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MOST-FAVORED NATION TREATMENT CLAUSE IN INVESTMENT ARBITRATION

Summary

Bilateral and regional investment agreements have proliferated in the last decade and new ones are still being negotiated. Most-Favored-Nation (MFN) clauses link investment agreements by ensuring that the parties to one treaty provide treatment no less favorable than the treatment they provide under other treaties in areas covered by the clause. MFN clauses have thus become a significant instrument of economic liberalization in the investment area. Moreover, by giving the investors of all the parties benefiting from a country's MFN clause the right, in similar circumstances, to treatment no less favorable than a country's closest or most influential partners can negotiate on the matters the clause covers, MFN avoids economic distortions that would occur through more selective country-by-country liberalization. Such a treatment may result from the implementation of treaties, legislative or administrative acts of the country and also by mere practice. The present article provides a factual survey of jurisprudence and related literature on MFN treaty clauses in investment agreements with a view to contributing a better understanding of the MFN interfaces between such agreements.

Key words: *dispute resolution, foreign investment, ICSID, most-favored nation treatment, third party treaty, mandate of the arbitration tribunal, a selective import*

Introduction

Initially, the application of MFN in investment treaties did not raise much debate. Since 2000, however, with Maffezini v. Spain, an original interpretation of MFN led to a seismic shift in international investment law: the possibility for investors protected under a bilateral investment treaty (BIT) to import more favorable provisions from a third-party BIT made by their host state. This trend then accelerated and led to many criticisms, crystallized in one essential point: the latitude given to foreign investors to bring together elements from various treaties made by the host state and to custom tailor a treaty, ignoring the bilateral character of the commitments made by two states in the context of specific negotiations. (3, p.1)

The vast majority of BITs in force around the world today contain some form of MFN provision. Typically, such provisions require each contracting state to accord to investors of the other contracting state treatment that is no less favorable than that accorded to the investors of third states. In doing so, they link BITs by requiring state parties to one treaty to provide investors with treatment that is no less favorable than the treatment provided by them to other investors under other treaties. However, critically, the wording of individual MFN clauses varies widely from treaty to treaty, with the result that the scope and extent of the protection offered by the clauses can be very different under one treaty as compared with another. (4, p.131)

A stock taking of MFN clauses in investment treaties will not yield a uniform picture. In fact, the universe of MFN clauses in investment treaties is quite diverse. Some MFN clauses are narrow, others are more general. Moreover, the context of the clauses varies, as does the object and the purpose of the treaties which contain them. (5, p.3)

By way of example the Azerbaijan-Turkey BIT (2011) contains the following MFN provision:

1. Each Contracting Party shall admit in its territory investments on a basis no less favorable than that accorded in like circumstances to investments of investors of any third State, within the framework of its laws and regulations.

2. Each Contracting Party shall accord to these investments, once established, treatment no less favorable than that accorded in like circumstances to investments of its own investors or to investments of investors of any third State, whichever is the most favorable, as regards the management, maintenance, use, enjoyment, extension, or disposal of the investment. (2, article 3)

As summarized by Campbell McLachlan, general elements of MFN Clauses in investment treaties form a legal test which requires responding to the following questions:

• What acts of the State are capable of constituting "treatment"?

• What is the relevant class of persons or things – the comparators – whose treatment is to be compared with the class of persons protected under the MFN Clause?

• The level of treatment accorded: is it less or no less favorable? (6, para. 7.305.)

When interpreting an MFN clause, just as when interpreting any other treaty provision, the essential aim is to identify the intention of the contracting parties. The Vienna Convention on the Law of Treaties adopts, as the general rule of interpretation, a textual approach by way of Article 31. Article 31 of the Vienna Convention reads:

General rule of interpretation

(1) A treaty shall be interpreted 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. (2) The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

(3) There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; (c) any relevant rules of international law applicable in the relations between the parties.

(4) A special meaning shall be given to a term if it is established that the parties so intended. (1, article 31)

Each of these four elements of Article 31 is expressed in mandatory terms and is designed to apply within a single and integrated exercise of treaty interpretation.

There are many variations on the MFN clause in investment treaties and chapters, but it is possible to classify them according to three main criteria. First, a distinction may be made on whether MFN is a stand-alone clause, attached to a national treatment clause or attached to another clause in the BIT.

