLOBALIZATION OF INTELLECTUAL PROPERTY RIGHTS 7 (2003); Peter Drahos, et. al, *supra* note 325, at 249 (suggesting that multinationals have coordinated intellectual property rights in international treaties).

329. Free Trade Agreement, Austl-U.S., *supra* note 303, art. 17.1.

330. International Convention for the Protection of New Varieties of Plants, Dec. 2, 1961 (as it relates to the patenting of plants); *see also* TRIPS Agreement, *supra* note 199, art. 27(3)(b) (providing for the protection of plant varieties through patents).

those works especially for the fixation of sounds.[331]

Other FTAs require the accession to similar treaties, such as the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure (1977),[332] the Trademark Law Treaty (1994), the Patent Law Treaty (2000), the Hague Agreement Concerning the International Registrations of Industrial Designs (1999), the Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite (1974), and the Madrid Protocol Relating to the Madid Agreement Concerning the International Registrations of Marks (1989).[333] This route, to further universalise intellectual property rights treaties (and other treaties that have implications for aspects of intellectual property rights) constitute how the interaction or accession to treaties form part of a cosmopolitan network of treaties driven by private rights.

One of the explicit differences between the TRIPs Agreement and FTAs such as the *US — Morocco FTA* is the circumvention of TRIPs flexibilities to provide patent protection for example "new uses of using a known product . . . [for] the treatment of humans and animals."[334] TRIPs flexibilities provide for socio-economic development of some countries including transition periods (Articles 65–66) and the criteria for patentability in Article 27.[335] Prior to the *US — Morocco FTA*,[336] TRIPs flexibilities provided for countries such as Morocco, to determine patentability for

331. Free Trade Agreement, Singapore-U.S., *supra* note 315, art. 16.1(2). For discussions on these treaties, see generally Rebecca Martin, *The WIPO Performances Treaty and Phonograms Treaty: Will the U.S. Whistle a New Tune?*, 44 J. COPYRIGHT SOC'Y 157 (1997); Julie Sheinblatt, *The WIPO Copyright Treaty*, 13 BERKELEY TECH. L.J. 535 (1998).

332. Free Trade Agreement, Peru-U.S., *supra* note 314, art. 16.1(2)(b).

333. *See, e.g.*, Free Trade Agreement, Peru-U.S., *supra* note 314, art. 16.1(1)–(4); Trade Promotion Agreement, Pan.-U.S., *supra* note 313, art. 15.1(1)–(4); Free Trade Agreement, Oman-U.S., *supra* note 312, art. 15.1(1)–(3); Free Trade Agreement, Morocco-U.S., *supra* note 310, art. 15.1(1)–(3); Free Trade Agreement, Chile-U.S., *supra* note 306, art. 17.1(1)–(4); Free Trade Agreement, Colom.-U.S., *supra* note 307, art. 16.1(1)–(4); Dominican Republican-Central America Free Trade Agreement, Dom. Rep.-U.S., *supra* note 305, art. 15.1 (2)(6); Between the United States of America and the Hashemite Kingdom of Jordan on the Establishment of a Free Trade Area, Jordan-U.S., *supra* note 308, arts. 4(1)(a)–(d), 4(2); Free Trade Agreement, S. Kor-U.S., *supra* note 309, art. 18.1(3)–(4); Free Trade Agreement, Bahr.-U.S., *supra* note 304, art. 14.1(2)–(3); Free Trade Agreement, Austl-U.S., *supra* note 303, art. 17.1(2)–(5).

334. Free Trade Agreement, Morocco-U.S., *supra* note 310, art. 15.9(2).

335. *See* TRIPS Agreement, *supra* note 199, arts. 27, 65, 66.

336. *See* Omar Aloui, *Intellectual Property Rights,* in CAPITALIZING ON THE MOROCCO-US FREE TRADE AGREEMENT: A ROAD MAP FOR SUCCESS 151 (Gary Hufbauer & Claire Brunel eds. 2009).

known products. For example, Article 27(3)(a) - (b) TRIPs allows members to "exclude from patentability: diagnostic, therapeutic and surgical methods for the treatment of humans or animals."[337] However, Article 15.9(2) of the *US — Morocco FTA* changes that dynamic and provides for patentability of known products that include "for the treatment of humans and animals."[338] Similarly, the *US — Australia FTA* requires that patents must be available for "new uses or methods of using a known product."[339] In this regard, the *US — Australia FTA* "globalizes" the criteria for patentable products with other nations. But what these examples demonstrate is that a standard provision in an FTA can increase the global reach of an intellectual property norm through treaties.

The cosmopolitan network of treaties is more synonymous with intellectual property and related rights. This includes, from a historical perspective, the Paris and Berne Conventions,[340] the numerous WIPO administered treaties, the TRIPs Agreement (and the expansive intellectual property provisions in FTAs and recent mega-regional treaties such as the TPP). Thus, the intellectual property cosmopolitan treaty network propagates an interdependency of obligations that are increasingly subject to compliance and enforcement.

Another impact of the cosmopolitan network of treaties in the intellectual property realm is that they provide for an aura of *pluralistic rights* — whereas, various forms of rights that are subject to protection, from traditional knowledge, geographical indications to test data in the pharmaceutical industry – can shape how global rules are in sync with the notion of *rights*. It is along these lines, taking into account the proliferation of TRIPs-plus agreements, that *lex cosmopolis* fits into the narrative as part of the social regulatory needs of the community of intellectual property actors and contributes to the paradigms and frames of privatisation in international law.

Critics of intellectual property provisions in FTAs such as Susy Frankel, have argued that "the proliferation of TRIPS-plus standards may

337. TRIPS Agreement, *supra* note 199, art. 27(3)(a)–(b).

338. Free Trade Agreement, Morocco-U.S., *supra* note 310, art. 15.9(2).

339. United States – Australia Free Trade Agreement, *supra* note 229, art. 17.9.1; *see also* Ping Xiong, *Patents in TRIPs-Plus Provisions and the Approaches to Interpretation of Free Trade Agreements and TRIPs: Do They Affect Public Health?*, 46 J. WORLD TRADE 155 (2012).

340. Paris Convention for the Protection of Industrial Property (as amended on Sept. 28, 1979), Mar. 20, 1883, 828 U.N.T.S. 305 [hereinafter Paris Convention]; Berne Convention for the Protection of Literary and Artistic Works (as amended on Sept. 28, 1979, July 24, 1971, 828 U.N.T.S. 221 [hereinafter Berne Convention].

cumulatively amount to a systemic violation of the TRIPS Agreement structure and purpose."[341] I, however, do take a different view on the matter. Rather than deeper harmonization resulting in new norms that violates the TRIPs — other international law instruments, such as FTAs, indicate how norms can contribute to the evolution of other norms. It is such contributions or social regulatory needs for the community of States and intellectual property actors that I tried to outline within the framework of the cosmopolitan network of treaties (*lex cosmopolis*). Moreover, the International Law Commission's Fragmentation Report[342] has suggested a similar line of argument, where it underscores how norms interact as *relationships of interpretation*.[343]

> (1) As a legal system, international law is not a random collection of such norms. There are meaningful relationships between them. Norms may thus exist at higher and lower hierarchical levels, their foundation may involve greater or lesser generality and specificity and their validity may date back to earlier or later moments in time.
> (2) In applying international law, it is often necessary to determine the precise relationship between two or more rules and principles that are both valid and applicable in respect of a situation. For that purpose the relevant relationships fall into two general types:
>
> > - *Relationships of interpretation.* This is the case where one norm assists in the interpretation of another. A norm may assist in the interpretation of another norm for example as an application, clarification, updating, or modification of the later. In such a situation, both norms are applied in conjunction.[344]

Based on this prognosis from the ILC, and the arguments I set out above, *lex cosmopolis* represents a system of relationships that universalizes how intellectual property norms travel the cosmopolitan network of treaties such as FTAs as part of the social regulatory standards that generate the needs of the community in international law. The result is that this new evolutionary norm is all but one part of the cell that contributes to the privatisation of international law.

341. Susy Frankel, *supra* note 312, at 1041 ("The violation occurs when multiple FTAs have [a deeper harmonization] and new norms develop without consensus.")

342. CONCLUSIONS OF THE WORK OF THE STUDY GROUP ON THE FRAGMENTATION OF INTERNATIONAL LAW: DIFFICULTIES ARISING FROM THE DIVERSIFICATION AND EXPANSION OF INTERNATIONAL LAW, INT'L L. COMM'N (July, 18, 2006), available at https://legal.un.org/ilc/documentation/english/a_cn4_l702.pdf.

343. *Id*. at 7.

344. *Id. Id.*

V. FRAMING A THEORETICAL PERSPECTIVE: NETWORK OF OBLIGATIONS

The different private actors in the global economic system have different regulatory needs. I am proposing that the requirement of network of obligations fit the plethora of dispute settlement mechanisms under international law. As, I shall argue in this section, it includes how to interpret and assert jurisdiction in international intellectual property disputes. Anne Peters has identified network of obligations as "a mixture of vertical and horizontal relationships, a criss-cross of relationships."[345] However, I am constructing the concept of network of obligations differently, albeit with a subtle reference to hierarchical relationships, to consider how different tribunals and alternative dispute settlements for intellectual property disputes operate in the international legal system. For instance, the WTO DSB is the main tribunal for TRIPs disputes, but the various *ad hoc* tribunals under investment treaties and FTAs have competence for intellectual property disputes. And there is also the WIPO Mediation and Arbitration centre, which concerns private law on cross-border issues, among others. What these tribunals have in common is that they apply international intellectual property law as part of the system of international law.

There are two particular arguments which Peters articulates in her article that is linked to my own arguments in this Article. The first is that there is an inherent "duty to cooperate in dispute settlement"[346] that invariably involves "customary law" and "conventional law."[347] This formulation of cooperation in the international law of dispute settlement invokes the idea that dispute settlements are of legal characteristics and different, or a hierarchy of tribunals are tasked with settling disputes via customary and conventional law.

From my perspective, an example of a conventional law instrument is the *US — Korea FTA* that provides for the settlement of disputes via (a) state-

345. Anne Peters, *International Dispute Settlement: A Network of Cooperational Duties*, 14 EUR. J. INT'L L. 1, 32–33 (2003) ("The international law of dispute settlement, which is becoming increasingly institutionalized, may be imagined as a *network of obligations*. The network idea builds on, and intensifies, the concept of cooperation. While inter-state cooperation still presupposes horizontal relationships between sovereign actors, the network idea allows for hierarchy in the international system. A network is . . . a mixture of vertical and horizontal relationships, a criss-cross of relationships. It is partly rigid, partly flexible. The network embodies not only different types of cooperational duties, but also duties with different degrees of bindingness, depending, inter alia, on the different actors involved.").

346. *Id.* at 9.

347. *Id.*

to-state and (b) investor-state.[348] These two formal mechanisms in the *US — Korea FTA* call for "cooperation" "to agree on the interpretation and application of this Agreement . . . .[349] Of course, what is fascinating about the "legal characteristics" of dispute settlements under treaties such as the *US — Korea FTA* is that, on the one hand, there is an *obligation* to settle dispute and on the other, there is a need for *cooperation*. This seemingly integrated situation raises the bar in terms of how to effectively enforce and assert jurisdiction.

Another important argument of Peters is the role of private investors (and to an extent international private law) in the international law system of dispute settlement via mechanisms such as adjudication. Peters, eloquently, makes the point the following way:

> Although states are certainly still the primary actors — think of access to the ICJ or to the WTO Dispute Settlement Body — this primacy of states is eroding. Some of the most interesting duties of cooperation involve private-law corporations or individuals . . . .[350]

This argument reinforces my own claim regarding the occurrence of the culture of privatization, and also the private law obligations of intellectual property rights in the privatization of international law. Therefore, through these two observations on (a) the duty to cooperate to settle international disputes and (b) the active role of private actors in the international dispute settlement systems are elements of a broader network of obligations pertaining to the enforcement and *ascertainment* of jurisdiction in international intellectual property disputes via various tribunals.

Although there is an evolving debate on the concept of jurisdiction in international law,[351] that debate often leaves out the "private law" or

348. U.S. – Korea Free Trade Agreement, *supra* note 310, art. 22(setting out investor-state dispute settlement).

349. *Id.* art. 22.3.

350. Peters, *supra* note 345, at 31. Peters also made the following observation: "The 'privatization' of international disputes effected by the integration of non-state actors has the positive effects of avoiding inter-state conflicts and of improving the protection of material rights because the states' discretion (and reluctance) to exercise diplomatic protection is foreclosed. It also increases the effectiveness of adjudication because the strong self-interests of the private stakeholders contribute to promoting legal security." *Id.*

351. *See, e.g.*, CEDRIC RYNGAERT, JURISDICTION IN INTERNATIONAL LAW (2d ed. 2008); Alex Mills, *Rethinking Jurisdiction in International Law*, 84 BRITISH YB. INT'L L. 187 (2014); Michael Akehurst, *Jurisdiction in international Law*, 46 BRITISH YB. INT'L L. 145 (1973); Abhimanyu Jain, Universal Jurisdiction in International Law 55

"international private law" aspect of global dispute settlement or transnational private litigation.

Jurisdiction in international law is, in my view, primarily a matter and concern of "international private law," as the issues that are the subject of jurisdiction are increasingly of an economic nature that draw upon private law norms.[352] For intellectual property rights, the issue of jurisdiction is interwoven through questions on cyberspace, copyrights, trademarks, patent litigations, intellectual property as investments, and other economic rights, which by and large makes the issue of jurisdiction a matter of public international law and international private law. Thus, as jurisdiction is raised in different intellectual property disputes at the international level, the way how the tribunals handling those disputes is essential to how the concept of jurisdiction is interpreted, but more importantly, how it is asserted.

As indicated earlier, my concern is the multiplicity of those tribunals, and to view them as part of the network of obligations to interpret, enforce, and assert jurisdiction in international intellectual property disputes.[353] It is through this prism of tribunals, which I view as a network of obligations for the purposes of the privatization of regulatory needs, where "international private law" is used to resolve matters that are of a public international law nature through the assertion of jurisdiction and or applying doctrinal interpretation.

An illustration of network of obligations as I construe it (asserting jurisdiction and interpreting treaties by tribunals) can be seen through how tribunals interpret intellectual property doctrines and international law obligations under the TRIPs Agreement or a BIT/FTA. The other issue is the actual assertion of jurisdiction over an intellectual property law matter by a tribunal where domestic laws are seen as breaching international law obligations under the TRIPs Agreement. Two cases can illustrate these two points. The first is *Australia — Plain Packaging*[354] WTO decision of June

---

Indian J. INT'L L. 20 (2015); Devika Hovell, *The Authority of Universal Jurisdiction*, 29 EURO. J. INT'L L. 427 (2018).

352. E.g. Club Resorts Ltd. v. Van Breda, [2012] S.C.R. 572 (Can.) (involving private international law claims around operations in Cuba, which by nature ought to be also public international law). Cases in other international tribunals such as the PCIJ and ICJ also feature a "international private law" nature. E.g. Mavrommatis Palestine Concessions (Greece v. U.K.), Judgment, 1924 P.C.I.J. (ser. B) No. 3 (Aug. 30); Barcelona Traction, Light, & Power Co. (Belg. v. Spain), [1970] ICJ 1 (Feb. 5).

353. *See* Cedric Ryngaert & Mark Zoetekouw, *The End of Territory? The Re-Emergence of Community as a Principle of Jurisdictional Order in the Internet Era*, *in* THE NET AND THE NATION STATE: MULTIDISCIPLINARY PERSPECTIVES ON INTERNET GOVERNANCE (Uta Kohl ed. 2017).

354. Panel Reports of 2018, *supra* note 105.

28, 2018, where regulatory measures in domestic law were challenged.[355] The other is a 2015 ICSID decision on jurisdiction, *Philip Morris v. Australia*,[356] as to whether the tribunal had jurisdiction. Thus, two issues are important for the network of obligations argument. The first is the international obligation of protecting trademark registration under Article 6 (6*quinquies*) of the Paris Convention[357] and the interpretation of trademark obligations in the WTO decision. And second, how the ICSID tribunal asserted jurisdiction through the interpretation of a bilateral investment treaty and its intellectual provisions regarding trademarks.

The international intellectual property law regime provides for the protection of trademarks, which are set out in Article 15 of the TRIPs Agreement. Specifically, Article 15(1) provides for protection for trademarks that are "capable of distinguishing the goods or services . . . from those of other undertakings . . . ."[358] Article 15(2) provides that members can deny trademark registration "on other grounds, provided that they do not derogate from the provisions of the Paris Convention (1967)."[359] Furthermore, Article 20 provides that "[t]he use of a trademark in the course of trade shall not be unjustifiably encumbered . . . ."[360]

In addition to the TRIPs provisions, the provisions under Article 6 of the Paris Convention (1967) are also to be taken into consideration when interpreting the TRIPs Agreement.[361] Thus, for instance, Article 6*bis*[362] and

355. *Id*. ¶ 7.1453.

356. Philip Morris Asia Ltd. (Hong Kong) v. Australia, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (Dec. 17, 2015).

357. Paris Convention, *supra* note 340, art. 6(A)(1). Article 6*s* provides for the protection of marks registered in one country of the Union in the countries of the Union. Thus, Article 6(a)(1) states: "Every trademark duly registered in the country of the origin shall be accepted for filing and protected as in the other countries of the Union." For further discussion, see, e.g., Ng-Loy Wee Loon, *Absolute Bans on the Registration of Product Shape Marks: A Breach of International Law*, *in* THE PROTECTION OF NON-TRADITIONAL TRADEMARKS: CRITICAL PERSPECTIVES 147 (Irene Calboli & Martin Senftleben eds., 2018); Andrew Mitchell, *Australia's Move to Plain Packaging of Cigarettes and its WTO Compatibility*, 5 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 399 (2010); Appellate Body Report, *United States — Section 211 Omnibus Appropriations Act of 1998*, ¶ 148, WTO Doc. WT/DS176/AB/R (adopted Jan. 2, 2002) (finding that parts of US law was not inconsistent with the TRIPS Agreement).

358. TRIPS Agreement, *supra* note 199, art. 15(1).

359. *Id.* art. 15(2).

360. *Id.* art. 20.

361. Paris Convention, *supra* note 340, art. 6.

362. *Id.* art. 6(B)(3) (providing that registration may be denied if the trademark is "contrary to morality or public order and, in particular, of such a nature as to deceive the public").

6*quinquies* are important. In terms of Article 6*quinquies* of the Paris Convention, it provides that (a) trademarks registered in one state "shall be accepted for filing and protected as in the other countries of the Union" and (b) trademarks can be denied registration or invalidation only under certain conditions.[363] These minimum standards on the registration and invalidation of trademarks were incorporated into the TRIPs Agreement.[364] The Paris Agreement, therefore, as default via the TRIPs Agreement, is part of the broader international law system and dispute settlement mechanism where states have a legal responsibility to comply with their international legal obligations. The TRIPs Agreement is the more "mature" treaty than the Paris Convention, in that the TRIPs takes the protection of trademarks beyond the minimum standards of the Paris Convention to a higher level that include recourse to an international dispute settlement system in the event there is a breach of treaty obligations.

When Australia introduced its plain packaging legislation and regulations[365] it was allegedly seen as a breach of the international obligations under the Paris Convention. The legislation was challenged in domestic courts by some companies such as Japan Tobacco[366] and furthermore, Phillip Morris also sought arbitration under the Hong Kong Australia BIT[367] for its alleged expropriation of intellectual property rights in Australia including its registered and unregistered trademarks. Philip Morris alleged that its intellectual property investments were expropriated given that "[t]he plain packaging legislation bars the use of intellectual property on tobacco products and packaging"[368] and sought compensation for financial loss under the treaty and also the suspension of the legislation.[369] Australia countered and argued that because Philip Morris used corporate restructuring to make the BIT claims it was an "abuse of right" in order to gain treaty protection.[370] The tribunal did not find Philip Morris's arguments convincing that its restructuring came about as a result of taxes and other

363. *Id.* art. 6(A)–(B).

