Two Takeaways from the Recent EU-Turkey Trade Dispute in the Pharma Sector

On July 25, 2022, an arbitral tribunal confirmed on appeal an WTO ad hoc panel’s finding that certain measures enacted by Turkey – requiring foreign companies to produce pharmaceuticals in Turkey and to refrain from importing them to qualify for government-provided health care reimbursements – were inconsistent with the WTO agreements. Turkey’s measures were aimed at reducing the country’s dependence on imported pharmaceutical products by attracting foreign investment into local pharmaceutical production.

The appeal award offers valuable lessons for States looking to boost their domestic healthcare system, particularly in the context of the COVID-19 pandemic. As the first WTO appeal decision by an arbitral tribunal, the award is also a promising development for practitioners concerned by the current paralysis of the WTO’s Appellate Body.

I. Investment Attraction Measures May be at Risk of Breaching WTO Law

Turkey introduced a phased program to exclude imported pharmaceutical products from the Turkish Universal Health Insurance Scheme (“UHIS”). Under the UHIS, patients can access certain pharmaceutical products at reduced prices, with the Turkish Government covering the difference between the price paid by patients and the full price.

The phased program required that foreign pharmaceutical companies “relocate” their pharmaceutical production to Turkey to maintain UHIS coverage by, for example, acquiring real estate in Turkey, building pharmaceutical production facilities in the country, employing local workforce, and sharing relevant know-how. The program further prohibited foreign companies from importing pharmaceuticals that were produced locally.

The goal of the phased program was to attract foreign direct investment in the pharmaceutical industry to reduce Turkey’s import dependence. For Turkey, reliance on imports – rather than on domestic production – posed a risk to human life and health by exposing patients to global supply shortages.

The appeal award confirmed that Turkey’s phased program breached national treatment obligations under Article III:4 of the WTO General Agreement on Tariffs and Trade (“GATT”). Under Article III:4 of the GATT, WTO members must accord imported products treatment no less favorable than accorded to like domestic products in respect to all laws, regulations, and requirements affecting their internal sale, offering for sale,
purchase, transportation, distribution, or use. According to the arbitrators, Turkey’s program discriminated against imported products by creating a financial incentive for consumers in favor of local subsidized pharmaceutical products and against imported products, which were excluded from UHIS reimbursement.

The appeal award’s determinations take on new meaning in the context of the COVID-19 pandemic, which has exposed how global supply chain disruptions can threatened a country’s healthcare system and other critical sectors. Countries looking to address that threat by boosting local pharmaceutical production should design incentives carefully to avoid infringing upon the WTO agreements.

II. Appellate Arbitration of Panel Reports as a Way Forward

For years, practitioners have been concerned about the crisis in the WTO’s dispute settlement mechanism. Since May 2017, the U.S. has blocked the appointment of new members to WTO Appellate Body – the standing WTO organ of seven members charged with hearing appeals against reports issued by *ad hoc* panels deciding disputes between WTO member States. The Body became fully paralyzed and unable to render reports in December 2019 when the terms of two out of the three then remaining members expired. Without an operating Appellate Body, WTO panel reports cannot be appealed, adopted by the WTO Dispute Settlement Body, or enforced.

As a response to the Appellate Body’s standstill and seeking to preserve the WTO’s two-level adjudication dispute settlement system, several WTO members negotiated the Multi-Party Interim Appeal Arbitration Arrangement (“MPIA”) in accordance with Article 25 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (“DSU”), which allows the resolution of WTO disputes via arbitration. Members that are party to the MPIA, consent to arbitrate WTO disputes among them which would have otherwise been subject to appeal before the WTO Appellate Body.

While Turkey is not currently a member of the MPIA, it entered into arbitration agreement with the EU under Article 25 of the DSU and agreed that the arbitrators would be selected “from a combined list of former Appellate Body Members and [MPIA] appeal arbitrators”. The appeal arbitral tribunal so selected issued its award on July 25, 2022 – marking only the second time in history that WTO members resort to arbitration of trade disputes under Article 25 of the DSU (the first was *DS160 United States – Section 110(5) of US Copyright Act*) and the first appeal award.

Since the standstill at the WTO Appellate Body does not seem close to resolution, the *Turkey — Pharmaceutical Products (EU)* offers hope of maintaining the WTO’s dispute settlement mechanism alive through Article 25 arbitration, either under the umbrella of the MPIA or under bilateral arbitration agreements like EU-Turkey Agreement.
How Curtis Can Help

With deep expertise in both international trade and international investment arbitration, Curtis is well-positioned to advise Sovereign clients in designing WTO-compliant measures aimed at attracting foreign investment to critical sectors and in the appeal arbitration of trade disputes challenging those measures.

About Curtis

Established in 1830, Curtis, Mallet-Prevost, Colt & Mosle LLP is a leading international law firm headquartered in New York with 19 offices in the United States, Latin America, Europe, the Middle East and Asia. For more information about Curtis, please visit www.curtis.com.

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