Second, a distinction can be made on whether the MFN clause specifies or not the type of "treatment" covered. The majority of traditional BITs do not specify the scope of application of MFN—that is, the categories of measures covered.

Finally, one can make a distinction on whether or not the MFN clause incorporates a criterion of comparison between foreign investors. Thus, a growing number of BITs state that a comparison will be made between investors or investments located "in like circumstances or situations":

The term "circumstance" is used more frequently than "situation" in investment treaties, and the legal implications of the choice of the one rather than the other are yet to be determined.

Other treaties go further and provide guidelines for tribunals that must rule on whether like circumstances are present. This is the case of article 17.2 of the Investment Agreement for the COMESA Common Investment Area (CCIA):

For greater certainty, references to 'like circumstances' in paragraph 1 of this Article requires an overall examination on a case-by-case basis of all the circumstances of an investment including, inter alia:

(a) its effects on third persons and the local community;

(b) its effects on the local, regional or national environment, including the cumulative effects of all investments within a jurisdiction on the environment;

(c) the sector the investor is in;

(d) the aim of the measure concerned;

(e) the regulatory process generally applied in relation to the measure concerned; and

(f) other factors directly relating to the investment or investor in relation to the measure concerned; and the examination shall not be limited to or be biased towards any one factor. (3, p.5)

Many MFN clauses in investment treaties contain specific restrictions and exceptions, which exclude certain areas from their application. Such areas may include inter alia regional economic integration, matters of taxation, subsidies or government procurement and country exceptions. Depending on the way these exceptions are drafted, the fact that these limitations are specifically mentioned could be a factor in deciding whether certain other matters are within the scope of an MFN clause. Consider the following examples. The 1998 German Model BIT provides in its Article 3, points (3) and (4) that: "(3) Such treatment shall not relate to privileges which either Contracting State accords to investors of third States on account of its membership of, or association with, a customs or economic union, a common market or a free trade area. The treatment granted under this Article shall

not relate to advantages which either Contracting State accords to investors of third States by virtue of a double taxation agreement or other agreements regarding matters of taxation." (5, p.5)

More controversy, however, emerges regarding the use of an MFN Clause in order to import more favorable procedural and/or dispute resolution provisions from a third treaty. In this respect, arbitral tribunals have taken diametrically opposed positions.

In one series of decisions, arbitral tribunals have taken a liberal approach considering that, except if otherwise indicated in the BIT, there is nothing that would prevent an MFN Clause to be used in order to import a more favorable dispute resolution mechanism from a third treaty. This approach started to proliferate after the decision in Maffezini v. Spain case, where the arbitral tribunal held that "if a third-party treaty contains provisions for the settlement of disputes that are more favorable to the protection of the investor's rights and interests that those in the basic treaty, such provisions may be extended to the beneficiary of the most favored nation clause". (7, para. 56.) In the same vein, the tribunal in Austrian Lines v. Slovakia considered that there is "no conceptual reason why an MFN clause should be limited to substantive guarantees and rule out procedural protections, the latter being a means to enforce the former." (8, para. 124).

Nevertheless, other arbitral tribunals have rejected the argument that an MFN clause could extend to procedural and/or dispute resolution provisions. For example, while interpreting the Argentina-Italy BIT, the arbitral tribunal in the Impregilo v. Argentina case held that "Impregilo cannot rely upon the MFN clause in Article 3(1) of the Argentina-Italy BIT for the purpose of avoiding the obligation to resort to the local courts for 18 months. This clause cannot be used to circumvent the obligation to resort to the competent administrative or judicial bodies for 18 months." Likewise, the tribunal in Euram v. Slovakia held that even if that BIT contains a broadly worded MFN clause, that clause cannot substitute for the arbitration provision and make it possible for an investor successfully to bring arbitration proceedings against a State Party to the BIT, no matter what provisions for arbitration that State Party might have agreed to include in its other BITs. It concluded that the MFN provision in Article 3(1) of the BIT does not affect the scope of its jurisdiction under Article 8." Other tribunals have followed the same approach.

In particular, several arbitrators, such as Professor Brigitte Stern, claim to be "very strongly convinced that unless the BIT states otherwise MFN clauses should not apply to dispute settlement mechanisms and therefore disagree with the result arrived at in the Maffezini and al. cases". More particularly, she is of the opinion that the MFN Clause concerns only the rights that an investment of an investor is to enjoy under the BIT, be it substantive or jurisdictional, but it does not extend to the conditions that need to be met as per the BIT, such as the jurisdiction prerequisites in order to access such rights.