364. TRIPS Agreement, *supra* note 199, art. 2(1).

365. *Tobacco Plain Packaging Act 2011* (Cth) (Austl.); *Tobacco Plain Pancaking Regulations 2011* (Cth) (Austl.).

366. *JT International SA v Australia* (2012) HCA 30 (Austl.) (holding that the Act was not in contravention of Section 51(xxxi) of the Australian constitution which grants the Parliament to make laws for "the acquisition of property on just terms.")

367. H.K.-Austl. BIT, *supra* note 109.

368. Philip Morris Asia Ltd. (Hong Kong) v. Australia, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility, ¶ 7 (Dec. 17, 2015).

369. *Id*. ¶ 8.

370. *Id*. ¶ 546.

financial concerns[371] and ultimately declined jurisdiction.[372]

> [T]he initiation of this arbitration constitutes an abuse of rights, as the corporate restructuring by which the Claimant acquired the Australian subsidiaries occurred at a time when there was a reasonable prospect that the dispute would materialise and as it was carried out for the principal, if not sole, purpose of gaining Treaty protection. Accordingly, the claims raised in this arbitration are inadmissible and the Tribunal is precluded from exercising jurisdiction over this dispute.[373]

Based on this ruling, the Tribunal was more concerned about how corporate restructuring constituted an abuse of rights, as opposed to whether Australia's international obligations were being met. In fact, the tribunal only on one occasion directly raised concerns about international treaties such as the TRIPs Agreement by noting that "intellectual property or *like treaties* (such as the WTO TRIPs Agreement) and international investment treaties (i.e. BITS or FTAs)" are part of the sequence in how the dispute arose.[374] The lack of examination by the tribunal on the international intellectual property treaties or, what it called on two occasions, "like treaties"[375] is difficult to fathom. Thus, by averting the substantial claims on the expropriation of intellectual property rights and instead, turning to whether the jurisdictional challenge was more important,[376] the tribunal effectively side-lined the relevance of international intellectual property obligations under international law.

If the tribunals had offered more discussions on some of the specifics on "use of trademarks," or "international obligations" under intellectual property treaties, for example, this would in my view, make the *Plain Packaging Act* (2011) more palatable to digest. In other words, it would have been easier to argue that Australia "expropriated the intellectual property investments" of Philip Morris Asia Ltd.[377] In this regard, the

371. *Id*. ¶ 582.

372. *Id*. ¶ 588. The Tribunals' lengthy discussions on the scope of jurisdiction are set out in paragraphs 524 through 534. For an analysis, see Ulf Linderfalk, *Philip Morris Asia Ltd v. Australia – Abuse of Rights in Investor-State Arbitration* 86 NORDIC J. of INT'L Law 404 (2017).

373. *Philip Morris*, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility, ¶ 588.

374. *Id.* ¶ 392.

375. *Id.* ¶¶ 392, 446.

376. *Id.* ¶¶ 524–34.

377. *Id.* ¶¶ 559–68.

meaning of trademark "use" is relevant to the dynamics of how investments are expropriated. Furthermore, the issue of international registration of trademarks had also been under looked. The TRIPs provide for registration under Article 15 and "use" under Article 20, and equally, the Paris Convention (1967) provides for trademark registration under Article 6*quinquies*, and Article 6*bis* provides, among other things, to prohibit the "use" of a mark under certain circumstances. Thus, the "use" test is important in light of international intellectual property obligations. This leads me to the 2018 decision of the WTO regarding the Plain Packaging legislation.[378] My discussion in the next few paragraphs relates to the issue of jurisdiction in international private law as part of the network of obligations argument vis-à-vis trademark use.

In *Australia — Certain Measures*, the Panel effectively sided with Australia and upheld Australia's plain packaging legislations. There are many issues that the Panel addressed in the lengthy report that spanned more than eight hundred pages. I have discussed parts of it earlier, and in order to be succinct for the purposes of the rest of the discussion, I am concerned mostly with how the Panel dealt with the issue of "trademark use" in TRIPs Article 20. The main part of this provision states:

> The use of a trademark in the course of trade shall not be unjustifiably encumbered by special requirements, such as use with another trademark, use in a special form or use in a manner detrimental to its capability to distinguish the goods or services of one undertaking from those of other undertakings.[379]

The Panel examined in detail a number of key concepts from TRIPS Article 20, such as "use," "in the course of trade," and "unjustifiably encumbered," and ultimately viewed Australia's measures as "far-reaching" regarding the economic effects on private rights holders.[380] Nevertheless, the Panel observed that even though the "use of trademarks" to "distinguish products in the marketplace" is important[381] there was no need to "conflate actual trademark use with different functions served by such use."[382] The introduction by the Panel of the trademark use versus trademark functions, was in my view, the opportunity for the Panel to rule that Australia did not

378. Panel Reports of 2018, *supra* note 54.
379. TRIPS Agreement, *supra* note 199, art. 20.
380. Panel Reports of 2018, *supra* note 54,¶ 7.2569.
381. *Id.*¶ 7.2561.
382. *Id.* ¶ 7.2563.

breach its commitments under Article 20 in order to "improve public health."[383] Thus, in the end, it was Article 8.1 of the TRIPs Agreement permitting members to adopt measures to protect public health and was therefore justifiable that swayed the Panel.[384] These developments, where an international tribunal effectively asserted jurisdiction and interpreted an international treaty (the network of obligation effect as I construe it) are important for the culture of privatization thesis that run throughout this Article.

What we have seen, for the purposes of the network of obligations arguments in this section, is that although the hierarchy of tribunals vary in the international system, they all conform and apply the *rule* of international law to disputes that are the domain of private rights nature. The *Philip Morris v. Australia* arbitration was about how private trademark rights were expropriated and equally, the *Australia — Certain Measures* was about how states breach their international obligations to protect private trademark rights.

The hierarchy of tribunals, in turn, either assess if they can assert jurisdiction to arbitrate when private rights holders alleged expropriation of intellectual property rights under treaties, or a tribunal such as the WTO DSB turns to interpreting international treaties to which states are committed to protecting private intellectual property rights. This "criss-cross" approach to private rights in the international adjudicatory system reflects the duty to cooperate in dispute settlement and how private rights holders such as Philip Morris Asia Ltd can invoke the rule of international law for its own economic purpose.

These dynamic relationships build up a system of network of obligations that meets the needs of the two major constituents in international intellectual property governance: private rights holders, and states as both the originator and enforcer of intellectual property rules. It is this dynamic relationship that international tribunals then respond to whenever an alleged breach of obligations occur.

VI. CONCLUSION: MORE QUESTIONS

This Article sought to clarify the needs of the community — generally discussed as the community of global intellectual property players — through different stages of privatization regulatory process that leads to the

383. *See id.* ¶¶ 7.2586, 7.2753 (analyzing Article 20 of the TRIPS Agreement from the perspective of Article 10*bis*(3) of the Paris Convention).

384. *See id.* ¶¶ 7.2399–7.2577

privatization of international law. I tried to explain in particular how certain interpretative tribunals "succeed in *making* legal authority"[385] in the international legal system. Moreover, the early linkage of intellectual property with the concept of investment in BITs and ICSID cases that were not of an intellectual property nature were excavated to show the relation on emerging narratives on international investment and intellectual property. Additionally, the article invoked arguments from HLA Hart's *Concept of Law* to provide a theoretical foundation on the privatization of international law through intellectual property norms in the global system.

Nowadays, the international legal system is being expanded upon with the emergence of (or negotiations) of various super trading and investment agreements such as CETA, the TPP, the Regional Comprehensive Economic Partnership (RCEP) or other super-BITS such as the *US — Australia FTA* that have intellectual property provisions that "have been defined and driven by specific sectoral demands of the industries concerned, as they were translated in negotiating positions of industrialized country governments."[386]

Naturally, one cannot discount the influence of different sub-sectors of intellectual property rights and their epistemic representatives for not being influential in international intellectual property rulemaking. On the contrary, all epistemic forces in intellectual property rights are influential, and in the case of *brail epistemic forces*, have influenced the negotiations and conclusions of treaties for copyrights and brail.[387]

The influence arises because intellectual property rights are private rights and rights holders use a variety of networks (epistemic systems) to lobby governments in setting negotiating agendas and formally adopting international legal instruments.[388] From this perspective, the privatization of

385. NILS JANSEN, THE MAKING OF LEGAL AUTHORITY: NON-LEGISLATIVE CODIFICATIONS IN HISTORICAL CONTEXTS AND COMPARATIVE PERSPECTIVE 77 (2010).

386. Thomas Cottier, *Intellectual Property and Mega-Regional Trade Agreements: Progress and Missed Opportunities*, *in* MEGA-REGIONAL TRADE AGREEMENTS: CETA, TTIP, AND TISA – NEW ORIENTATIONS FOR EU EXTERNAL ECONOMIC RELATIONS 156 (Stefan Griller et al. eds. 2017); *see also* Peter Yu, *The RCEP and Trans-Pacific Intellectual Property Norms*, 50 VAND. J. TRANSNAT'L L. 673 (2017).

387. *See* Marrakesh Treaty to Facilitate Access to Published Works for Persons Who Are Blind, Visually Impaired, or Otherwise Print Disabled, June 27, 2013, available at http://www.wipo.int/meetings/en/doc_details.jspPdoc_id=24l683. *But see* Margot Kaminski & Shlomit Yanisky-Ravid, *The Marrakesh Treaty for Visually Impaired Persons: Why a Treaty was Preferable to Soft Law*, 75 U. PITT. L. REV. 255 (2014).

388. *See* Katrina Moberg, *Private Industry's Impact on U.S. Trade Law and International Intellectual Property Law: A Study of Post-TRIPs U.S. Bilateral Agreements and the Capture of the USTR*, 96 J. PAT. & TRADEMARK OFF. SOC'Y 228 (2014).

international law occurs not only because of private actor's ability to concern themselves with the needs of the community through a privatization vision, but because the needs of the community also demand the recognition of global legal regulations by international law. In other words, as Philip Allot has argued, "international law, as properly conceived, must therefore control all the property-power which is exercised internationally in the form of legal relations."[389]

It is clear that legal relations in today's globalized world are still a matter of the state. Yet the evidence (as gathered in this work, and elsewhere[390]) has shown that states are nudged to perform legal relations on behalf of private actors and epistemic communities. More widely, the specific sectors of the intellectual property regimes have been actively engaged in diplomatic conferences or global agenda setting for the governance of intellectual property.

Furthermore, the concept of intellectual property must be seen more than just what is limited to narrow regulated rules such as trademarks, patents or copyrights. Intellectual property and allied rights are also part of a social fabric of global society that has relations to both artificial intelligence, biomedical modifications, technological innovations, and other social patterns of society. In other words, intellectual property and allied rights are entrenched in the evolutions and revolutions of global society. Such entrenchment, in turn give rise to new regulatory norms including the need for a way of describing the law-making process from the domestic to the global of modern intellectual property and allied rights.

Thus, in a similar way that nations are forced to work together in world crises — the evolutions and revolutions of intellectual property and allied rights have also coerced nations and other intellectual property players to engage in a normative and law-making process to respond to changes in the world order generated by intellectual property and allied rights.

We have seen how the allied rights of intellectual property have shaped the conversation about law and cyberspace,[391] and yet, there are bound to be more evolutions and revolutions that will challenge the concept of law

389. PHILIP ALLOT, EUNOMIA: NEW ORDER FOR A NEW WORLD 372 (2001).

390. *See* Terrence Halliday & Gregory Shaffer, *Transnational Legal Orders*, *in* TRANSNATIONAL LEGAL ORDERS 5 (2015) (developing a theory of transnational legal order which they defined as "a collection of formalized legal norms and associated organizations and actors that authoritatively order the understanding and practice of law across national jurisdictions"); *see also* YVES DEZALAY & BRYAN GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER (2010).

391. CHRIS REED & ANDREW MURRAY, RETHINKING THE JURISPRUDENCE OF CYBERSPACE (2018); CHRIS REED, MAKING LAWS FOR CYBERSPACE (2012).

relating to different aspects of intellectual property. Naturally, the formal requisites of law will remain as the baseline to develop how new challenges *qualify* as law. But the normative process that involves the different actors has already been a game of high stakes and power play as new normative dynamics attempt to shift the old guard and processes of law and regulatory change.

Thus, what the new modalities of evolution and revolution in global society represents, are either specific communities of knowledge, or how the interests of private rights holders' shapes changes in global society. As Slouka argues "the technological phenomenon tends to push normative issues not into one particular arena but into many of them simultaneously"[392] and for me, some of those normative issues create a culture of privatization in international law that is based on the needs of the community of players in the global regulatory system of intellectual property governance.

In this context, then international intellectual property law has come to symbolize the "legitimate expectations of members and private rights holders concerning conditions of competition."[393] But this does not mean that new modalities of intellectual property and allied rights developments in the global community is driving towards the end of the state as a global law-making entity. Rather, we need to better understand the rapid formation of normative orders and how the normative process works. Who are the participants, what motivates them, what are their goals and intentions, and at the very least, what is the legal structure that helps to explain new developments in international law and can that structure be described in a new language? Part of that new language maybe a theoretical framework of intellectual property investments. The evidence in this article on the legal characteristics of intellectual property investments and the changing dynamics in the adjudication disputes in tribunals suggests that the culture of privatization in international law is part of the new realms of relationship interpretations.

392. Zdenek Slouka, *International Law-Making: A View from Technology*, *in* LAW-MAKING IN THE GLOBAL COMMUNITY 163 (Nicholas Greenwood ed., 1982).

393. Report of the Appellate Body, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, ¶ 48, WTO Doc. WT/DS50/AB/R (adopted Dec. 7, 1997). *But see* Heinz Klug, *Campaigning for Life: Building a New Transnational Solidarity in the Face of HIV/AIDS and TRIPs*, *in* LAW AND GLOBALIZATION FROM BELOW: TOWARDS A COSMOPOLITAN LEGALITY (Boaventura de Sousa Santos and Cesar Rodriguez-Geravito eds., 2005).

POSTSCRIPT

Since I completed this Article (2016 - 2018)[394] along with a series of published and unpublished papers on intellectual property and investment using "heterodox legal argumentations", a number of articles and books by other scholars have since been published. Most of the narratives are similar and the few instances of hard-core cases are relied upon for support. My approach has always been "heterodox" and that is what separates my arguments from the various publications so far.[395] And in this Article, the emphasis has been on injecting HLA Hart in the narrative to paint a picture of the culture of privatization in international intellectual property and investment where adjudication has a practical meaning and also a jurisprudential one by looking beyond the texts of treaties with provisos on intellectual property and investment.

394. Parts of the paper have been updated to reflect developments in the law as opposed to style and narrative, or other editorial duties by members of this journal.

395. At the time of revision in 2021 some of the published papers including my own are: Mary Zhao, *Investor-State Dispute Settlement Reform: Reconsidering the Multilateral Investment Court in the Context of Disputes Involving Intellectual Property Law*, 44 COLUM. J.L. & ARTS 545 (2021); Pratyush Nath Upreti, *The Role of National and International Intellectual Property Law and Policy in Reconceptualising the Definition of Investment*, 52 INT'L REV. INTELL. PROP. & COMPETITION L. 103 (2021); RESEARCH HANDBOOK ON INTELLECTUAL PROPERTY AND INVESTMENT LAW (Christophe Geiger ed., 2020); EMMANUEL KOLAWOLE OKE, THE INTERFACE BETWEEN INTELLECTUAL PROPERTY AND INVESTMENT LAW: AN INTERTEXTUAL ANALYSIS (2021).

MOVIES TO FALL ASLEEP TO: THE ANTITRUST IMPLICATIONS OF TERMINATING THE PARAMOUNT CONSENT DECREES

ISHA C. BISWAS*

I. INTRODUCTION

U.S. antitrust law promotes competition and prevents monopolies in various industries in order to foster economic growth.[1] Antitrust law in the

*Editor-in-Chief, *American University Business Law Review,* Volume 12; J.D. Candidate, American University Washington College of Law, 2023; B.A. History, *cum*

media and motion picture industries became more of a controversial issue after *United States v. Paramount*[2] in 1948, a landmark case in the entertainment industry.[3] The studios subsequently signed the Paramount Consent Decrees (the "Paramount Decrees"), which would go on to govern anticompetitive practices jointly with the Sherman and Clayton Acts in the motion picture industry for the next six decades.[4] The resulting Paramount Decrees serve to restrict the original defendant studios from collusive and anticompetitive behavior, divest the major conglomerates, and set a new regulatory standard in conjunction with the Sherman Act.[5]

In 2018, the Department of Justice ("DOJ") reviewed legacy judgments to terminate any obsolete antitrust decisions that may not have any relevance or effect today.[6] Among those decisions was the Paramount Decrees, for which the DOJ filed a motion to terminate in 2020.[7] The Paramount Decrees were subsequently terminated by the United States District Court for the Southern District of New York.[8] The court cited many reasons, including new technology and changes in the law and market conditions.[9]

---

laude, 2020, Rutgers University, New Brunswick. The author would like to extend a huge thank you to the *American University Business Law Review* Volume 11 and 12 staff for all their hard work to make this piece possible. She is incredibly lucky to have constant support from her parents, loved ones, and friends. The author would specifically like to thank her parents, Niraj and Swati, for pushing her to dream big and for all of their countless sacrifices, and to thank her partner, Shubham Ojha, for all of his support and encouragement.

1. *See* Sherman Act, 15 U.S.C. §§ 1–2.

2. 334 U.S. 131 (1948).

3. *See* Jonathan A. Schwartz, *Bringing Balance to the Antitrust Force: Revising the Paramount Decrees for the Modern Motion Picture Market,* 27 UCLA ENT. L. REV. 45, 49 (2020) (reasoning that "the '*Paramount* Decrees' encapsulated over ten years of antitrust actions by the Department of Justice against the nation's largest film production, distribution, and exhibition companies").

4. *See id.*

5. *Id.* at 51–52 (discussing the invasive nature of the major movie studios' divestiture resulting from the Decrees).

6. Press Release, U.S. Dep't of Just., Department of Justice Announces Initiative to Terminate "Legacy" Antitrust Judgments (Apr. 25, 2018), https://www.justice.gov/opa/pr/department-justice-announces-initiative-terminate-legacy-antitrust-judgments (announcing that all "open" legacy judgments would be reviewed to facilitate the termination of those that "no longer serve to protect competition").

7. Press Release, U.S. Dep't of Just., Federal Court Terminates Paramount Consent Decrees (Nov. 19, 2020), https://www.justice.gov/opa/pr/federal-court-terminates-paramount-consent-decrees [hereinafter DOJ Press Release].

8. United States v. Paramount Pictures, Inc., 19 Misc. 544 (AT), 2020 U.S. Dist. LEXIS 141427 (S.D.N.Y. Aug. 7, 2020).

9. *Id.* at *12 (reasoning that "seventy years of technological innovation, new competitors and business models, and shifting consumer demand have fundamentally

This Comment will argue that, while the Consent Decrees seem obsolete in the 21st century when studios own significant numbers of theaters, movies are no longer released one theater at a time like they were in 1948, which implicates relevant antitrust standards. With the prevalence of streaming, termination of the Paramount Decrees would allow streaming giants such as Disney+ and Netflix to monopolize the movie release market through the hybrid release model, impacting future case law and litigation. Part II of this Comment will examine the *Paramount* case, the consent decrees that resulted from it, and the judicial and congressional history of antitrust in the movie industry. Part III will apply those antitrust standards, case law, and the Sherman Act to the hybrid streaming model. Finally, Part IV will recommend that the Paramount Decrees be reworked in order to accommodate for the hybrid streaming model and stay in line with the Sherman Act and antitrust precedent as well as to preserve artistic integrity in the motion picture industry.

