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Assessing the legality of data-localization requirements: Before the tribunals or at the negotiating table?*

by

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The development of digital technologies and the globalization of the Internet have tremendously enhanced the ability to transfer data across borders. Trans-border data flows are intrinsic to integrated international production systems and global value chains established by MNEs regarding virtually all corporate functions.

Governments, however, are increasingly imposing local data-storage and/or processing requirements, thereby restricting data transfers. Their concerns include data protection, national security, law enforcement, and industrial policy (hence economic development). China and Russia, among others, enforce such requirements, and India is about to adopt a [data protection bill](#) requiring that a copy of personal data be stored within the country, and “critical” personal data be only processed in servers or data centers located in India.

Data-localization requirements have been labeled as trade barriers and identified as regulatory protectionism.¹

Uncertainty remains in international law about the applicable regime and its interpretation. Intra-MNE services and services provided locally by established subsidiaries, associates or branches of foreign-owned or controlled companies (mode 3 of the General Agreement on Trade in services (GATS)) exemplify this. Assessing, in these situations, the legality of data-localization requirements under the GATS and international investment agreements (IIAs) should prompt investors, decision-makers and engineers to take action.

Data-localization requirements are comparable to residency requirements, according to which advantages are conditional upon prior residency of designated persons within the host country, and thus could violate the GATS national treatment provisions. Even though residency requirements are applicable to all “like” service providers regardless of nationality, this formally identical treatment de facto modifies the conditions of competition to the detriment of foreign-owned suppliers, as cost-effective compliance is more demanding for the latter. Therefore, several WTO members have scheduled residency requirements as national treatment limitations. Similarly, data-localization requirements can distort the conditions under which foreign-owned and domestic suppliers compete,² whenever foreign-owned service suppliers have to build or purchase—and maintain—(or rent) servers or data centers locally. Data-

localization requirements put foreign-owned suppliers at a competitive disadvantage by requiring them to undertake FDI and subjecting their activities to additional regulatory constraints and expenses related to infrastructure, management and compliance that domestic suppliers do not have to deal with.

Exception clauses are relevant to the analysis, especially regarding data protection. However, given the stringent conditions for trade restrictions to fall within the scope of GATS article XIV (especially the necessity test), one may doubt that data-localization requirements are justifiable. Less trade-restrictive alternatives may be reasonably available, such as using encryption technologies. Also, the contribution of particular data-localization measures to stated objectives may be compromised if they undermine security.

Likewise, data-localization requirements presumably breach IIAs' national treatment protections. If IIAs are available—and considering that most-favored-nation provisions might be invoked to multilateralize their content—they could be more efficient tools than the GATS to challenge the legality of data-localization requirements. The reason is that the national treatment provisions of IIAs are cross-sectoral obligations that do not apply only to services inscribed by WTO members in their schedules. Also, IIAs provide foreign investors with direct access to investor-state arbitration, while states might be reluctant to resolve disagreements on the matter through the WTO dispute-settlement mechanism.

It is just a matter of time before investors resort to international investment law to attempt defeating data-localization requirements, unless a global consensus arises on the necessity of such measures. In that regard, the disparities between national treatment standards among IIAs remain to be studied. The analysis of these requirements through the prism of national treatment will depend on the creative interpretation of IIAs by tribunals, on a case-by-case basis. Existing jurisprudence is largely irrelevant, and expertise on the economic impact of data-localization requirements and the technical availability of alternative measures is limited.

An international legal framework on restrictions on data flows could ensure openness, certainty and efficiency, together with data protection, security and other public policy objectives, and introduce consistency by unifying national treatment standards. In January 2019, a group of 76 WTO members, including China and Russia, announced the intention to open negotiations on “trade related aspects of electronic commerce,”³ which presumably encompass data localization. Also, plurilateral initiatives are moving forward, although institutionalizing fragmentation. The Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the United States-Mexico-Canada Agreement include provisions that allow data transfer across borders and prohibit data-localization requirements, but reserve states wide scope of action and margin of discretion; restrictions are allowed if strictly required to achieve “a legitimate public policy objective,” and in absence of “arbitrary or unjustifiable discrimination” or “disguised restriction on trade.”⁴ Investors could take the lead and challenge data-localization requirements, thereby spurring engineers and decision-makers to work together toward ensuring “public policy by design” in the open global economy.

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¹ E.g., [United States International Trade Commission, National Trade Estimate Report on Foreign Trade Barriers \(2018\)](#).

² An analogous assessment for mode 1 services would lead to similar, and even more cogent, conclusions. WTO members have acknowledged that residency requirements impinge on cross-border supplies. WTO, “Guidelines for the scheduling of specific commitments under the GATS,” March 28, 2001.

³ [WTO, “Joint statement on electronic commerce,” January 25, 2019](#).

⁴ CPTPP, article 1 (TPP, articles 14.11, 14.13); USMCA, articles 19.11, 19.12.

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