The second and third element required for an MFN Clause to be susceptible of application is the existence of a comparator third treaty which contains more favorable treatment provisions. As summarized by Campbell McLachlan, a double identity needs to exist between the two treaties: (6, para. 7.312.)

•Identity of subject matter between the rights protected by the clause and the rights compared;

•That the persons or things protected by the clause belong to the same category of persons or things to those which the comparison is made and are in the same relationship with the relevant State.

The double identity test relates to the so-called ejusdem generis rule. This rule is often seen to impose that an MFN Clause can be used to import from a third treaty only treatment that already exists in the basic treaty, but in less-favorable terms. For example, a treaty between States A and B contains a full protection and security provision that is restricted only to physical protection. If this treaty contains an MFN Clause, the latter can attract a more favorable full protection and security provision from a treaty concluded between States A and C that covers not only a physical, but also a legal protection. However, if the treaty between States A and B does not contain a full protection and security clause, the MFN Clause cannot serve as a gateway to import such provision from the treaty between States A and C. In the terms of the ILC's Commentary on the Draft Articles on MFN Clauses, there needs to be "a substantial identity between the subject-matter of the two sets of clauses concerned because States cannot be regarded as being bound beyond the obligations they have undertaken." (10, para. 11.)

This principle has been applied in investment arbitration case law. For example, the arbitral tribunal in the Doutremepuich v. Mauritius case ruled that the purpose of the ejusdem generis rule is to "prevent a State, via the application of the MFN clause, from seeing its obligations extended to matters it did not contemplate." The same position was taken by the arbitral tribunal in the Rawat v. Mauritius case.

Conclusion

In conclusion, the extension of the scope of MFN could turn out to be endless if states and tribunals do not set limits in a uniform and definitive manner. The limits imposed by the Maffezini award have already been rejected by some tribunals. It is possible to make recommendations of a general and specific nature for countries wishing to protect themselves in future from the undesired effects of MFN.

Above all, there is a need in all future treaties to adopt a consistent national position on the negotiation of investment treaties in general and the MFN clause in particular. This implies, as a minimum, determining whether the country wishes to continue to sign BITs and, if so, whether MFN should be included and in what form. It is important at this level to set the non-negotiable elements in MFN, be these the extension or not of the pre-establishment phase or the content of exceptions. In any case, it is prudent to not engage in new investment treaty negotiations or quickly finalize those that are under way at a time when discussions about a systemic reform of the universe of BITs and investment arbitration are ongoing.

For existing treaties with vague clauses, the options are renegotiation or joint interpretation by the signatory states. Failing these, the state concerned could proceed to a unilateral interpretation of the treaty or the termination of the agreement on its expiry date.

For future treaties, there are three options available. The first is, quite simply, not to include MFN.

The second option consists of: (1) limiting MFN to the post-establishment phase; and (2) limiting the scope of the clause during the post-establishment phase. These limitations could be of three orders, cumulatively: (i) Exclude all previous or subsequent investment treaties (or both) from the scope of MFN, be these substantive or procedural rules, starting with the words “for greater certainty” or a similar expression. (ii) Include the expression “like circumstances” as a comparator and give an indicative list of factors to be taken into account to analyze “like” character. (iii) Make exceptions for regional integration organizations and double taxation treaties, but also exclude specific measures and sectors that are sensitive for the state.

The third option, finally, concerns the scenario whereby the country wishes, nevertheless, the MFN clause to cover the pre-establishment phase. In this case, it would be necessary (1) to apply the above recommendations for the post-establishment phase; and (2) to provide, cumulatively: (i) Progressive liberalization for selected sectors through a (preferably) positive list (ii) Grandfathering of all existing non-conforming measures in the liberalized sectors (iii) A list of future non-conforming measures in liberalized sectors excluded from the scope of MFN (iv) Exclusion of all obligations from the pre-establishment phase from investor-state arbitration to limit the risks associated with the MFN clause. We should recall once again that no state is required to grant pre-establishment rights in their territory to foreign investors in an investment treaty. States can always liberalize sectors of their economies through domestic law.

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