II. THE JUDICIAL HISTORY OF ANTITRUST IN THE MOVIE AND BROADCASTING INDUSTRY AND THE PARAMOUNT CONSENT DECREES

A. The Sherman Act and Monopoly Power

Congress enacted the Sherman Act in 1890 to promote competition, economic liberty, and prevent growth of monopolies. The Sherman Act is enforced by the Federal Trade Commission ("FTC") and the DOJ.[10] Companies are evaluated under antitrust actions based on their anticompetitive conduct, barriers to entry into the industry, and attempts to monopolize.[11] Sections 1 and 2 of the Sherman Act are especially significant as they govern anticompetitive conduct.[12] Section 1 prohibits "every contract, combination, or conspiracy in restraint of trade," and is more geared toward coordinated anticompetitive conduct.[13] Section 2 prohibits "monopolization, attempted monopolization, or conspiracy or combination

changed the industry").

10. *The Enforcers*, FED. TRADE COMM'N, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/enforcers (last visited Apr. 27, 2022).

11. *See Monopolization Defined*, FED. TRADE COMM'N, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/single-firm-conduct/monopolization-defined (last visited Mar. 20, 2022); *see also* Eliot G. Disner, *Barrier Analysis in Antitrust Law,* 58 CORNELL L. REV. 862, 863–64 (1973) ("Advertising intensity and the size of existing firms have also been regarded as separate barriers to entry.").

12. *See* Sherman Act, 15 U.S.C. §§ 1–2.

13. *Id.* § 1; *see also Parallel Conduct and Section 1 of the Sherman Act,* EPSTEIN BECKER GREEN, https://www.ebglaw.com/insights/parallel-conduct-and-section-1-of-the-sherman-act/ (last visited Jun. 26, 2022).

to monopolize."[14] This section in particular serves to promote "the process of competition that spurs firms to succeed" by outlawing business methods which are incompatible with the competitive process.[15] Congress's intent in passing the Sherman Act was to promote a fair, open, and competitive marketplace, as "excessive market concentration threatens basic economic liberties, democratic accountability, and the welfare of workers, farmers, small businesses, startups, and consumers."[16] The Sherman Act also serves to preserve competition that "spurs companies to reduce costs, improve the quality of their products, invent new products, educate consumers, and engage in a wide range of other activity that benefits consumer welfare."[17]

Courts assess monopoly power based on several factors, the primary ones being market share, exclusionary conduct, and business justification, as well as strength of competition, nature of anticompetitive conduct, and elasticity of consumer demand.[18] Market share alone is not enough to sustain a claim under the Sherman Act, but monopoly power can be proven without this as well.[19] The factors for monopoly power must be assessed on a case-by-case basis and weighed accordingly.

B. United States v. Paramount and the Resulting Consent Decrees

In 1948, the DOJ filed a lawsuit against eight major movie studios claiming several antitrust violations such as horizontal and vertical price

14. 15 U.S.C. § 2; *see also Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act: Chapter 1*, U.S. DEP'T OF JUST., https://www.justice.gov/atr/competition-and-monopoly-single-firm-conduct-under-section-2-sherman-act-chapter-1 (last visited Mar. 18, 2022) (describing how specific intent to monopolize entails a "specific intent to destroy competition or build monopoly").

15. U.S. DEP'T OF JUST., *supra* note 14.

16. Exec. Order No. 14,036, 86 Fed. Reg. 36,987 (July 9, 2021). *Compare* Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7, 8 (1966) (asserting that "Congress intended the courts to implement . . . only that value we would today call consumer welfare"), *with* Barak Orbach, *How Antitrust Lost Its Goal*, 81 FORDHAM L. REV. 2253, 2255–57 (2013) (stating that "consumer welfare" is an ambiguous term and that the Sherman Act's legislative history does not support the claims leading to the adoption of the consumer welfare standard).

17. U.S. DEP'T OF JUST., *supra* note 14.

18. *See* FED. TRADE COMM'N, *supra* note 11.

19. *See id*; *see also* William E. Kovacic, et al., *Plus Factors and Agreement in Antitrust Law,* 110 MICH. L. REV. 393, 397, 405 (listing the "chief plus factors," including actions contrary to each defendant's self-interest unless pursued as part of a collective plan, phenomena that can be explained rationally only as the result of concerted action, evidence that the defendants created the opportunity for regular communication, industry performance data that suggests successful coordination, and the absence of a plausible, le4gitiate business rationale for suspicious conduct).

fixing and other behaviors that prevented smaller studios from engaging in reasonable competition within the industry.[20] This lawsuit produced the Paramount Decrees that governed the actions of movie studios for decades.[21] Horizontal price fixing is "any arrangement among competitors that interferes with" the influence of free market forces on setting prices organically.[22] Horizontal price fixing does not have to be explicit in writing but can also be indirect or inferred from its detrimental effects.[23] Vertical price fixing on the other hand refers to agreements between entities in a supply or distribution chain, either controlling prices or more implicitly in terms of customer or territorial restrictions.[24]

For years, the Paramount Decrees successfully prevented price-fixing actions that violated the Sherman Act.[25] Until 1948, Paramount, Loew's, Warner, RKO, and Fox (five of the "major defendants") owned large movie theater circuits, including "over seventy percent of the best and largest 'first-run' theaters in the ninety-two largest cities in the United States."[26] This structure led to collusion because the defendants limited the first run of their pictures to the theaters that the major defendants owned and controlled.[27] In addition, they closed off first-run theaters to their competitors, who were independent motion picture distributors.[28] In the initial *Paramount* lawsuit, the district court found monopoly power in the distribution market for the first-run movies and found a conspiracy in the licensing practices, which limited local theaters by admission price-fixing, run categories, and clearances.[29]

---

20. United States v. Paramount Pictures, Inc., 334 U.S. 131, 140 (1948).

21. *See id*.

22. 1 JULIAN O. VON KALINOWSKI ET AL., ANTITRUST LAWS AND TRADE REGULATION: DESK EDITION § 2.03 (2d ed. 2021).

23. *See id.* ("An agreement need not literally fix prices to be condemned as illegal horizontal price fixing, nor does it matter whether the price fixing agreement is direct or indirect.").

24. *See id.* § 2.04; *see also Dealings in the Supply Chain*, FED. TRADE COMM'N, https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/dealings-supply-chain (last visited Apr. 27, 2022) (providing that vertical relationships in the supply chain are tested for reasonableness because they may violate antitrust laws if they reduce competition between companies at the same level or prevent new ones from entering the market).

25. *See Paramount Pictures, Inc*., 334 U.S. at 172; *see also* Schwartz, *supra* note 3, at 68–70 (tracing the Consent Decrees' history and the *Paramount* decision's legacy).

26. United States v. Paramount Pictures, Inc., No. 19 Misc. 544 (AT), 2020 U.S. Dist. LEXIS 141427, at *3 (S.D.N.Y. Aug. 7, 2020) (citing *Paramount Pictures, Inc.*, 334 U.S. at 167).

27. *See id.*

28. *See id.*

29. *See id.* at *4.

The DOJ imposed consent decrees with several conditions. The decrees limited block booking, which is the practice of licensing films in groups by conditioning one film license on many others.[30] Additionally, the decrees prohibited the buying of films without viewing and replaced this practice with special screenings at which representatives of all theater districts in the country could see films before booking any.[31] The decrees also barred the defendants from setting minimum movie ticket prices, granting exclusive film licenses for overly-broad geographic areas, and licensing a film to all theaters under common ownership instead of by individual theater.[32] The imposition of the decrees proved to be especially influential as it fully uncovered the vertical agreements that unreasonably restrained trade and established that even without an explicit horizontal agreement to fix prices, courts can infer collusion from the facts and the effects of such restraints of trade.[33] The Supreme Court in this case inferred a horizontal agreement between the major defendants from examining the similar price structures, which served as important evidence of collusion, barriers to entry, and anticompetitive conduct.[34] Following *Paramount*, the DOJ created the Society of Independent Motion Picture Producers to regulate and impose these requirements.[35] Additionally, the DOJ ordered Paramount to divest between film distribution and exhibition and sell their theaters to new independent companies in order to foster competition, eliminate barriers to entry, and allow more independent distributors and studios to enter the market.[36]

C. Notable Cases After United States v. Paramount

Cases following *Paramount* have largely built upon the structure and

30. *See id.* at *5–6; *see also* Mark Marciszewski, *The Paramount Decrees and Block Booking: Why Block Booking Would Still Be a Threat to Competition in the Modern Film Industry*, 45 VT. L. REV. 227, 230 (2020) (describing the practice of "block booking" as bundling multiple films under one license, which the Paramount Decrees outlawed).

31. *See Paramount Pictures, Inc.*, 334 U.S. at 146 n.11.

32. *Paramount Pictures, Inc.*, 2020 U.S. Dist. LEXIS 141427, at *6.

33. *See* Alexandra Gil, *Breaking the Studios: Antitrust and the Motion Picture Industry*, 3 NYU J.L. & LIBERTY 83, 110–12 (2008) (noting how the court found inferred collusion without an explicit horizontal agreement to fix prices).

34. *See id.* at 111-12 (explaining that the court inferred price fixing from the uniformity of ticket prices absent a horizontal agreement to set a minimum price).

35. *See The Formation of the Society (1941 & 1942)*, HOLLYWOOD RENEGADES ARCHIVE, https://www.cobbles.com/simpp_archive/simpp_1941formation.htm (last visited Apr. 28, 2022).

36. U.S. Dep't of Just., *supra* note 7; *see also The Paramount Decrees*, U.S. DEP'T OF JUST., https://www.justice.gov/atr/paramount-decree-review (last visited Jun. 26, 2022).

standards that were laid out in the Paramount Decrees.[37] *United States v. Loew's*,[38] decided in 1962, concerned the violation of Section 1 of the Sherman Act regarding block booking, even though there was no evidence of an elaborate monopolization scheme in addition to the tying agreements.[39] The government brought suits against six major motion picture distributors alleging that each one engaged in block booking in violation of Section 1 of the Sherman Act to show their programs on television.[40] The Supreme Court held that block booking was illegal according to the standards set forth in *Paramount* and the Sherman Act, even though it was applied to a television program rather than a motion picture.[41] The defendants conditioned the licensing of one copyright on another's acceptance, so block booking occurred when the defendants "conditioned the license or sale of one or more feature films upon the acceptance . . . of a package or block containing . . . inferior films."[42] Often, agreements that tie distributors together to suppress competition or fix prices may force consumers into giving up their autonomy in purchasing a product as they are forced to purchase the tied products.[43] Tying agreements may also have other unintended consequences, such as jeopardizing the access of competing suppliers in a free market.[44] Another issue with block booking is that, due to the conditional nature of the copyright license, movies are equalized in terms of quality, target audience appeal, themes, and performances.[45] This occurs especially when the requirement that all be taken if one is desired increases the market for those that may not be as well-made or in demand; "each stands not on its own

37. *See* Jefferson Par. Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 16 (1984) (stating how conditioning a patented item on the purchase of other products from the patentee is prohibited and equating this practice to block booking); Broad. Music, Inc. v. Columbia Broad. Sys., Inc., 441 U.S. 1, 28 (1979) (asserting that "[t]he rules which prohibit a patentee from enlarging his statutory monopoly by . . . refusing to grant a license under one patent unless the licensee also takes a license under another, are equally applicable to copyrights").

38. 371 U.S. 38 (1962).

39. *See id.* at 49, 51–52 (discussing that "the thrust of the antitrust laws cannot be avoided merely by claiming that the otherwise illegal conduct is compelled by contractual obligations").

40. *See id.* at 40.

41. *See id.* at 48–49.

42. *Id.* at 40.

43. *See id.* at 45 (noting the Court's recognition that "tying agreements serve hardly any purpose beyond the suppression of competition").

44. *See id.* at 45 (listing cutting off completing suppliers' access as one of two undesirable effects of tying agreements).

45. *See id.* at 47–49 (referring to "equalizing" as the copyright law practice in which a film of inferior quality borrows quality from a high-quality film, thus "strengthen[ing] its monopoly by drawing on the other").

footing but in whole or in part on the appeal which another film may have."[46]

Another notable case in this realm is *Sony Corp. of America v. Universal City Studios, Inc.*,[47] in which the Supreme Court held that Sony could not be held liable for copyright infringement for broadcasting Universal's copyrighted works on their Betamax devices to consumers.[48] The Court reasoned that "although every commercial use of copyrighted material is presumptively an unfair exploitation of the monopoly privilege that belongs to the owner of the copyright, noncommercial uses are a different matter" because they require proof that the use is harmful or that it would "adversely affect the potential market for the copyrighted work."[49] Time-shifting in this case, with viewing the copyrighted material at different times from the broadcast, was not an infringement on the monopoly rights of a copyright holder for the original work.[50]

Around the same time in 1984, the Supreme Court decided *National Collegiate Athletic Ass'n v. Board of Regents*,[51] determining that the National Collegiate Athletic Association ("NCAA") unreasonably restrained trade in televising football games through a system that had appearance requirements and limitations on how often a member institution could appear on television.[52] The district court found multiple restraints on competition due to the streaming plan, including instances of price-fixing for particular telecasts, exclusive network contracts and sanctions, and an artificial limit on the football broadcasts.[53] The Supreme Court ruled that the NCAA's practices were restraints on trade because they limited their members' "freedom to negotiate and enter into their own television contracts," and that the ceiling on the number of games permitted to be televised was an artificial limit.[54]

Lastly, in *United States v. International Business Machines Corp.*,[55]

46. *See id.* at 47.

47. 464 U.S. 417 (1984).

48. *Id.* at 421.

49. *Id.* at 451.

50. *See id.* at 454–55 (finding that the time-shifting practice was unlikely to "impair the commercial value of their copyrights or . . . create any likelihood of future harm").

51. 468 U.S. 85 (1984).

52. *See id.* at 91–94 ("[The television plan] limits the total amount of televised intercollegiate football and the number of games that any one team may televise. No member is permitted to make any sale of television rights except in accordance with the basic plan.").

53. *See id.* at 96.

54. *See id.* at 98–99 (explaining that horizontal agreements that limit output and price fixing are unreasonable restraints of trade).

55. 163 F.3d 737 (2d Cir. 1998).

International Business Machines ("IBM") moved to terminate the remaining provisions of a longstanding antitrust consent decree.[56] The government filed a civil antitrust complaint filed against IBM in 1952 that alleged that "IBM had used its monopolistic market power in the electronic tabulation machine industry to force customers to lease, rather than purchase, its machines," restraining trade.[57] In 1956, the government and IBM entered into a consent decree that constrained IBM's ability to exercise its market power, with the intention of encouraging competition.[58] It required IBM to sell its machines in addition to leasing them, as well as sell parts and provide training to outside firms that could compete with IBM for supplies and services for IBM machines.[59] It also prohibited IBM from reacquiring its machines.[60] Most of the decree provisions were terminated in 1995, as tabulating machines became obsolete, and some other provisions were automatically terminated.[61] The government proceeded to investigate the impact of terminating the decree provisions with respect to two specific computers: the S/390 and AS/400 lines.[62] The court terminated the decree provisions, finding that the phasing out presented no material threat of violating Sections 1 and 2 of the Sherman Act, as there was now an active market for computer repair services and the market would likely remain competitive if the decree was terminated because IBM would continue to sell spare parts to independent repair providers.[63] The court also found that IBM faced some competition in the computer market, deterring monopolistic tactics.[64]

D. The Hybrid Streaming Model

The emergence of streaming in today's day and age has numerous legal implications in terms of licensing and competition in the motion picture

56. *Id.* at 739.

57. *Id.* at 738 (providing that the civil complaint filed alleged that "IBM monopolized, attempted to monopolize, and restrained trade" under Sections 1 and 2 of the Sherman Act).

58. *Id.* (noting that IBM chose to enter into a consent decree with the government rather than proceed to trial).

59. *Id*. at 738–39.

60. *Id.* at 738.

61. *Id*. at 739 (stating that, in 1995, the government agreed to terminate all of the consent decree's provisions except as they applied to two specific product lines).

62. *Id*.

63. *Id*. at 740.

64. *Id*. (including "monopolistic tactics designed to shut off the supply of parts to independent repair companies").

industry.[65] Most notably, the new phenomenon of the hybrid streaming model raises many questions about how antitrust should be handled today when it comes to movies.[66] The hybrid streaming model is the simultaneous release of a movie both in theaters and on a streaming platform, such as Netflix or Disney+.[67] Robust competitors such as Netflix dominate the motion picture industry while avoiding many of the strict regulations which are imposed on the major movie studios.[68] In December of 2021, Legendary Entertainment, the production company behind *Dune* and *Godzilla vs. Kong*, was largely unaware that Warner Bros. planned to send seventeen films to HBO Max and any open theaters at the same time.[69] As a result, Legendary's executives considered suing Warner Bros., and *Dune*'s director, Denis Villeneuve, spoke to *Variety* in an op-ed in December of 2020 to condemn the HBO Max deal.[70] In 2021, Warner Bros. announced during the pandemic that all its 2021 movies would be released on both HBO Max and in theaters.[71] Bloomberg reported in January of 2021 that Warner Bros. may enact a multiplier that would lower the threshold of box office revenue needed to trigger a payout.[72] This multiplier would guarantee payment

---

65. *See* Dawson Oler, Note, *Netflix, Disney+, & a Decision of Paramount Importance*, 2020 U. ILL. J.L. TECH. & POL'Y 481, 491 (2020) (noting that "the [Paramount] Decrees [are] not binding upon streaming services like Netflix and Amazon").

66. *See id.*

67. *See id.* at 491–92 (describing the hybrid streaming model as one that uses both a theatrical release and streaming platforms to showcase films).

68. *See id.* at 491 (pointing out that the Department of Justice originally emphasized that streaming services, such as Netflix, were not bound by the Paramount Decrees).

69. Rebecca Rubin & Brent Lang, *'Dune' Producer Legendary Entertainment May Sue Warner Bros. Over HBO Max Deal*, VARIETY (Dec. 7, 2020, 9:50 AM), https://variety.com/2020/film/news/legendary-entertainment-warner-bros-hbo-max-deal-dune-godzilla-1234847605/; *see also* Rebecca Rubin, *Film Critics Say 'Dune' Should Be Seen on the Big Screen. Here's Why Warner Bros. Still Plans to Debut the Movie Simultaneously on HBO Max*, VARIETY (Sept. 13, 2021, 1:35 PM), https://variety.com/2021/film/box-office/dune-hbo-max-release-1235062312/; Owen Gleiberman, *'Dune' Is Opening in Movie Theaters . . . and Your Living Room. Here's Why That's a Mistake (Column)*, VARIETY (Sept. 26, 2021, 11:16 AM), https://variety.com/2021/film/columns/dune-hybrid-release-warner-bros-hbo-max-1235074489/.

70. Rubin, *supra* note 70; *see also* Denis Villeneuve, *'Dune' Director Denis Villeneuve Blasts HBO Max Deal (EXCLUSIVE)*, VARIETY (Dec. 10, 2020, 5:00 PM).

71. *See* Rubin & Lang, *supra* note 69; *see also* Rubin, *supra* note 70; Gleiberman, *supra* note 70.

72. Lucas Shaw & Kelly Gliblom, *Warner Bros. Guarantees Filmmakers a Payday for HBO Max Movies*, BLOOMBERG (Jan. 9, 2021, 5:36 PM), https://www.bloomberg.com/news/articles/2021-01-09/warner-bros-guarantees-filmmakers-a-payday-for-hbo-max-movies (noting that the stipulation that "if more theaters close down, the threshold will fall further" is known as the "Covid-19

regardless of box-office sales or theaters being closed.[73] With an absence of regulations in the motion picture industry regarding the hybrid release model, movie studios and production companies are crafting their own arrangements.[74] Some studios have struck deals with theaters to shorten the theatrical window, after which they can release the movie to streaming platforms.[75]

E. The Termination of the Paramount Decrees

In 2018, the Antitrust Division of the DOJ reviewed the Paramount Decrees with the intention to "terminate or modify 'legacy antitrust judgments that no longer protect competition' because of 'changes in industry conditions, changes in economics, changes in law, or for other reasons.' "[76] Since the establishment of the Paramount Decrees, the major defendants had to "separate their distribution and theater operations; today, none of them own an appreciable percentage of the nation's movie theaters."[77] Major films are now released to thousands of theaters at one time, and film distributors are no longer as reliant on theatrical distribution due to the advent and proliferation of streaming services.[78] Many of the original defendants from the *Paramount* case are no longer in business or distribute far fewer films, and new motion picture distributors have entered

multiplier").

73. *See id.* (providing that "anyone entitled to a bonus will receive one at half the box-office revenue that would normally be needed to trigger a payout").

74. *See* Travis Clark, *Why Movie-theater Owners are Still Troubled by Hybrid Release Strategies, Even as Some Studios Commit to an Exclusive Theatrical Window*, BUS. INSIDER (Aug. 26, 2021, 3:27 PM) (highlighting that "Universal has struck deals with the major theater chains to shorten the theatrical window to as little as 17 days, at which point it can release its movies to digital-rental platforms," Warner Bros. intends to grant a forty-five-day exclusive theatrical window starting next year, and Paramount plans to release some of its movies to Paramount+ after forty-five days); *see also* Scott Mendelson, *First 'Matrix 4' Poster Hints At a Preference in Streaming Vs. Theaters Debate*, FORBES (Sept. 8, 2021, 1:35 PM), https://www.forbes.com/sites/scottmendelson/2021/09/08/movies-matrix-resurrections-poster-keanu-reeves-wachowski-hbo-max-warner-bros/?sh=4c13623d7ef5.

75. *See* Clark, *supra* note 74 (discussing major film studios' release plans).

76. United States v. Paramount Pictures, Inc., No. 19 Misc. 544 (AT), 2020 U.S. Dist. LEXIS 141427, at *6–7 (S.D.N.Y. Aug. 7, 2020) (quoting U.S. Dep't of Just., *supra* note 6).

77. *Id.* at *12; *see also* José Gabriel Navarro, *Movie Studios in the U.S. - Statistics & Facts*, STATISTA (Nov. 30, 2021), https://www.statista.com/topics/4394/movie-studios/#dossierKeyfigures (noting that Disney, Paramount, Sony, Universal, and Warner Bros. held about 81 percent of the movie market in the U.S. and Canada as of September 2021).

78. *Paramount Pictures, Inc.*, 2020 U.S. Dist. LEXIS 141427, at *13–14.

the market who are not part of the Paramount Decrees.[79]

III. ANALYZING THE TERMINATION OF THE PARAMOUNT CONSENT DECREES WITH THE CURRENT STREAMING LANDSCAPE

With the emergence of streaming in today's motion picture industry, the lack of regulatory authority and oversight is more relevant than ever. Hybrid streaming, a newer phenomenon, implicates many of the antitrust factors that courts look at to determine monopoly power and circumvents the regulations that the Paramount Decrees once enforced.[80]

A. The Relevance of the Paramount Decrees to the Hybrid Streaming Model

The hybrid release model may be contractually sound, but, in effect, stifles competition and minimizes a competitor's revenue (a competitor in this case being a traditional movie studio such as Loew's or Regal).[81] The Paramount Decrees are integral to the functioning of the motion picture industry, even today as streaming services proliferate and have changed the landscape of the movie industry fundamentally.[82]

The Paramount Decrees not only outlawed block booking, blind screening, and other anticompetitive practices in Hollywood at the time, but also changed what kind of evidence a party can present to allege an antitrust violation in the media industry.[83] The Court's reasoning in *Paramount* relied on effects, rather than express agreements and verbatim language, to prove conspiracy and monopolization.[84]

79. *Id.* at *14–15 (providing as examples that the RKO film distribution company is no longer in business, that MGM currently distributes far fewer films than it did in the 1930s and 1940s, and that Disney has become a leading movie distributor).

80. *See, e.g.*, Complaint at 5, Periwinkle Ent., Inc., f/s/o Scarlett Johansson v. Walt Disney Co., No. 21STCV27831 (Cal. Super. Ct. July 29, 2021) [hereinafter *Periwinkle* Complaint] (describing how the hybrid release of *Black Widow* would "bolster Disney's market valuation").

81. *See* Oler, *supra* note 65, 491–92 (explaining how COVID-19 in the United States led major studios to use streaming platforms to showcase their movies over the exclusive theatrical experience).

82. *See* United States v. Paramount Pictures, Inc., 334 U.S. 131, 140–41 (1948) (describing the complaint giving rise to the Paramount Decrees as charging the defendants with restraining trade in the distribution and exhibition of films).

83. *See Paramount Pictures, Inc.*, 2020 U.S. Dist. LEXIS 141427, at *7; *see also* U.S. Dep't of Just., *supra* note 6.

84. *See Paramount Pictures, Inc.*, 334 U.S. at 142 ("It is not necessary to find an express agreement in order to find a conspiracy. It is enough that a concert of action is contemplated and that the defendants conformed to the arrangement."); *see also* U.S. DEP'T OF JUST., *supra* note 14 (explaining how Section 2 of the Sherman Act "achieves this end by prohibiting conduct that results in the acquisition or maintenance of

However, movies are no longer only shown in theaters under the hybrid model, which was the original framework for the decrees.[85]

B. Application of Court Factors to the Hybrid Release Model

The effects of the hybrid model work to stifle competition in terms of licensing and revenue streams and are thus problematic under antitrust law.[86] A court looks at many factors to assess monopoly power, including market share, strength of competition, probable development of industry, barriers to entry, nature of anticompetitive conduct, and elasticity of consumer demand.[87] The anticompetitive conduct in this case refers to the competition between traditional theater chains and streaming services.[88] With streaming services releasing a movie at the same time as a theater, anticompetitive conduct is evident in that the theaters and production studios lose out on revenue they would have otherwise had if it was not released simultaneously.[89] In this instance, the elasticity of consumer demand is not

---

monopoly power, thereby preserving a competitive environment that gives firms incentives to spur economic growth").

85. *See Paramount Pictures, Inc.*, 334 U.S. at 140–41 (describing how the complaint giving rise to the Paramount Decrees charged the defendants with restraining trade in the distribution and exhibition of films).

86. *See, e.g.*, *Periwinkle* Complaint, *supra* note 80, at 12–13 (arguing Disney moved films slated for theatrical release to its streaming platform to hurt theatres while bolstering the bottom line for the new subscription service); Eriq Gardner, *Indie Cinema Alliance Warns Amazon May Buy Movie Theaters, Abuse Power if DOJ Gets Its Way*, HOLLYWOOD REPORTER (Jan. 17, 2020, 11:47 AM), https://www.hollywoodreporter.com/business/business-news/indie-cinema-alliance-warns-amazon-may-buy-movie-theaters-abuse-power-doj-gets-way-1270696/ [hereinafter Gardner, *Indie Cinema*] (suggesting that owners of streaming services may purchase physical theatres to push their own film releases); Eriq Gardner, *The Real Impact of Getting Rid of the Paramount Consent Decrees,* HOLLYWOOD REPORTER (Aug. 16, 2018, 6:55 AM), https://www.hollywoodreporter.com/business/business-news/real-impact-getting-rid-paramount-consent-decrees-1134938/ [hereinafter Gardner, *Real Impact*] ("[O]nce-restricted practices that might have been perceived as an illegal restraint of trade in one era may be given a fresh look as pro-competitive in a different era. If Disney wished to tempt scrutiny by conditioning the license of the latest Avengers film on a theater accepting its other movies, Disney would probably point to how indie producers have access to Netflix and other alternative distribution markets.").

87. *See* Sherman Act, 15 U.S.C. § 1; *see also* Thomas G. Krattenmaker et al., *Monopoly Power and Market Power in Antitrust Law*, 76 GEO. L.J. 241, 254–55 (1987).

88. *See generally* Gardner, *Real Impact*, *supra* note 87 (explaining how streaming services may foray into purchasing traditional theaters, and the market power of studios has diminished since the Paramount Consent decrees were established).

89. *See* Schwartz*, supra* note 3, at 89–90; *see also* Tyler Riemenschneider, *'Don't Run Up the Stairs!': Why Removing the Paramount Decrees Would Be Bad for Hollywood*, 13 OHIO. ST. BUS. L.J. 334, 350–51 (2019).

as transient.[90] Consumer demand for movies is steady with the supply of movies that are released, but also fluctuates depending on where it is released and economic factors.[91] Most recently, the COVID-19 pandemic severely affected the demand for movie theaters.[92] During the pandemic, consumers were more likely to watch movies on streaming platforms than theatres due to personal safety and a majority being closed for months.[93] Consequently, streaming services took advantage of people staying home to watch movies rather than in theaters, which is inherently anticompetitive.[94] Additionally, barriers to entry remain prevalent today.[95] The industry currently makes it almost impossible for smaller studios to enter and succeed in the market without a streaming service alternative or the means to do so.[96] Without

90. *See* Olivia Pakula, *The Streaming Wars+: An Analysis of Anticompetitive Business Practices in Streaming Business*, 28 UCLA ENT. L. REV. 147, 149, 159 (2021) (explaining that streaming video on demand revenues generated $50 billion in revenue in 2019, and that many streaming services have now been creating their own original content in order to further take advantage of consumer demand); *see also* Elaine Schwartz, *2 Reasons We Don't Go to the Movies,* ECONLIFE (Mar. 29, 2014), https://econlife.com/2014/03/price-elasticity-and-substitutes-diminish-movie-goers/ ("Elasticity involves how much a change in price affects the amount we buy. When a relatively large drop in price generates much higher sales and more revenue, the cause is elastic demand. If however, price and revenue both go up, then the quantity we demand is relatively inelastic.").

91. *See* Schwartz, *supra* note 3, at 91–92 (examining how "consumers hav[e] more options than ever before to access, buy, rent and stream content, . . . "); *see also* Pakula, *supra* note 91, at 170 (describing that "a streaming service's ability to maintain users while eroding user privacy could be 'considered equivalent to a monopolist's decision to increase prices or reduce product quality.'").

92. *See* Shashank Srivastava, *After COVID-19, Will Movie Fans Return to the Theater—or Keep Watching at Home?*, DELOITTE INSIGHTS (July 31, 2020), https://www2.deloitte.com/us/en/insights/industry/technology/pvod-upend-content-covid.html.

93. *See id.*

94. *See* Pakula, *supra* note 91, at 160–62 (reasoning that the major streaming platforms in the motion picture industry today operate as an oligopoly, dominating the market); *see also* Dave Simpson, *Disney Settles Scarlett Johansson's 'Black Widow' Pay Suit*, LAW360 (Sept. 30, 2021, 10:58 PM), https://www.law360.com/articles/1427178/disney-settles-scarlett-johansson-s-black-widow-pay-suit (noting that "[w]ith 'millions' of fans staying home to view *Black Widow* and also not buying multiple tickets if they wanted to see it more than once, [the film's] box-office receipts were harmed . . . ").

95. *See* Gil, *supra* note 33, at 122 (indicating how "[t]he barriers to entry for film production have continued to drop with the introduction of new technology that allows filmmakers to produce high quality films at lower prices, but the barriers to entry for film distribution and exhibition remain unchanged"); *see also* Pakula, *supra* note 91, at 149.

96. *See* Gil *supra* note 33, at 122–23 (highlighting the disadvantages of being a smaller studio when lacking the assistance of a distribution streaming service or ties to large media conglomerates).

connections to a streaming service, finding a distributor for an independent producer is even more difficult.[97] Streaming services are continuing to flourish as a result, increasing in value as they gain more users and increasing barriers to entry.[98]

C. Application of Case Law and Sherman Act to the Hybrid Release Model

Relevant antitrust precedent sheds light on how a court may handle a case regarding the hybrid release model.[99] *United States v. Loew's* emphasizes that a concert of action that is anticompetitive and a restraint of trade can still be adjudicated even if there is no direct evidence of a monopolization scheme under Section 1 of the Sherman Act.[100] Similar to agreements that tie distributors together to suppress competition, agreements between movie studios and streaming platforms that condition the release of a movie on a streaming platform first can be predatory and suppress the competition of a traditional exclusive theatrical release.[101] Conditional agreements may also be an unfair exercise of monopoly power, as in *Sony Corp. of America.*[102] Just as Sony exploited the copyrighted material to condition other releases on one copyright, the hybrid release model takes advantage of one movie release in theaters to bolster the stock price and revenue on the streaming platform on which it is released at the same time.[103] The hybrid release model also affects the potential market for the theatrical release adversely because it cuts into a studio's revenue from box office sales and can negatively impact compensation for actors whose earnings are tied to box office performance of the film.[104]

Although many of the Paramount Decrees may be obsolete in the sense that there are now multiple movie theaters in one metropolitan area and streaming did not exist in 1948, the basic precepts of the decrees and the

---

97. *See* Pakula, *supra* note 91, at 160 (discussing how "a few dominant companies can prevent the entry of competitors, which reduces innovation and creativity through a lack of competition").

98. *See id.*

99. *See* Oler, *supra* note 65, at 492 ("[C]ourts have noted that the Paramount Decrees do not apply to home videos, national theater chains, and television . . . .").

100. *See* 371 U.S. 38, 51–52 (1962) (explaining that, under Section 1 of the Sherman Act, lacking evidence of a monopolization ploy does not necessarily prevent the issue from being litigated).

101. *See id.*

102. 464 U.S. 417, 476 (1984) ("There are situations, nevertheless, in which strict enforcement of this monopoly would inhibit the very 'Progress of Science and useful Arts' that copyright is intended to promote.").

103. *See id.* at 421.

104. *See* Simpson, *supra* note 95.

underlying reasoning are necessary to keep competition in the movie industry under the Sherman Act.[105] Sections 1 and 2 of the Sherman Act work together to ban anticompetitive conduct.[106] Section 1 of the Sherman Act allows for a showing of evidence to support barriers to competition even if there is parallel conduct or an attempted monopoly in terms of exhibition.[107] Additionally, Section 2 of the Sherman Act enumerates that even if monopoly power is unexercised, "the power to exclude competition combined with the intent to exercise that power violates the Act."[108] Terminating the Paramount Decrees with no replacement regulations would allow streaming giants to monopolize revenue by aggressively marketing for consumers to watch movies on their platforms rather than on screen.[109] This practice demonstrates anticompetitive intent and would shift market power in the industry.[110] Additionally, Congress's intent when enacting the Sherman Act would be sullied.[111] Terminating the Paramount Decrees would cause a vacuum in the streaming industry and threaten consumer welfare, as well as competition.[112] Although the strength of the competition

105. *See* DOJ Press Release, *supra* note 7 (detailing how the Paramount Decrees "banned various motion picture distribution practices, including block booking (bundling multiple films into one theatre license), circuit dealing (entering into one license that covered all theatres in a theatre circuit), resale price maintenance (setting minimum prices on movie tickets), and granting overbroad clearances (exclusive film licenses for specific geographic areas)").

106. *See* Sherman Act, 15 U.S.C. §§ 1–2.

107. *See id.* § 1; *see also* Pakula, *supra* note 91, at 152 (explaining how "Section 1 of the Sherman Act bans unreasonable restraints of trade or commerce, and section 2 bans any monopolization of trade or commerce.").

108. *See* 15 U.S.C. § 2; Pakula, *supra* note 91, at 152.

109. *See Periwinkle* Complaint, *supra* note 80, at 3–4 ("In order to convince consumers that Disney+ was worth the $7 (now $8) monthly access fee – and to convince investors that the service would be profitable – Disney announced that the offerings on Disney+ would include Disney's entire library of films, a number of library television series, original content, and – crucially – that Disney+ would eventually be the go-to source to stream the MCU."); *see also* Simpson, *supra* note 95.

110. *See* Riemenschneider, *supra* note 90, at 369 (explaining how if the Paramount Decrees are eliminated, streaming services such as Amazon Prime would be able to fully control production, distribution, and exhibition through vertical integration, maximizing its competitive advantage).

111. *See* Bork, *supra* note 16, at 10–11 (stating Congress's predominant goal in enacting the Sherman Act was consumer welfare, and that the statute intended to strike at cartel agreements, monopolistic mergers, and predatory business tactics).

112. *See* Orbach, *supra* note 16, at 2262 (describing how in 1890 "anti-trust legislation" was interpreted to mean a variety of things that would be beneficial to the American economy, including a general state of competition, "freedom from restraints of trade, low prices, better conditions of supply, and prosperity opportunities"); *see also* Maureen Lenker, *Why the End of the Paramount Decrees is Bad for Movies and Movie Theaters: Opinion,* ENT. WEEKLY (Aug. 7, 2020, 2:35 PM),

between streaming services is fierce, it is far from perfectly competitive and is skewed in many ways.[113] With large content libraries, the ability to have an international platform, and content being exclusive to one platform at a time, barriers to entry are even more profound and indicative of anticompetitive practices.[114] Due to the entrance of more streaming services into the industry and the subsequent issues with licensing the platforms also work to stifle market power and competition as consumers develop "subscription fatigue" and are "becoming overloaded with choices and the inconvenience of subscribing to multiple platforms."[115] Streaming platforms have also further consolidated market power to restrict competition through "mergers, a first-mover advantage, or leveraging other businesses."[116]

Additionally, price-fixing and limitations on appearances like in *National Collegiate Athletic Association* can restrain trade and are anticompetitive under the Sherman Act.[117] The district court's determination of trade restraints in that case is rather similar to how the hybrid release model restrains trade with forcing production studios to comply with the simultaneous streaming release at the same time it is released in theaters by the same distribution house.[118] Hybrid streaming is also a limitation on trade as the hybrid release model restricts a production studio's freedom to negotiate, constituting a barrier to entry.[119] In order to distribute the movie through a particular distribution house, the production studio must accept the

https://ew.com/movies/judge-ends-paramount-decrees/.

113. *See* Pakula, *supra* note 91, at 161 (examining how the assumption that strong competition from new entrants in streaming keeps subscription prices low is not accurate because streaming services can raise prices in response to new entrants due to its large audience without sharing content across platforms).

114. *See id.* at 161–62.

115. *Id.* at 162.

116. *Id.* at 179; *see also* Nicholas Jasinski, *What a Combined WarnerMedia and Discovery Means for the Streaming Wars,* BARRON'S (May 17, 2021, 4:03 PM), https://www.barrons.com/articles/what-a-combined-warnermedia-and-discovery-means-for-the-streaming-wars-51621281798; Alex Sherman, *Here Are the Next Media Mergers that Make the Most Sense,* CNBC (May 29, 2021, 9:31 AM), https://www.cnbc.com/2021/05/29/media-mergers-whos-next-.html.

117. *See* Nat'l Collegiate Athletic Ass'n v. Bd. of Regents, 468 U.S. 85, 96 (1984) (quoting Bd. of Regents v. Nat'l Collegiate Athletic Ass'n, 546 F. Supp. 1276, 1319–23 (W.D. Okla. 1982) (discussing how appearance limitations and price fixing operate as a "classic cartel" with "an almost absolute control over the supply of college football which is made available to the networks, to television advertisers, and ultimately to the viewing public . . . . The NCAA cartel imposes production limits on its members and maintains mechanisms for punishing cartel members who seek to stray away from these production quotas.").

118. *See id.* at 96, 98–99.

119. *See id.* (providing that the NCAA's practices restrained trade because they "limit[ed] members' freedom to negotiate and enter into their own television contracts").

simultaneous streaming release, undercutting profits from the crucial first week at the box office.[120]

Unlike *United States v. IBM Corp.*, terminating the Paramount Decrees altogether without any regulations to replace them would be detrimental to the motion picture industry.[121] The phasing out of the decrees would not be as much of a deterrent to streaming platforms engaging in monopolistic tactics, unlike IBM.[122] In this case, terminating the Paramount Decrees completely would only allow companies such as Netflix and Amazon to purchase their own theaters, engage in more vertical agreements to control the motion picture supply chain, and to monopolize the industry.[123] Additionally, the technology itself is not heading towards becoming obsolete like the tabulating machines in *United States v. IBM*—streaming is very much proliferating and is one of the main ways people now consume content and media online.[124] Even with the active market for streaming, it is dominated by a few major players, and the hybrid model only makes their market power more profound.[125]

Other antitrust factors are also prevalent in the streaming landscape today.[126] The nature of the anticompetitive conduct in the motion picture

---

120. Stephen Colbert, *How 2021 Box Office was Impacted by Simultaneous Streaming Releases,* SCREEN RANT (Dec. 8, 2021), https://screenrant.com/streaming-box-office-impact-2021-covid-theaters/.

121. *See* 163 F.3d 737, 740 (2d Cir. 1998) (citing United States v. Int'l Bus. Machs. Corp., No. 52 Civ. 72-344 (TPG), 1997 U.S. Dist. LEXIS 5829 (S.D.N.Y. May 1, 1997)).

122. *See id.* (quoting *IBM Corp.*, 1997 U.S. Dist. LEXIS 5289, at *6, *9) ("[T]he [district] court found that the phasing-out of the remaining Decree provisions 'presents no material threat of violation of §§ 1 and 2 of the Sherman Act' . . . and noted that there was now an active market in computer repair services.").

123. *See id.*; *see also* Riemenschneider, *supra* note 90, at 367–68 ("If the Decrees are eliminated (thus removing the scrutiny of production studios owning theaters), Amazon and Netflix would have an easier route to purchase their own theater chains (an idea both companies have already begun exploring).").

124. *See generally* Mendelson, *supra* note 74 (examining recent blockbuster hits, including *In the Heights*, *Reminiscence*, *Those Who Wish Me Dead*, and *The Little Things*, which still received wide viewership on subscription-based services even though they flopped in theaters); *see also* Oler, *supra* note 65, at 492 (discussing Disney's recent release of *Mulan* on Disney+ and charging subscribers an additional $29.99 to view the film).

125. *See IBM Corp.*, 163 F.3d at 739-40 (citing *IBM Corp.*, 1997 U.S. Dist. LEXIS 5289, at *6) (explaining the active market for computer repair services that led to the termination of the decree); *see also* Pakula *supra* note 91, at 159 (listing the major companies in the streaming industry today: "Amazon Prime Video, Google's YouTube Red, Facebook Watch, Apple TV+, Paramount Plus, Disney+, Peacock, HBO Max, Netflix, Showtime, and Starz"); *see also* Emilio Calvano & Michele Polo, *Market Power, Competition and Innovation in Digital Markets: A Survey*, 54 INFO. ECON. AND POL'Y 1, 3 (2020).

126. *See* FED. TRADE COMM'N, *supra* note 11; *see also* Pakula, *supra* note 91, at 161,

industry by streaming platforms is one that is characterized not only by vertical mergers and subscription-based streaming, but also by aggressive marketing.[127] For example, Disney+ capitalized on its Marvel cinematic universe, tying together well-known characters and stories, even if they are not all sequels.[128] Additionally, every Marvel film features a short clip at the end of the movie to tease a continuing story for the next one, which "is used as a sort of in-film marketing, building hype for the next Marvel film before the audience has even left the theater, and tying seemingly-unrelated storylines together."[129] Disney has also targeted younger audiences who are more likely to buy into television advertising and buy movie merchandise, as well as to ensure that these audiences will come back for subsequent movies within the Marvel universe.[130] These strategies serve to bolster Disney's stock price and its market power, and in conjunction with the hybrid release model, are effectively stifling competition by other studios and taking advantage of consumers who are fully invested into the franchise.[131] Marvel now "boasts three of the top ten highest grossing domestic films (*Black Panther*, *Avengers: Infinity War*, and *The Avengers*)."[132] Streaming services now own production, distribution, and exhibition under one roof, stifling competition further in conjunction with vertical mergers.[133] Indeed, "[i]n many ways, the streamers have been rebuilding Hollywood's old studio system" by using vertical integration

178 (describing aggressive marketing practices, consolidation of market power, bundling, and barriers to entry in streaming services).

127. *See* Riemenschneider, *supra* note 90, at 352–53 (examining the Disney+ business model and the marketing success of the Marvel franchise).

128. *Id.* at 352.

129. *Id.* at 353.

130. *See id.* at 353–54 (stating that younger audiences have more free time to watch television and go to the theater).

131. *See id.* at 352–55; *see also Periwinkle* Complaint, *supra* note 80 (explaining how when Disney+ launched, the market was already saturated with subscription video-on-demand services such as Netflix, Amazon, Hulu, HBO Now, and Apple TV+.); *see also* Simpson, *supra* note 95 (explaining how Disney reached a settlement with Scarlett Johansson in September 2021); *see also* U.S. DEP'T OF JUST., *supra* note 14 ("When a competitor achieves or maintains monopoly power through conduct that serves no purpose other than to exclude competition, such conduct is clearly improper.").

132. Riemenschneider, *supra* note 90, at 353.

133. *Id.* at 367; *see also* R.T. Watson, *In a Netflix World, Movie Studios Make More Movies Than Ever. Is That a Good Thing?*, WALL STREET J. (June 16, 2021, 1:33 PM), https://www.wsj.com/articles/in-a-netflix-world-movie-studios-make-more-movies-than-ever-is-that-a-good-thing-11623864782#comments_sector (contending that with the increase of vertical mergers and a shift of focus on streaming services creating their own content, the general quality of movies have gone down).

similarly as it was used during the 1920s to 1950s with a modern twist.[134]

IV. Proposed Regulations to Accommodate for the Hybrid Release Model and Preserve the Exclusive Theatrical Release

The motion picture industry of today needs a new set of regulations to govern the recent advent of streaming platforms and how they will interact with theaters and studios moving forward.[135] The complete termination of the Paramount Decrees with no other regulations to replace them would create a vacuum, giving streaming giants free reign over the revenue streams that keep Hollywood alive today.[136] The hybrid release model has caused considerable backlash in Hollywood, including most recently with Scarlett Johansson's lawsuit against Disney+.[137] Although a breach of contract case in its essence, it alleged that Disney knowingly and intentionally breached their promise to Johansson regarding a traditional exclusive theatrical release, and simultaneously released *Black Widow* on Disney+ to bolster their own revenue and stock price.[138] Similarly, the producers of *Dune*, Legendary Entertainment, intended to sue Warner Bros.[139] Legendary was largely unaware that Warner Bros. planned to release several of their films on HBO Max, and this would have cut into their box office revenue considerably from an exclusive theatrical release.[140] Both of these news items demonstrate that the hybrid release model requires regulation to make sure studios and talent are given their rightful share of box office sales, without the interference of streaming platforms.[141]

134. Kristin Hunt, *Are You Still Watching?: The Work of Cinema in the Age of Streaming Services*, JSTOR DAILY (Nov. 24, 2021), https://daily.jstor.org/are-you-still-watching/.

135. *See generally* Eriq Gardner, *Judge Agrees to End Paramount Consent Decrees*, HOLLYWOOD REPORTER (Aug. 7, 2020, 7:50 AM), https://www.hollywoodreporter.com/business/business-news/judge-agrees-end-paramount-consent-decrees-1306387/; *see also* Gardner, *Indie Cinema*, *supra*, note 87; Gardner, *Real Impact*, *supra* note 87.

136. *See* Pakula, *supra* note 91, at 160–62 (characterizing the current streaming landscape as an oligopoly with only a few, interdependent companies dominating the market and with costly barriers to entry).

137. *See Periwinkle* Complaint, *supra* note 80; *see also* Simpson, *supra* note 95 (quoting Johansson, who criticized Disney's release plan as "cynically orchestrated . . . so that it could keep the film's revenues for itself, grow [its] subscriber base . . . and boost [its] stock price, which jumped 4% in the days following the release . . . .").

138. *See* Simpson, *supra* note 95 (alleging that Disney had conspired to release *Black Widow* at the same time as in theaters to undercut Johansson's earnings from the film).

139. Rubin & Lang, *supra* note 69.

140. *Id.*

141. *See* Eriq Gardner, *Will New Media Revive Old Labor Concerns Amid Streaming-Era Issues?*, HOLLYWOOD REP. (May 28, 2021, 6:30 AM),

The Paramount Decrees should be replaced with regulations that will govern the hybrid release model so as to not violate the Sherman Act.[142] Additionally, this would address fairness for actors, studios, and talent in Hollywood.[143] One possible avenue to approach this would be to treat movie streaming as music streaming is treated.[144] For streaming of a motion picture, licensing could be obtained through a copy license and then performance rights for the streaming component, just like music streaming.[145] This would allow for movies to be licensed separately for the silver screen and then require streaming platforms to purchase the "performance rights" in order to have it available for viewing on their respective subscriptions.[146] This would preserve the exclusive theatrical release model as production houses could decide to grant performance rights to streaming services after the initial theatrical release is complete, without any conditional agreements or surprise releases. Additionally, this would reintroduce much needed competition into the industry and would also prevent revenue streams from being monopolized.

Another possible way to combat this issue would be to change the definition of what it means to be a "traditional movie studio" and include the major streaming platforms in addition to theaters.[147] This could bar

---

https://www.hollywoodreporter.com/business/business-news/new-media-old-labor-concerns-1234958989/; *see also* Brooks Barnes, *'Star Wars,' 'Pinocchio' and More as Disney Leans Sharply Into Streaming*, NEW YORK TIMES (Dec. 10, 2020), https://www.nytimes.com/2020/12/10/business/media/disney-star-wars.html.

142. *See* Lenker, *supra* note 113("The decision seems to make a huge assumption that all studios will now continue to act in good faith, using a hope for best practices as a justification for ending these anti-trust laws.").

143. *See id.* ("The order further emphasizes that many movie studios were already technically not subject to these decrees and that existing federal and state antitrust laws should work to protect against future abuses.").

144. *See* Loren Shokes, *Financing Music Labels in the Digital Era of Music: Live Concerts and Streaming Platforms*, 7 HARV. J. OF SPORTS & ENT. L. 133, 142–46 (2016) (explaining the copyright implications behind music streaming and the loss of monopoly over music distribution that record labels had to face after the advent of iTunes and Spotify).

145. *See id.*; *see also* Emily Tribulski, *Look What You Made Her Do: How Swift, Streaming, and Social Media Can Increase Artists' Bargaining Power*, 19 DUKE L. & TECH. REV. 91, 95 (2021) (examining how Taylor Swift's recent dispute with Scooter Braun shed light on the issue of ownership and rights of artists in the media).

146. *See* James H. Richardson, *The Spotify Paradox: How the Creation of a Compulsory License Scheme for Streaming On-Demand Music Platforms Can Save the Music Industry*, 22 UCLA ENT. L. REV. 45, 59 (2014) (analyzing how Netflix must negotiate with content owners to establish rights to stream movies and television shows with little law governing these negotiations).

147. *See* Oler, *supra* note 65, at 492–93 (asserting that Netflix could be considered a movie studio since it produces and distributes films all within its company).

streaming giants specifically from allowing simultaneous theater and streaming releases rather than having blanket regulations to govern streaming and licensing separately. Now that "[b]oth Netflix and Amazon have shown an interest in obtaining theatrical releases for their original films," streaming services are looking toward purchasing theaters to further the hybrid release model on their own terms.[148] This would only make the monopoly power of streaming platforms even more profound, allowing them to vertically integrate to the point of controlling not only production, but also distribution and exhibition, leading to a greater stifling of competition.[149]

A lack of regulation of streaming services could have adverse effects on movie studios, cutting into revenue, as well as adverse effects on actors and talent, including artistic and financial ramifications.[150] Hollywood may be producing more films, but the shift to favoring quantity over quality is palpable to both film critics and consumers.[151] Consumers are losing interest in Netflix films compared to those produced by major studios for example, even when some have included Oscar contenders.[152] A lack of legislation to replace the Paramount Decrees would also require theatrical releases to compete with streaming releases at the same time.[153] Removing them completely would harm theater chains as well as smaller independent studios which are fulfilling demands for niche films from consumers who may be tired of watching movies all from the same few franchises.[154] This would also allow horizontal and vertical price fixing to proliferate, and violate the antitrust factors and the Sherman Act.

---

148. *See* Riemenschneider, *supra* note 90, at 367.

149. *See id.* at 369.

150. *See, e.g.*, *Periwinkle* Complaint, *supra* note 80; Schwartz*, supra* note 3, at 80 (explaining how major film distributors and streaming services have already aggressively expanded their power in the market through horizontal and vertical mergers, undercutting traditional studios); Simpson, *supra* note 95.

151. *See* Watson, *supra* note 134 (explaining how the general quality of each individual film is lowered "both from a company and a consumer standpoint" when streaming services "lure subscribers with a steady flow of films and series to keep them satisfied enough to continue paying their subscription fee—which costs roughly the same as one theater ticket—month after month").

152. *See id.* (describing how "cinema as art is being devalued as movies are lumped together with television series and unscripted shows and offered as 'content' on streaming platforms").

153. *See* Schwartz, *supra* note 3, at 89–90 (examining how many film distributors have decided to create their own streaming services and end their distribution deals with third-party streaming services).

154. *See* Riemenschneider, *supra* note 90, at 347 (asserting that, after the Paramount Decrees were issued, theater owners had the autonomy to choose which films they showed, and "major studios had newfound competition from smaller studios and independent filmmakers for screen time in theaters").

V. CONCLUSION

Terminating the Paramount Consent Decrees without any other standing regulations would give free reign to streaming services and allow the hybrid release model to continue, redirecting revenue to a growing monopoly power in the motion picture industry. Allowing the hybrid model to continue will only lead to streaming platforms monopolizing the market to a greater degree, resulting in more vertical mergers, acquisitions of smaller studios, and greater barriers of entry and anticompetitive behavior. The Sherman Act alone is not enough to combat these issues that threaten the economy and the motion picture industry. The Paramount Consent Decrees must be replaced with updated regulations to accommodate for the new phenomenon of the hybrid release model and the rise of streaming giants such as Netflix and Disney+. The antitrust implications of such a phenomenon must be considered carefully and the framework to evaluate it should be updated accordingly to ensure that competition is not stifled, and the Sherman Act is complied with.

ITEM 105 AND THE THIRD CIRCUIT'S CRYSTAL BALL STANDARD: I SEE REGULATORY RISK IN YOUR FUTURE

COOPER D'ANTON*

I. INTRODUCTION

A few weeks before Hudson City Bancorp ("Hudson") merged with M&T Bank Corporation ("M&T"), former Hudson shareholders sued, alleging that the banks omitted facts concerning M&T's compliance with federal regulations from their joint proxy statement.[1] The United States District Court for the District of Delaware dismissed the suit, so the shareholders appealed to the Third Circuit and prevailed.[2] M&T appealed, but the Supreme Court denied its Petition for Writ of Certiorari.[3]

The shareholders succeeded when the Third Circuit found the bank's Item 105 risk factor disclosures deficient.[4] Relying on Securities and Exchange Commission ("SEC") guidance, the court ruled that M&T should have specifically linked its proxy statements to the regulatory risks that its BSA/AML program posed using particular details.[5] To the Third Circuit, M&T failed to disclose just how treacherous "jumping through" its already disclosed "regulatory hoops" would be.[6] The Third Circuit effectively held that issuers of publicly traded securities are liable for failing to disclose unknown and unadjudicated risks, lowering the bar for issuer liability.[7] The

---

* Senior Staff, American University Business Law Review, Volume 12; J.D. Candidate, American University Washington College of Law, 2024; B.A. Government and Politics, Minor in Philosophy, University of Maryland, College Park. The author would like to thank the Volume 11 Note and Comment Editors for their support as he wrote this Comment and the Volumes 11 and 12 Editorial Board and Staff for their dedication to editing this Comment for publication. He would also like to thank Professor Hilary Allen for her guidance and support. Finally, he is incredibly grateful for and very lucky to have the love and support of his family and friends.

1. Emilie Ruscoe, *High Court Won't Take Up M&T Bank Merger Case*, LAW360 (Jan. 25, 2021, 11:31 AM), https://www.law360.com/articles/1348070/high-court-won-t-take-up-m-t-bank-merger-case; James P. McLoughlin Jr. & Neil T. Bloomfield, *3rd Circuit Panel Raises the Bar on Risk Disclosures as the Trend Toward Greater Disclosure Continues*, 26 WESTLAW J. BANK & LENDER LIAB., Apr. 12, 2021, at 2 (including facts like M&T's alleged Bank Secrecy Act and Anti-Money Laundering (BSA/AML) compliance weaknesses and a checking account issue).

2. Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670, 678 (D. Del. 2017), *vacated*, 962 F.3d 701 (3d Cir. 2020), *cert. denied* 141 S. Ct. 1284 (2021).

3. Jaroslawicz v. M&T Bank Corp., 141 S. Ct. 1284, 1284 (2021); *see also* Ruscoe, *supra* note 1.

4. *See* Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 715 (3d Cir. 2020) (stating that "the Shareholders have plausibly alleged that had M&T disclosed" its money laundering program practices, shareholders would have considered those practices when voting and that M&T's discussions of its checking account practices were deficient).

5. *Id.* (asserting that M&T's disclosure was too general and applicable to any industry).

6. *Id.* (describing regulatory compliance requirements as "jumping through . . . regulatory hoops").

7. *Compare* Brief for SIFMA et al. as Amicus Curiae Supporting Petitioners at 6,

holding's Item 105 standard significantly expands class action securities liability, the legal risk of which disincentivizes securities issuance, negatively impacting the process by which public companies access capital.[8]

The Second and First Circuits' interpretation of Item 105 disclosure requirements do not require the same exhaustive disclosure the Third Circuit required in *Jaroslawicz v. M&T Bank.*[9] Unlike the Third Circuit, the First and Second Circuits only require disclosure of known risk and do not require the issuer to disclose uncharged and unadjudicated risk.[10] These varying circuit court interpretations of Item 105 create confusion among securities market participants in an industry that funds over 70 percent of all economic activity in the U.S.[11] In addition, the Third Circuit's standard is unworkable and threatens to become the default nationwide standard for Item 105 due to the Third Circuit's jurisdiction over Delaware, the source of most United States corporate law.[12]

Part II of this Comment outlines the current Regulation S-K: Item 105 requirements and the cases establishing the different Item 105 disclosure standards of the Third, Second, and First Circuits, including the Third Circuit's hindsight 2020 standard requiring the disclosure of unknown risk,

---

M&T Bank v. Jaroslawicz, 962 F.3d 701 (3d Cir. 2020) (No. 20-678) [hereinafter SIFMA Brief] (providing the industry's interpretation of the holding's effect), *with Jaroslawicz*, 962 F.3d at 716 ("Later . . . regulatory enforcement does not create a retroactive duty to disclose.").

8. SIFMA Brief, *supra* note 7, at 6; *see* Mark Klock, *Do Class Action Filings Affect Stock Prices? The Stock Market Reaction to Securities Class Actions Post PSLRA*, 15 J. BUS. & SEC. L. 109, 110 (2015) (finding "a significant negative return at the time of filing" and in "the weeks preceding the filing" of securities class action lawsuits).

9. *See* 962 F.3d 701, 713 (3d Cir. 2020).

10. Silverstrand Invs. v. AMAG Pharms., Inc., 707 F.3d 95, 103 (1st Cir. 2013) ([T]o withstand dismissal at the pleading stage, a complaint alleging omissions of . . . risks needs to allege sufficient facts to infer that a registrant knew, as of the time of an offering, that . . . a risk factor existed."); City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 184 (2d Cir. 2014) (establishing the Second Circuit's Item 105 interpretation); *see also* SIFMA Brief, *supra* note 7, at 16.

11. *See* SIFMA Brief, *supra* note 7, at 4 (stating that the varying Item 105 interpretations are irreconcilable and create confusion in securities markets); *see also Our Markets*, SIFMA, https://www.sifma.org/about/our-markets/ (last visited June 11, 2021) [hereinafter Our Markets].

12. *See* SIFMA Brief, *supra* note 7, at 16 (noting the burden of the Third Circuit's standard on underwriters and issuers); 15 U.S.C.A. § 78aa (listing the Securities Act's process and revenue provisions); WILLIAM F. GRIFFIN, A PRACTICAL GUIDE TO MASSACHUSETTS CLOSELY HELD BUSINESS ORGANIZATIONS (MCLE) § 10.1 (2015) (describing the historical context for Delaware's rise to prominence as the domicile for most U.S. companies); *Why Businesses Choose Delaware*, DEL. DIV. OF CORPS., https://corplaw.delaware.gov/why-businesses-choose-delaware/ (last visited Mar. 1, 2022) (describing why companies choose to incorporate in Delaware).

the Second Circuit's uncharged and unadjudicated standard and the First Circuit's actual knowledge standard.[13] Part III will analyze the appropriate Item 105 standard in light of SEC guidance and Item 105.[14] Specifically, this Comment will argue that M&T complied with SEC guidance and the text of Item 105, which the Third Circuit failed to properly apply in its holding. Finally, Part IV will recommend that the SEC end the confusion around Item 105 by clarifying the appropriate standard through rulemaking or guidance adopting the Second and First Circuits' interpretations.[15] Additionally, the Supreme Court should grant certiorari to future appeals from circuit court decisions with similar circumstances to M&T's and affirm the standards of the Second and First Circuits' interpretations of Item 105 disclosure requirements.[16]

This analysis should be taken in the context of the larger discussion around risk disclosure and not interpreted as an endorsement of anything less than a robust, meaningful disclosure regime.[17] The national trend and most appropriate path forward in this conversation is and should be requiring disclosure of known, material risk factors widely acknowledged as necessary for the integrity of our capital markets.[18] Risk factor disclosure compliance requirements must be strong but achievable and supportive of access to capital.

---

13. *See* 962 F.3d at 705–06 (establishing the Third Circuit's Item 105 interpretation); *City of Pontiac Policemen's & Firemen's Ret. Sys.*, 752 F.3d at 184 (establishing the Second Circuit's Item 105 interpretation); *Silverstrand Invs.*, 707 F.3d at 103 (stating the First Circuit's Item 105 interpretation).

14. *See, e.g.*, SEC Updated Staff Legal Bulletin No. 7, 1999 WL 34984247, at *1 (June 7, 1999) [hereinafter Bulletin No. 7] (concerning SEC guidance on Item 105).

15. *See* SIFMA Brief, *supra* note 7, at 20 (suggesting that a federal agency clarify Item 105, implying a need for federal regulatory rulemaking); *see also City of Pontiac Policemen's & Firemen's Ret. Sys.*, 752 F.3d at 184 (establishing the Second Circuit's Item 105 interpretation); *Silverstrand Invs.*, 707 F.3d at 103 (stating the First Circuit's Item 105 interpretation).

16. *See* SIFMA Brief, *supra* note 7, at 3 (requesting that the Supreme Court grant M&T's petition for certiorari to reverse the Third Circuit's decision).

17. *See* John D. Frey, *Striving for Simplicity: Updates to Regulation S-K Items 101 and 105*, 81 LA. L. REV. 999, 1032–33 (2021) (discussing Item 105 and its genericism); *see also* Virginia Harper Ho, *Disclosure Overload? Lessons for Risk Disclosure & ESG Reporting Reform from the Regulation S-K Concept Release*, 65 VILL. L. REV. 67 (2020) (discussing Item 105 and downplaying concerns of disclosure overload).

18. *Cf.* SIFMA, Comment Letter on Climate Change Disclosures (June 10, 2021), https://www.sec.gov/news/public-statement/lee-climate-change-disclosures (recommending "principles-based" disclosure of climate-related information as part of Regulation S-K Item 101). *See generally* Lael Brainard, Governor, Fed. Reserve Bd., Financial Stability Implications of Climate Change, Address at "Transform Tomorrow Today" Ceres 2021 Conference (Mar. 23, 2021).

II. IDENTIFYING THE CIRCUIT SPLIT ON ITEM 105 DISCLOSURE

A. Regulation S-K: Item 105 Risk Disclosure

Regulation S-K: Item 105, formerly 503(c), requires issuers, including companies soliciting approval from shareholders for mergers, to discuss in their proxy statements material details about their company or line of business that make an investment speculative or risky, as opposed to factors absent from the Item 105 statute, such as unknown, uncharged, or unadjudicated risks.[19] Adopted in 1977, Regulation S-K details the SEC's disclosure provisions for nonfinancial statement sections of forms filed for the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[20] Per the SEC's intent, Regulation S-K harmonizes disclosure requirements for both laws.[21] The Securities Act provides for nationwide service of process and a wide choice of venue under claims regarding Item 105.[22] Item 105 provides a number of stylistic, organizational, and substantive instructions for risk factor disclosure.[23] This disclosure intends to provide investors with a clear and concise summary of the material risk — as opposed to what economist Frank Knight classically described as uncertainty — to an investment in the issuer's securities.[24] Materiality, in the context of risk in proxy statements, requires "a substantial

19. 17 C.F.R. § 229.105 (2022) (omitting of any requirement to disclose uncharged, unadjudicated wrongdoing); Modernization of Regulation S-K Items 101, 103, and 105, 85 Fed. Reg. 63,726 (Oct. 8, 2020) (codified at 17 C.F.R. pts. 229, 239, 240) [hereinafter Modernization of Regulation S-K]; *accord* Petition for Writ of Certiorari at 5, M&T Bank Corp. v. Jaroslawicz, 141 S. Ct. 1284 (2021) (No. 20-678) [hereinafter Petition for Certiorari];; United States v. Matthews, 787 F.2d 38, 49 (2d Cir. 1986) (holding that "at least so long as uncharged criminal conduct is not required to be disclosed by any rule lawfully promulgated by the SEC, nondisclosure of such conduct cannot be the basis of a criminal prosecution"); Ciresi v. Citicorp, 782 F. Supp. 819, 823 (S.D.N.Y. 1991) (stating that "the law does not impose a duty to disclose uncharged, unadjudicated wrongdoing"); *see also* Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 716 (3d Cir. 2020) (clarifying that the court does not hold that the regulatory enforcement actions alone required M&T to disclose its issues and stating that "later litigation or regulatory enforcement does not create a retroactive duty to disclose").

20. Petition for Writ of Certiorari, *supra* note 19, at 5..

21. *Id.* (recommending harmonizing both regulations by creating a single repository for disclosure regulation).

22. *See* 15 U.S.C. § 78aa (listing the Act's process and revenue provisions).

23. *See* 17 C.F.R. § 229.105 (stating that the discussion must be "concise," "organized logically," and non-generic, explain how the risk affects the issuer or securities offered, and place risk factors "under a subcaption that adequately describes the risk").

24. Securities Offering Reform, SEC Release No. 8501, 2004 WL 2610458, at *86 (Nov. 3, 2004); *see* FRANK H. KNIGHT, RISK, UNCERTAINTY, AND PROFIT 19–20 (1921) (explaining the difference between risk and uncertainty).

likelihood that a reasonable shareholder would consider [the information] important in deciding how to vote."[25]

i. Item 105 SEC Guidance

The SEC provided guidance over two decades ago to clarify then-Item 503(c).[26] The Commission's guidance describes Item 105, then Item 503(c), as being "the least understood of the plain English requirements."[27] The bulletin guidance obligates issuers to "specifically link each risk to [the] industry, company, or investment, as applicable" and provides two examples contrasting a generic discussion with a satisfactory disclosure.[28]

The first example involves a hypothetical lawn care company with substantially fewer financial and other resources than its competitors in what is described as a highly competitive industry.[29] The guidance requires the company to not only disclose the financial disadvantage, but also what that disadvantage means for the company's ability to capture its markets, and then what the inability to capture those markets means for the company's growth.[30] The second example in the SEC's guidance is of a public offering for a company with outstanding privately held common stock in which the satisfactory guidance highlights the potential for restricted shares to be sold into the market, thereby driving down the price of the common stock.[31]

The two guidance examples suggest a preference by the SEC for disclosure language that does not rely on inferences to deduce the connection

25. 17 C.F.R. § 240.12b-2 (2022); *see also* 3 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 10:77 (2022) (explaining common law establishing the definition of materiality).

26. *Contra* Bulletin No. 7, *supra* note 14, at *1 (stating that the bulletin is merely guidance, neither approved nor disapproved by the SEC); Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 711 (3d Cir. 2020) (citing the SEC staff bulletin).

27. *See* Bulletin No. 7, *supra* note 14, at *1.

28. *Id.* at *6–7 (showing before and after examples of a lawn care company and an unidentified stock issuer).

29. *Id.* at *6 (providing an example disclosure where the company states that its competitors' "financial strength could prevent [the lawn care company] from capturing those [geographical] markets" and provides examples of how a competitor used its resources to expand and how the company's lack of resources may result in failure to realize forecasted growth).

30. *See id.* (implying the requirement to draw a connection between a material risk factor and an effect on the purpose for which shareholders would invest in the company).

31. *Id.* at *7–8 (providing two sub-examples: (1) a generic example stating how the sale of common stock in the market after an offering could lower the stock price, that there is a resale ban for some time, and that underwriters can release the restricted shareholders from the resale ban; and (2) a satisfactory example linking the end of the resale restrictions to a significant drop in market price if the restricted shareholders sell, even if the company is doing well).

between the company's activities and shareholder risk.[32] The guidance also states in the risk factor comments section that the document should: (1) eliminate legalese and industry jargon; (2) state the risk as quickly as possible; (3) present the risk in concrete terms; (4) provide information necessary to assess the magnitude of risk; (5) avoid stating general risk factors; and (6) replace language stating "that" a risk factor would have an effect with language stating "how" a risk factor would have an effect.[33]

B. The Third Circuit's Item 105 Standard: Hindsight 2020

In August 2012, M&T and Hudson executed a merger agreement requiring approval by both banks' shareholders and filed a preliminary proxy statement in October 2012 that became effective in February 2013.[34] On April 12, 2013, the banks announced delays in the merger.[35] Three days later, the banks held a conference call with shareholders to discuss the delay, and shareholders voted to approve the merger a few days after the call.[36] In October 2014, the Consumer Financial Protection Bureau ("CFPB") took action against M&T, and in September 2015, the Federal Reserve approved the merger.[37] To provide the requisite notice for the merger, Hudson and M&T opted to issue a joint proxy statement, which requires Item 105 risk factor disclosure information.[38]

The joint proxy laid out a litany of references to potential regulatory hurdles.[39] The proxy further discussed the merger's subjection to the Federal

32. *See id.* at *7–8, 10 (implying the requirement to draw a connection between a risk factor and the object of the shareholder's investment—not just state that a risk factor exist—to guide the shareholder through the disclosure document since there may be investors who do not work in that industry).

33. *Id.* at *10, 13–14.

34. Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670, 673–74 (D. Del. 2017); *see, e.g.*, SEC Form PREM14A Preliminary proxy statement relating to a merger or acquisition, https://sec.report/Form/PREM14A ("A preliminary proxy statement, which remains subject to review by the SEC staff, filed in connection with a merger or acquisition.").

35. *Jaroslawicz*, 296 F. Supp. 3d at 674 (announcing through a press release the merger delay as a result of the need for regulatory approval); *see also* Amended Class Action Complaint for Violations of Securities and State Law at 3, Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670 (D. Del. 2017) (No. 1:15-cv-00897-RGA) (stating the existence of the announcement of the merger delay followed by a Rule 425 prospectus supplement).

36. *Jaroslawicz*, 296 F. Supp. 3d at 674.

37. *Id.*

38. Jaroslawicz v. M&T Bank Corp., 962 F.3d 701,705 (3d Cir. 2020) (providing disclosure through a single Form S-4 requiring Item 503 disclosure).

39. *See* M&T Bank Corp., Prospectus Supplement (Form 424B3), at 15, 26, 29 (Feb. 22, 2013) [hereinafter M&T Joint Proxy] (referencing several mentions of the need for

Reserve's approval and the potential impact that lack of approval could have on the timeline of the merger.[40]

In the "Risks Relating to the Regulatory Environment" subsection, the proxy disclosed the effects that regulation would have on M&T's practices and how failure to comply would result in regulatory action affecting M&T's business and business opportunities.[41] The subsection also addressed potential CFPB actions and their effects on compliance costs.[42] Under the subsection titled, "M&T is subject to operational risk," the proxy disclosed the risk that M&T faced as a result of failed internal processes.[43] Under a following legal and regulatory risk subsection, the proxy disclosed the possibility of government investigations impacting M&T's business.[44] Under the section titled, "Regulatory Approvals Required for the Merger," the proxy disclosed that completion of the merger was subject to the Federal Reserve's approval based on the effectiveness of M&T's anti-money laundering programs.[45] The proxy supplement fully disclosed that the Federal Reserve identified issues with M&T's anti-money laundering programs and that in order to address the regulator's concerns the closing of the merger would have to be delayed.[46]

A few weeks before the merger closed, former Hudson shareholders sued, alleging that the banks violated the Securities and Exchange Act by omitting from their joint proxy statement—issued before their supplemental proxy—several facts concerning M&T's compliance with federal regulations.[47] These facts included (1) M&T's alleged BSA/AML compliance weaknesses, the broad risk of which M&T disclosed in its proxy statement, (2) a checking account practice the bank had remedied before issuing the proxy, and (3) M&T's publishing of a misleading opinion that federal regulators would

---

regulatory approval by federal regulators including the proxy's statement that the merger was subject to approval from the Federal Reserve).

40. *See id.*

41. *See id.* at 34.

42. *See id.* at 35 (referencing potential rules promulgated by the CFPB and how those actions could affect compliance costs, including a merger delay).

43. *See id.* at 40.

44. *See id.* at 43 (stating that an investigation could lead to monetary damages or reputational harm).

45. *See id.* at 100 (citing the Federal Reserve's authority under the Bank Holding Company Act of 1956 to approve or disapprove the merger based on M&T anti-money laundering effectiveness).

46. M&T Bank Corp., Exhibit 99, Joint Press Release (Form 8-K) (Apr. 12, 2013) [hereinafter Form 8-K].

47. Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670, 674–75 (D. Del. 2017); *see also* Ruscoe, *supra* note 1.

approve the merger in the second quarter of 2013.[48] M&T disclosed its belief that its BSA/AML programs were compliant with federal law, demonstrating that the bank did not know its BSA/AML program was wrongful at the time of disclosure.[49] The checking account practice "had ceased prior to the publication of the joint proxy" but "cast doubt on M&Ts controls and compliance systems," and that doubt "created a regulatory risk to the merger that had to be disclosed."[50] Considering M&T thought its BSA/AML program was compliant with federal law and remedied its checking account practices, the bank did not know its BSA/AML program was wrongful and was unaware it was doing anything that would prompt regulatory action when it issued the joint proxy.[51] Still, the shareholders alleged that the regulatory compliance failures led to the delay in the merger that financially harmed them.[52]

The shareholders alleged that the banks violated Section 14(a) of the Exchange Act and SEC Rule 14a-9.[53] They argued that the non-compliant BSA/AML and checking account practices posed significant risks to regulatory approval of the merger and that Item 503(c) of Regulation SK therefore mandated that those risks be disclosed. However, the district court dismissed the suit. [54]

The Third Circuit on appeal found the bank's Item 105 risk factor disclosures around its BSA/AML programs deficient and that M&T knew it was under a federal regulatory review that could harm the merger if deficiencies were discovered.[55] The Third Circuit also found that M&T's consumer checking practice disclosures were deficient, inferring that the consumer checking practices cast doubt on M&T's controls and compliance systems and posed an independent regulatory risk to the merger material

48. McLoughlin, *supra* note 1; Memorandum of Law in Support of Defendants' Motion to Dismiss, Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670 (D. Del. 2017) (No. 15-897) (naming the Federal Reserve and applicable BSA/AML law in the proxy statement); Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 718 (3d Cir. 2020) (affirming the lower court's dismissal of the misleading disclosure allegation).

49. *See* M&T Joint Proxy, *supra* note 39, at 99.

50. McLoughlin, *supra* note 1; *accord Jaroslawicz*, 296 F. Supp. 3d at 674–75.

51. *See* M&T Joint Proxy, *supra* note 39, at 99; *see also* McLoughlin, *supra* note 1.

52. *See Jaroslawicz*, 962 F.3d at 705 (stating the shareholders' argument that the merger delay caused them financial harm, despite their healthy return on investment).

53. *Jaroslawicz*, 296 F. Supp. 3d at 673; *see also* 15 U.S.C. § 78n(a); 17 C.F.R. § 240.14a-9 (2020).

54. 296 F. Supp. 3d at 677–79 (concluding that the Plaintiffs failed to state a claim based on Item 503(c) since, at the time the proxy statement was issued, although the violations posed a risk to regulatory approval of the merger, M&T adequately disclosed risk that compliance failure posed to the merger).

55. *Jaroslawicz*, 962 F.3d at 716.

enough that a reasonable shareholder would consider it important in deciding how to vote.[56] Relying on SEC guidance, the court said that M&T should have used details to specifically link its statements of risk to the financial consequences of that risk to shareholders.[57] The court also said that concise and plain discussions of regulatory review similar to the SEC's guidance examples and "framed in the context of M&T's particular business and industry were absent from the [proxy statement]."[58] The court added that disclosing the weaknesses present in M&T's BSA/AML and consumer compliance programs would have altered shareholders' decision-making.[59] "[W]hether M&T had actual knowledge of the shortcomings in its BSA/AML compliance or its consumer checking practices" was not important to the court.[60] To the Third Circuit, "the risk to the merger posed by the regulatory inspection itself" gave rise to the disclosure requirement, and M&T failed to disclose how treacherous regulatory compliance would be despite disclosing in the proxy that regulatory compliance stood between the proposed merger and a final deal.[61] The court believed it could reasonably infer from the evidence in the shareholders' allegations that within the context of regulatory scrutiny and completion of the merger, the details of M&T's programs and those programs' wrongfulness were material and therefore required disclosure. According to the court, M&T did not adequately provide this disclosure.[62]

The Third Circuit affirmed in part and vacated in part the district court's decision.[63] M&T appealed to the Supreme Court asking two questions:

> (1) Whether Item 105 . . . requires a company with knowledge of a general risk factor to ascertain and disclose facts that may bear on that general risk factor that are not otherwise within the company's actual knowledge[;]
> (2) Whether Item 105 . . . requires companies to identify and discuss potentially unlawful business practices or inadequate compliance procedures in circumstances where neither the company nor any regulator

56. *Id.* at 717 (stating that the shareholders' allegations met the plaintiff's pleading burden and that it was also plausible that disclosing the weaknesses in M&T's programs "would have been viewed by the reasonable investor as having significantly altered the total mix of information made available" (quoting EP Medsystems, Inc. v. EchoCath, Inc., 235 F.3d 865, 872 (3d Cir. 2000)).

57. *Id.* at 715.

58. *Id.*

59. *Id.* at 717.

60. *Id.* at 716. ("[A]ctual knowledge . . . is of no moment . . . .").

61. *Id.* at 715–16.

62. *Id.* at 716–17.

63. *Id.* at 718 (affirming the "dismissal of the Shareholders' claims that M&T made misleading opinion statements, and vacat[ing] the dismissal of the claims about M&T's risk disclosure obligations").

> has identified an issue or concern and the company believes that such practices or procedures are compliant with applicable law.[64]

The Supreme Court denied M&T's Petition for Writ of Certiorari.[65]

Importantly, M&T's Petition for Writ of Certiorari to the Supreme Court gave the SEC an opportunity to weigh in on the questions presented.[66] The Third Circuit invited the SEC to file an amicus brief addressing whether Item 105 is satisfied where a proxy filer "neglects to disclose that one of the parties to the proposed merger has serious regulatory violations that could derail or significantly delay a merger[,]" but the SEC declined to comment.[67]

C. The Second Circuit's Item 105 Standard: No Need to Disclose Uncharged or Unadjudicated Wrongdoing

In *City of Pontiac Policemen's and Firemen's Retirement System v. UBS AG* ,[68] a group of institutional investors sued a Swiss bank ("UBS"), arguing in part that UBS's offering materials distributed as part of its 2008 offering were materially false because the bank was engaged in an undisclosed cross-border tax scheme at the time of the offering.[69] The investors argued that UBS's failure to disclose the tax scheme violated Item 503(c) and rendered the disclosures UBS made concerning a Department of Justice ("DOJ") investigation into the tax scheme materially incomplete.[70] The investors also argued that in addition to disclosing the existence of the DOJ investigation, the bank should have disclosed its engagement in the tax scheme.[71] The United States District Court for the Southern District of New York dismissed the case for failure to state a claim, and the investors appealed.[72]

On the issue of then-Item 503(c) disclosure, the Second Circuit asserted the long-standing doctrine that "[d]isclosure is not a right of confession" and that companies do not have a duty "to disclose uncharged, unadjudicated

---

64. Petition for Certiorari, *supra* note 19, at i.

65. M&T Bank Corp. v. Jaroslawicz, 141 S. Ct. 1284, 1284 (2021); *see also* Ruscoe, *supra* note 1.

66. Petition for Certiorari, *supra* note 19, at 9 (inviting the SEC to answer two legal questions regarding Item 105).

67. *Id.* at 9, 12 (noting the SEC's excuse that the agency could not meet Third Circuit's deadline to answer the legal questions raised, expressing no views on those legal questions, and, instead, offering background information on Item 105).

68. 752 F.3d 173 (2d Cir. 2014).

69. *Id.* at 182.

70. *Id.* at 183–84 (stating that 503(c) requires disclosure of facts that could make UBS's offer risky).

71. *Id.* at 184.

72. *Id.* at 178–79 (stating the District Court dismissed the claims for failure to state a claim for fraud, allege material misstatement, and lack of standing).

wrongdoing."[73] The Second Circuit held that UBS met its obligations by disclosing its "involvement in legal . . . proceedings and government investigations and indicating that its involvement" carried financial risks.[74] The Second Circuit affirmed the district court's ruling and dismissed all claims with prejudice.[75]

D. The First Circuit's Item 105 Standard: Actual Knowledge of Risk

In *Silverstrand Investments v. AMAG Pharmaceuticals Inc.*,[76] investors sued AMAG Pharmaceuticals ("AMAG") alleging that AMAG wrongly failed to disclose to investors twenty-three serious adverse reactions to the iron deficiency treatment drug Feraheme that occurred prior to a 2010 stock offering.[77] After reports came out about adverse reactions to the drug, "AMAG's stock price plummet[ed] by more than 70 percent from the offering price."[78]

The First Circuit explained that actionable omissions of Item 503 risks require "that a registrant knew, as of the time of an offering, that (1) a risk factor existed; (2) the risk factor could adversely affect the registrant's present or future business expectations; and (3) the offering documents failed to disclose the risk factor".[79] This interpretation meant that the investors made a reasonable claim that AMAG failed its disclosure obligations.[80] AMAG knew that a risk factor — the serious adverse reactions — existed and that their possible discovery could harm its business, yet they still neglected to disclose those risk factors in its offering documents.[81]

The First Circuit's holding revived the investors' claim, and the Supreme

73. *Id.* at 184 (quoting *In re* Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347, 365 (2d Cir. 2010); Ciresi v. Citicorp, 782 F. Supp. 819, 823 (S.D.N.Y. 1991)).

74. *Id.*

75. *Id.* at 176.

76. 707 F.3d 95 (1st Cir. 2013).

77. *Id.* at 100–01; *see also* Zachary Zagger, *AMAG Pharma Fails To Shirk Drug-Risks Investor Suit*, LAW360 (Apr. 9, 2014, 6:46 PM), https://www.law360.com/articles/526240 ("The First Circuit revived the case, ruling that omissions by AMAG and other defendants were actionable.").

78. Zagger, *supra* note 77.

79. *Silverstrand Invs.*, 707 F.3d at 103 (stating the First Circuit's interpretation of Item 105).

80. *See* Stewart Bishop, *High Court Won't Review Feraheme Investor Class Action*, LAW360 (Oct. 7, 2013, 3:26 PM), https://www.law360.com/articles/478632/high-court-won-t-review-feraheme-investor-class-action.

81. *See Silverstrand Invs.*, 707 F.3d at 106 (stating that since AMAG knew about the adverse reactions before the offering and omitted those risk factors from its offering document, the investors stated a plausible claim for omission of the risks).

Court denied AMAG's petition for writ of certiorari.[82] Following the First Circuit's ruling, the U.S. District Court for the District of Massachusetts denied a motion by AMAG to dismiss the investors' punitive class action against AMAG and its bank underwriters.[83] The case was eventually settled out of court.[84]

E. Summarizing the Three Standards

In short, the three circuit court opinions offer three different interpretations of Item 105.[85] The Third Circuit requires disclosure of risk unknown to the issuer at the time of disclosure.[86] The Second Circuit absolves the issuer of the duty to disclose uncharged, unadjudicated wrongdoing.[87] The First Circuit demands disclosure only of risks known to the issuer at the time of disclosure.[88]

III. ANALYZING THE APPROPRIATE ITEM 105 STANDARD IN LIGHT OF SEC GUIDANCE

A. The Third Circuit's Unlawful, Unworkable Standard

The Third Circuit's standard that requires disclosure of unknown risk and uncertainty does not comply with the law because unknown risk and uncertainty are absent from the text of Item 105.[89] Item 105 requires

---

82. Silverstrand Invs. v. AMAG Pharm., 571 U.S. 941, 941 (2013) (denying the petition without comment); Bishop, *supra* note 80.

83. Silverstrand Invs. v. AMAG Pharm., 12 F. Supp. 3d 241, 254 (D. Mass. 2014); Zagger, *supra* note 77 (summarizing the First Circuit's ruling that the putative class of plaintiff investors "met the minimum pleading standards, after . . . consider[ing] the dismissal motion on remand following [the] First Circuit's decision to partially overturn the previously dismissed case").

84. Angeion Group, *Claims Administrator Angeion Group Announces Settlement in* Silverstrand Investments v. AMAG Pharmaceuticals, Inc. *Litigation*, PR NEWSWIRE (Oct. 31, 2014, 8:00 PM), https://www.prnewswire.com/news-releases/claims-administrator-angeion-group-announces-settlement-in-silverstrand-investments-v-amag-pharmaceuticals-inc-litigation-281051452.html.

85. *Compare* Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 705 (3d Cir. 2020) (establishing the Third Circuit's Item 105 interpretation), *with* City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 184 (2d Cir. 2014) (establishing the Second Circuit's Item 105 interpretation), *and Silverstrand Invs.*, 707 F.3d at 103 (establishing the First Circuit's Item 105 interpretation).

86. *Jaroslawicz*, 962 F.3d 701, 705 (establishing the Third Circuit's Item 105 interpretation).

87. *See City of Pontiac Policemen's & Firemen's Ret. Sys.*, 752 F.3d at 184 (establishing the Second Circuit's Item 105 interpretation).

88. *See Silverstrand Invs.*, 707 F.3d at 103 (establishing the First Circuit's Item 105 interpretation).

89. *See* 17 C.F.R. § 229.105 (2022) (omitting the Third Circuit's risk disclosure

disclosure of material risk, but according to the SEC's guidance, that disclosure must be clearly explained and include specific details, a goal inconsistent with disclosing risks that an issuer does not believe to exist, despite whether that issuer is right.[90] The detailed and predictive disclosure of hypothetical risk promotes the kind of boilerplate, generic disclosure that the SEC sought to avoid in its most recent modification of Item 105.[91] The use of lengthy, boilerplate risk disclosure is a predictable consequence of requiring disclosure of unknown, unperceived, uncharged, and unadjudicated risk, because such a disclosure obligation increases legal costs that issuers and underwriters can lower by using this kind of disclosure language.[92] If underwriters can lower their legal costs through boilerplate disclosure, they will likely do so at the expense of market participants, issuers, and their shareholders who may suffer from inadequate and overly complex disclosure information when making investment decisions.[93]

The Third Circuit found that the proxy disclosures were deficient and that M&T should have disclosed the state of its BSA/AML program in the context of regulatory scrutiny by specifically linking its statements to its risks using details. Through that finding, the court effectively held that issuers of publicly traded securities are liable for failing to disclose not only known risks, but also risks that were not known or believed to exist by the issuer and not yet charged by regulators.[94] Under the Third Circuit's

requirement); *see also* Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1202 (1st Cir. 1996) ("The proposition that silence, absent a duty to disclose, cannot be actionably misleading, a fixture of securities law."); Roeder v. Alpha Indus., 814 F.2d 22, 27 (1st Cir. 1987) (stating that "there is no affirmative duty" to disclose material information without regulation requiring disclosure or under two other circumstances).

90. SIFMA Brief, *supra* note 7, at 15–16 (describing the SEC's guidance requirements for clarity and specificity and asserting that the Third Circuit's required disclosure cannot meet the SEC's clarity and specificity standard).

91. *Id.*; *see* Modernization of Regulation S-K, *supra* note 19, at 29 (noting that inclusion of disclosure of generic, boilerplate risks contributes to the increased length of risk factor disclosure and that the modernization of Item 105 is meant to address the lengthy and generic nature of many registrants' disclosures).

92. SIFMA Brief, *supra* note 7, at 16 (noting that the Third Circuit's standard would require underwriters to undertake costly investigation to uncover risks to the business that the issuer itself may not have perceived); *see also* Jeremy McClane, *Boilerplate and the Impact of Disclosure in Securities Dealmaking*, 72 VAND. L. REV. 191, 197 (2019) (stating that boilerplate disclosure language is associated with lower legal costs on average). *But cf.* McClane, *supra* note 92, at 191 (stating that issuers lose "$5 to $6 million in the market on average for each additional 10% of their disclosure" containing "rote recitations").

93. McClane, *supra* note 92, at 197 (stating that boilerplate disclosure language is associated with "higher average losses to issuers from mispricing" and does little to inform the investing public of the risk).

94. Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 715 (3d Cir. 2020); *see also*

reasoning, in order to avoid liability, M&T needed to (1) preemptively confess in its proxy to what the Federal Reserve and any of M&T's other regulators would later determine to be M&T's wrongful BSA/AML program and checking account misconduct that had not yet resulted in any regulatory action and (2) disclose the risk of unborn regulatory action regarding that conduct.[95] The Third Circuit imposed these requirements despite admitting in its opinion that it did not intend to require after-the-fact regulatory enforcement action to create a retroactive duty to disclose.[96]

The Third Circuit's standard is unworkable in practice as it demands that issuers disclose purely hypothetical or imagined risk or risk that the issuer does not know or cannot identify at the time of disclosure.[97] This requirement is ineffective since issuers cannot disclose what they do not already know is there to disclose.[98] In order to comply with the Third Circuit's standard, M&T would have had to disclose any regulatory compliance deficiencies that could be targeted by regulators, despite M&T being blind to (1) the existence of those deficiencies, as was the case for its BSA/AML program, or (2) the potential that, in hindsight and as was the case for its checking account practices, doubt in the programs would trigger regulatory action at the time of disclosure.[99]

B. Analyzing M&T's Actions Under the Second and First Circuit's Item 105 Standards

The Second Circuit's Item 105 interpretation complies with the text of Item 105 and the SEC's Item 105 guidance, which require only a discussion of material risk factors, not of uncharged conduct.[100] The Second Circuit's

SIFMA Brief, *supra* note 7, at 3–4.

95. *See* SIFMA Brief, *supra* note 7, at 3–4 (referencing regulatory action taken by the Federal Reserve and CFPB); Petition for Certiorari, *supra* note 19, at *3 (implying that the Third Circuit's standard would require an issuer to preemptively confess to misconduct that has not resulted in any regulatory or other sanction); *Jaroslawicz*, 962 F.3d at 715–16 (asserting M&T should have mentioned its non-compliant account practices before the CFPB took action, even though those practices had been curtailed prior to issuing the joint proxy).

96. *See Jaroslawicz*, 962 F.3d at 705, 716 ("Later litigation or regulatory enforcement does not create a retroactive duty to disclose.").

97. *See* SIFMA Brief, *supra* note 7, at 5–6. (stating that the standard is unworkable and would subject issuers and underwriters to liability for failing to disclose hypothetical, imagined, or unperceived risks).

98. *See id.*

99. *See id.* (arguing the impracticability of requiring foresight of regulatory risk).

100. *See* 17 C.F.R. § 229.105 (2020) (omitting requirement for the disclosure of uncharged, unadjudicated wrongdoing); *see also* United States v. Matthews, 787 F.2d 38, 49 (2d Cir. 1986) (holding that, as long as the SEC does not require uncharged criminal conduct to be disclosed, omitting such conduct disclosure cannot be criminally

interpretation in *City of Pontiac Policemen's & Firemen's Retirement System* would not have obligated M&T to disclose its BSA/AML compliance weaknesses and checking account issues because those issues had yet to be charged or adjudicated by regulators at the time the proxy statement was made.[101] Unlike the Third Circuit holding in which disclosing the Federal Reserve's potential and eventual regulatory action was insufficient, the court in *City of Pontiac Policemen's & Firemen's Retirement System* decided that disclosing UBS's involvement in government investigations and that those investigations could lead to regulatory restrictions were all that were needed for the issuer, UBS, to comply with its Item 503(c) obligations.[102] Just like UBS, M&T disclosed the Federal Reserve's inquiries into M&T's programs and that those inquiries could stall the merger; M&T complied with Regulation S-K disclosure requirements under the Second Circuit's interpretation of Item 105.[103] Likewise, the First Circuit's Item 105 interpretation is in line with Regulation S-K disclosure requirements, which require firms to discuss only risk known by the issuer at the time of disclosure.[104] The First Circuit's interpretation in *Silverstrand* would not have demanded M&T to disclose regulatory risks with any more detail than the bank had already disclosed because it had no knowledge at the time of disclosure that its programs were wrongful and would certainly be challenged by regulators who would stall the merger.[105]

---

prosecuted); Ciresi v. Citicorp, 782 F.Supp. 819, 823 (S.D.N.Y. 1991) (stating that "the law does not impose a duty to disclose uncharged, unadjudicated wrongdoing or mismanagement."); *Jaroslawicz*, 962 F.3d 701 at 716 (clarifying that the court is not holding that later regulatory enforcement creates a retroactive duty to disclose).

101. *See* Jaroslawicz v. M&T Bank Corp., 296 F. Supp. 3d 670, 674 (D. Del. 2017) (describing the timeline of the merger when the proxy was effective before regulators halted the merger); 752 F.3d 173, 184 (2d Cir. 2014); *see also Jaroslawicz*, 962 F.3d at 713 (summarizing the Second Circuit's Item 503(c) standard).

102. *See City of Pontiac Policemen's & Firemen's Ret. Sys.*, 752 F.3d at 184 (stating that "[b]y disclosing its involvement in . . . government investigations and indicating that its involvement could expose UBS to [regulatory restrictions], UBS complied with its disclosure obligations").

103. *See id.* at 184 (noting that UBS disclosed its involvement in government investigations and indicated that its involvement could expose UBS to regulatory restrictions); Form 8-K, supra note 46 (disclosing that the Federal Reserve identified issues with M&T's BSA/AML programs and that to address the regulator's concerns, the closing of the merger would have to be delayed).

104. *See* § 229.105 (omitting the disclosure of risk that is unknown to the issuer at the time of disclosure); Silverstrand v. AMAG Pharms., Inc., 707 F.3d 95, 103 (1st Cir. 2013).

105. *See Silverstrand*, 707 F.3d at 103; *Jaroslawicz*, 296 F. Supp. 3d at 674 (describing the timeline of the merger process in which the proxy was filed and made effective before regulators halted the merger); *see also Jaroslawicz*, 962 F.3d at 713 (explaining the First Circuit's Item 503(c) standard).

The First and Second Circuit's interpretations of Item 105 comply with the text of Item 105 and the SEC's guidance, but the Third Circuit's interpretation adds an ineffective requirement for predictive disclosure of how regulators may or may not treat specific wrongdoing unknown to issuers at the time of disclosure.[106]

C. M&T Complied with the Text of Item 105

M&T satisfied its disclosure obligation under the Second and First Circuits' Item 105 standards in compliance with the text of Item 105 and the SEC's guidance to provide a non-generic, adequate discussion of material risk.[107] M&T specifically discussed in its proxy statement the specific federal agencies taking action—the Federal Reserve and CFPB—the applicable laws for compliance, and the regulatory hurdles regarding its BSA/AML program that could but had not yet stalled the merger.[108] These were all specific details of the material risk that regulatory action posed to M&T's shareholders in the context of the merger that the shareholders were voting on.[109] Although M&T's disclosures certainly contained some generic language apparently included to couch its risk statements within the context of broader industry-wide risk, the proxy still contained the specificity, similar to that of the SEC's guidance, linking risk to M&T's activities.[110]

M&T disclosed that "regulatory hoops stood between the proposed merger and a final deal."[111] The proxy statement was littered with references to the threat that regulatory approval from the Federal Reserve posed to the merger

106. *See* SIFMA Brief, *supra* note 7, at 5–6 (stating that the Third Circuit's standard is "unworkable in practice"); § 229.105 (listing the existing requirements for Item 105 disclosure, omitting the Third Circuit's required disclosures); *cf. Jaroslawicz*, 962 F.3d at 716 (claiming it did not matter whether M&T knew about the shortcomings in its programs).

107. Memorandum of Law in Support of Defendants' Motion to Dismiss at 10, Jaroslawicz v. M&T Bank Corp. (D. Del. 2016) (No. 15-897) [hereinafter Defendants' Memo] (naming the Federal Reserve and applicable BSA/AML law in the proxy statement); *see also* M&T Joint Proxy, *supra* note 39, at 24, 27 (listing several warnings in the Risk Factor section and elsewhere about the threat posed to the merger by regulatory action).

108. Defendants' Memo, *supra* note 107, at 10; *see also* M&T Joint Proxy *supra* note 39, at 24, 27.

109. *See* M&T Joint Proxy, *supra* note 39, at 24, 27 (listing details of the material risk of regulatory action including the agencies involved, applicable laws, and their impact on the merger and M&T's business activities).

110. *Compare* Modernization of Regulation S-K, *supra* note 19 (noting that the modernization of Item 105 is meant to address the lengthy and generic nature of many registrants' disclosures), *with* M&T Joint Proxy, *supra* note 39, at 40 ("Like all businesses, M&T is subject to operational risk . . . .").

111. *Jaroslawicz*, 962 F.3d at 715.

and emphasized that completion of the merger was subject to the Federal Reserve's approval of M&T's BSA/AML program.[112] The proxy statement also clearly warned shareholders that M&T's internal programs might be wrongful and threaten the merger that the shareholders were voting on.[113] M&T specifically disclosed which federal agencies were applying which federal laws to scrutinize which of M&T's compliance programs and how the agency's application of those laws to M&T's compliance programs could halt completion of the merger.[114] Importantly, M&T's supplemental proxy following its press release about the Federal Reserve's action disclosed the action that the Federal Reserve took against M&T in the context of a specific law and specific M&T program and that action's effect of extending the merger.[115]

The Third Circuit even admitted that M&T identified that the merger hinged on obtaining the Federal Reserve's approval and singled out that determining the effectiveness of its BSA/AML program would be crucial to obtaining that approval.[116] M&T's disclosure stated that "in every case under the Bank Merger Act, the Federal Reserve must take into consideration . . . records of compliance with anti-money-laundering laws."[117] The Third Circuit also conceded that M&T disclosed that the Federal Reserve had the authority to evaluate the bank's BSA/AML compliance under two laws — the Bank Holding Company Act of 1956 and

112. Defendants' Memo, *supra* note 107, at 10; *see, e.g.*, M&T Joint Proxy, *supra* note 39, at 15, 26, 29, 43 (referencing several mentions of the need for regulatory approval for closing the merger and disclosing that the Federal Reserve identified certain regulatory concerns regarding M&T's Bank Secrecy Act and anti-money-laundering compliance program).

113. M&T Joint Proxy, *supra* note 39, at 40 (stating that, under the subsection titled, "M&T is subject to operational risk," that M&T is subject to risk resulting from inadequate processes).

114. *See id.* at 99–100 (showing where, under the section titled "Regulatory Approvals Required for the Merger," the proxy states that "[c]ompletion of the merger is subject . . . to . . . the Federal Reserve's [approval] pursuant to . . . the Bank Holding Company Act" and that approval was also subject to the Federal Reserve's review of the effectiveness of M&T's anti-money laundering programs).

115. Form 8-K, *supra* note 46 (stating that M&T learned that the Federal Reserve identified certain regulatory concerns with M&T's procedures, systems, and processes relating to M&T's anti-money laundering program, M&T's effort to address the Federal Reserve's concerns, and that to do so would require an extension of the merger's closing beyond the date previously expected).

116. *Jaroslawicz*, 962 F.3d at 714–15 (conceding that M&T seemingly disclosed what it should have in its supplemental proxy regarding the merger's reliance on approval from the Federal Reserve regarding its BSA/AML programs).

117. *Id.* at 714.

the Federal Deposit Insurance Act.[118]

M&T fulfilled its Item 105 obligations through the combination of its amended proxy and subsequent supplemental statements.[119] Per the text of Item 105, M&T discussed material risk factors, namely, the threat that federal regulatory action posed to completion of the merger.[120] The bank organized the discussion with relevant subheadings and subcaptions describing the risk that regulatory action posed to the merger.[121] The proxy also explained how the risk factor, regulatory action, would affect the registrant, M&T, by disclosing that regulators could stall the merger.[122] The proxy addressed the main points of Item 105, demonstrating that M&T complied with the law in this regard.

D. Analyzing M&T's Disclosure Under the SEC's Example

Furthermore, M&T's disclosure mirrors that of the SEC's guidance examples, which the court relied on for its opinion in *Jaroslawicz v. M&T Bank*.[123] Just as the SEC guidance's lawn care example specifically named the hypothetical lawn care company's asset size relative to its competitors as a risk that might render it unable to compete against larger competitors, M&T named a specific federal agency – the Federal Reserve – and that agency's scrutiny of specific M&T programs – its BSA/AML programs – as a potential roadblock for the merger that the shareholders were voting on.[124]

118. *Id.*

119. *See* M&T Joint Proxy, *supra* note 39; Form 8-K, *supra*, note 46.

120. *See* 17 C.F.R. § 229.105 (2020) (stating the requirement to provide "a discussion of the material factors that make an investment in the registrant or offering speculative or risky"); M&T Joint Proxy, *supra* note 39, at 15, 26, 29, 34, 40, 43 (listing several points throughout the proxy statement where M&T disclosed that regulatory hurdles from the Federal Reserve might hinder the merger); Form 8-K, *supra* note 46 (disclosing the material risk factor that M&T had to delay the merger in order to address the concerns of the Federal Reserve).

121. *See* § 229.105 (stating the requirement that the disclosure discussion "be organized logically with relevant headings and that each risk factor should be placed under a subcaption that adequately describes the risk); M&T Joint Proxy, *supra* note 39, at 34, 40, 100 (organizing the disclosures under the subcaptions "Risks Relating to the Regulatory Environment," "M&T is subject to operational risk," and "Regulatory Approvals Required for the Merger").

122. *See* § 229.105 (stating the requirement for the disclosure to "[c]oncisely explain how each risk affects the registrant"); M&T Joint Proxy, *supra* note 39, at 15, 26, 29, 34, 40, 43 (describing instances where regulation could stall the merger).

123. *See* Petition for Certiorari, *supra* note 19, at 5; Bulletin No. 7, *supra* note 14, at 6–7; *Jaroslawicz*, 962 F.3d at 711–13, 715 (citing the SEC's Bulletin No. 7).

124. M&T Joint Proxy, *supra* note 39, at 15, 26, 29, 34, 40, 43 (disclosing that regulatory hurdles from the Federal Reserve might hinder M&T's business activities, including the merger); *see* Form 8-K, *supra* note 46 (disclosing that the merger was being held up by the Federal Reserve's regulatory action against M&T for its BSA/AML

The proxy also stated that the Federal Reserve was taking longer to render a decision on applications than the typical time period for approval set forth in the Federal Reserve's regulations.[125] This is the kind of detailed, non-generic statement describing a smaller facet of a larger generic risk that the SEC is looking for and provided an example of.[126]

E. Uncertainty is Not an Item 105 Disclosure Requirement

Item 105 does not require disclosure of uncertainty, which is different than risk and reflects the category of information the Third Circuit stipulated in its ruling.[127] Widely cited in academia, economist Frank Knight's classic differentiation between risk and uncertainty sheds light on the divergence of the uncertainty that the Third Circuit identified as risk from the risk that Item 105 requires for disclosure.[128] Given that uncertainty is unmeasurable and lacks the quantifiability inherent in risk, risk that is unknown or unperceived by the issuer at the time of disclosure is best classified as unmeasurable uncertainty because its nature makes it not quantifiable.[129] Aside from the policy argument over whether registrants ought to disclose uncertainty and whether some uncertainty is material, uncertainty and risk are different, and Item 105 does not require disclosure of uncertainty.[130] Item 105 demands that registrants disclose only material risk, which must be quantifiable under the classic definition of risk, and such measurability is absent from the Third

---

practices and that a delay in the merger's closing was necessary for M&T to address the Federal Reserve's concerns). *But see* Bulletin No. 7, *supra* note 14, at *1 (exemplifying a preference by the SEC for disclosure language that does not rely on the inferences of the reader to deduce the connection between the company's activities and the risk borne by the shareholder).

125. Petition for Certiorari, *supra* note 19, at 6.

126. *See* Bulletin No. 7, *supra* note 14, at 6 (giving an example of how the hypothetical lawn care company's larger financial disadvantage keeps it from capturing market share due to its inability to open more offices, which is a detail within the overarching risk of the company's limited resources relative to its competitors).

127. *See* § 229.105 (omitting a requirement to disclose uncertainty); *see also* KNIGHT, *supra* note 24 (differentiating risk and uncertainty).

128. *See* § 229.105 (noting the absence of a requirement to disclose uncertainty); KNIGHT, *supra* note 24 (differentiating risk and uncertainty); Daniel Cahoy, *Patently Uncertain*, 17 NW. J. TECH. & INTELL. PROP. 1, 12 (2019) (noting there is no one more cited for conceptualizing uncertainty than Frank Knight).

129. *See* KNIGHT, *supra* note 24, at 233 (explaining that for risk, the distribution of outcome in a group of instances is known through calculation or statistics of past experience—in other words, risk is measurable—whereas uncertainty is judgment of future events using opinion, not scientific knowledge).

130. *See id.* (explaining the difference between risk and uncertainty); § 229.105 (omitting a requirement to disclose uncertainty).

Circuit's compulsion for disclosure of unknown risk.[131] Therefore, the Third Circuit's holding fails to conform to the Item 105 text's requirement for disclosure of material risk and instead demands disclosure of uncertainty.[132]

F. The Broad Reach of the Third Circuit's Ruling

The Third Circuit's ruling likely will not be confined to its own jurisdiction.[133] As M&T's noted in its Petition for Writ of Certiorari, the Third Circuit's interpretation could become the nationwide standard for Item 105 due to federal securities laws' broad venue provisions and Delaware's status as the dominant jurisdiction for U.S. public companies.[134] The Securities Act of 1933 and the Securities Exchange Act of 1934 contain expansive process and forum provisions for plaintiffs under the law.[135] The nationwide service of process provision specifies that process under the Act "may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found."[136] Plaintiffs can serve defendants anywhere they are.[137] The law provides for proper venue in any district where a violation of the Act occurred or where a defendant is found, lives, or conducts business.[138] Most large public companies and many private corporations choose Delaware for their domicile.[139] According to the Delaware Division of Corporations website, "more than one million business entities have made Delaware their legal home," and "more than 60 percent

131. Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 705 (3d Cir. 2020) (failing to provide a measurability requirement for the disclosed risk); KNIGHT, *supra* note 24, at 233 (explaining the definition of risk).

132. *Compare* KNIGHT, *supra* note 24, at 19–20 (defining risk), *and* § 229.105 (2020) (noting the absence of a requirement to disclose uncertainty), *with Jaroslawicz*, 962 F.3d at 705 (establishing the Third Circuit's Item 105 standard).

133. *See* Petition for Certiorari, *supra* note 19, at 5 (Nov. 15, 2020) (stating that the Third Circuit's expansive interpretation of Item 105 "threatens to become the de facto national standard").

134. *Id.*

135. 6 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 17:1 (2021) ("Section 22 of the Securities Act of 1933 and Section 27 of the Securities Exchange Act of 1934 provide for nationwide service of process" and "a wide choice of federal forums.").

136. 15 U.S.C. § 78aa.

137. *See id.* (summarizing the relevant gist of the expansive service of process provision under the Securities Exchange Act).

138. *Id.*

139. Griffin, *supra* note 12; *see also* Why Businesses Choose Delaware, *supra* note 12 (noting that "Delaware has been the premier state of formation for business entities since the early 1900s"); Petition for Certiorari, *supra* note 19, at 23 (noting "Delaware's status as the domicile of choice for U.S. public companies.").

of the Fortune 500 companies are incorporated in Delaware."[140]

G. Negative Impact of the Third Circuit's Hindsight 2020 Standard on Capital Markets

Varying circuit court interpretations of Item 105 create confusion among securities market participants.[141] The Third Circuit's interpretation "significantly reduce[s] the pleading and evidentiary standards plaintiffs must meet in bringing claims under the federal securities laws," thereby "submit[ting] issuers to liability for failing to disclose otherwise unknown and unperceived risks."[142] This would "significantly expand potential class action securities liability," "negative[ly] impact[ing] . . . the process by which public companies access investment capital."[143] Concerns over securities liability could disincentivize lenders from working with early stage and start-up small businesses perceived to be higher risk than their counterparts who have the financial resources and internal infrastructure to manage and litigate compliance with the Third Circuit's standard, limiting the growth and health of the small business sector, a huge driver of the U.S. economy.[144]

IV. RECOMMENDING THE SECOND AND FIRST CIRCUIT'S ITEM 105 STANDARD TO RESOLVE INDUSTRY CONFUSION

A. The Supreme Court Should Grant Cert

The Third Circuit incorrectly applied Item 105 in *Jaroslawicz*.[145] The Supreme Court should grant certiorari in future cases where the federal Circuit has required an issuer to disclose uncharged, unadjudicated,

---

140. *Why Businesses Choose Delaware*, *supra* note 12.

141. *See* SIFMA Brief, *supra* note 7, at 4 (noting the confusion caused by the different Item 105 standards).

142. SIFMA Brief, *supra* note 7, at 6; Petition for Certiorari, *supra* note 19, at *3.

143. SIFMA Brief, *supra* note 7, at 5–6.

144. *Id.* at 5 (explaining that the standard could discourage underwriters and investment banks from raising capital for entrepreneurial and start-up businesses perceived as posing greater litigation risks). *See generally* Abigail Thorpe, *Infographic: The Cost of Compliance*, NFIP (Oct. 24, 2016), https://www.nfib.com/content/resources/infographic/infographic-the-cost-of-compliance-75773/ (stating that "[s]mall businesses are the engine of the economy . . . make up 99 percent of all U.S. employer firms" and shoulder disproportionate compliance costs relative to other businesses).

145. SIFMA Brief, *supra* note 7, at 3 (describing the Third Circuit's Item 105 interpretation as wrong as a matter of law and policy and requesting that the Supreme Court grant M&T's petition for certiorari to reverse the decision).

unknown, and unperceived risk in proxy statements at the time of issuance.[146] In doing so, the Court should clarify the disclosure standard fractured by *Jaroslawicz* to hold that knowledge of specific, charged, or adjudicated wrongdoing presenting risk at the time of issuance is the only applicable standard for Item 105.[147] This would be in contrast to the Third Circuit's standard compelling disclosure of company-specific unknown future risk of harm not yet developed, identified by the issuer, or charged by regulators.[148]

This standard captures the knowledge element of the First Circuit interpretation and the adjudicated or charged element of the Second Circuit interpretation while satisfying the specificity element that the Third Circuit opinion emphasized.[149] The Third Circuit and the SEC demand specificity as part of Item 105.[150] As a desired policy outcome and to the extent the letter of the law demands, the Supreme Court should include specificity in its Item 105 risk disclosure standard so long as the material risk that issuers disclose is recognizable and identifiable enough to be specified in the issuers' proxy statement.[151]

B. New SEC Rulemaking or Amending Existing Guidance

The SEC should promulgate a rule to clarify the standard applied to Item 105 disclosure.[152] The SEC could similarly put forth guidance supplementing its 1999 guidance or most recent rulemaking governing Item 105 to establish a combination of the Second and First Circuits' Item 105 interpretations as the appropriate standard.[153]

This may entail the SEC adding a section onto its 1999 guidance or amending the "Risk factor comments" section of its guidance to dispel the

146. *See id.* at 3 (stating a request by industry participants, as represented by SIFMA, BPI, and ABA, for the Supreme Court to grant M&T's petition for certiorari).

147. *See* Petition for Certiorari, *supra* note 19, at 12 (highlighting that "[t]he Third Circuit's decision in this case establishes a clear split of authority in the federal circuit courts regarding the scope of Item 105").

148. *See* Jaroslawicz v. M&T Bank Corp., 962 F.3d 701, 705, 715 (3d Cir. 2020) (establishing the Third Circuit's Item 105 standard).

149. *See id.* at 713 (explaining the Second Circuit's and First Circuit's Item 105 standards); SIFMA Brief, *supra* note 7, at 6 (explaining that the Third Circuit's standard would make issuers liable for not disclosing unknown and unperceived risks).

150. *See* SIFMA Brief, *supra* note 7, at 15 (describing the SEC's guidance requirements for clarity and specificity in Item 105).

151. *But see id.* at 16 (contrasting the Third Circuit's standard with a recognizable and identifiable material risk disclosure requirement).

152. *See id.* at 20 (suggesting that the U.S. Solicitor General under the U.S. Department of Justice clarify Item 105, implying a need for federal regulatory rulemaking).

153. *See id.* (suggesting agency clarification on Item 105).

need to predict specific regulatory action.[154] The SEC could either add new language or simply amend an existing comment. Regardless of the path the SEC chooses, the language should specify that the risk factors needed for disclosure should be identifiable and known at the time of disclosure and answer the question of whether Item 105 requires disclosure of unknown facts or facts pertaining to business practices or procedures that are unknown to be wrongful or noncompliant at the time of disclosure.[155]

The SEC missed an invited opportunity to weigh in on this issue when M&T petitioned for writ of certiorari and failed to do so in part because of deadline restraints.[156] There is no court deadline now, but there exists ample time to address the Circuit split through the various regulatory tools at the SEC's disposal.[157]

V. CONCLUSION

Despite the Third Circuit's opinion, M&T complied with the SEC's Regulation S-K Item 105 disclosure requirements and 1999 guidance when it disclosed regulatory risks posed by a specific program and a specific federal regulator. Per the Second and First Circuits' interpretations, the Third Circuit should not have applied a disclosure standard compelling M&T to predictively disclose the wrongfulness of its programs and the unknown risks those programs posed to the timeline of the merger.[158]

The Supreme Court should grant future petitions for writ of certiorari in similar cases to clarify the standard, or the SEC should promulgate a rule or issue guidance to clarify the standard in order to provide certainty to securities market participants in an industry that fuels 70 percent of the U.S. economy.[159] Item 105 risk factor disclosure obligations must be clear and

---

154. Bulletin No. 7, *supra* note 14, at 13–14.

155. *See* Petition for Certiorari, *supra* note 19, at 9 (raising two questions for the Supreme Court).

156. *See id.* (inviting the SEC to weigh in on the questions for the Supreme Court and noting deadline restraints for why the SEC did not weigh in).

157. *See* Ruscoe, *supra* note 1 (stating that the Supreme Court denied M&T Bank's petition for certiorari, negating the deadline issue for the SEC to weigh in on the appropriate Item 105 standard); *SEC Interpretive Releases*, U.S. SECURITIES & EXCHANGE COMMISSION, https://www.sec.gov/rules/interp.shtml (Feb. 25, 2020) (explaining one of the SEC's regulatory instructive tools that could clarify Item 105).

158. City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 184 (2d Cir. 2014) (explaining the doctrine that disclosure is not a right of confession and that companies do not have to disclose uncharged, unadjudicated wrongdoing).

159. Our Markets, *supra* note 11; *see* SIFMA Brief, *supra* note 7 at 3, 20 (requesting for the Supreme Court to grant M&T's petition for certiorari and suggesting that the U.S. Solicitor General clarify Item 105).

achievable, so the standard set should not be predictive and should require disclosure only of material risk factors identifiable and known at the time of disclosure. This will strengthen the disclosure regime by setting an achievable, meaningful standard for the issuers to whom it applies.

AMERICAN UNIVERSITY
BUSINESS LAW REVIEW

VOLUME 12 • 2022-2023

AMERICAN UNIVERSITY BUSINESS LAW REVIEW

SUBSCRIPTION ORDER FORM

Subscription Options (check one):

______ $30.00 Alumni Subscription

______ $45.00 Domestic Subscription

______ $50.00 Foreign Subscription

______ $20.00 Single-Issue Only

______ **Please check here if you would like to enclose a check for the amount selected.**

Please complete the form below and send it with your check made payable to *American University Business Law Review* at:

American University Business Law Review
Washington College of Law
4300 Nebraska Avenue, NW
Suite CT11
Washington, D.C. 20016
Attn: Journal Coordinator

______ **Please check here if you would like to receive an invoice for the amount selected.**

Please complete the form below and email it to Sharon Wolfe, the Journal Coordinator, at shuie@wcl.american.edu.

Please begin my subscription with Volume ______ Single-Issue only ______

Name:
____

Institution:
____

Address:
____

City, State, Zip:
____

*Subscriptions are automatically renewed unless cancellation is requested.