

# The Development of Most-favored-nation Treatment——From Substance to Procedure

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**Abstract:** MFN treatment in international investment law is implemented by the host country to foreign investors, the treatment is not less than treatment already given or will give the third countries investors. More and more investors sought to take advantage of the general provisions of MFN clause in bilateral investment treaties in an attempt to enjoy more favorable treatment for dispute settlement in third treaties. This paper expounds on the basis of cases to analyze whether MFN clause could be applied to the dispute settlement procedure or MFN treatment could extend to procedural rights.

**Keywords:** MFN treatment; Procedural rights; Limitation of MFN clause

## 1. The definition of most-favored-nation treatment

The International Law Commission (ILC) has defined MFN treatment as follow: “Most-favored-nation treatment is a treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favorable than treatment extended by the granting State or to a third State or to persons or things in the same relationship with that third State.” The granting State refers to a country that grants MFN, and the beneficiary State means a country that has been accorded MFN status. At present, international treaties generally use the reciprocal, unconditional, and restricted MFN treatment. MFN clause can be found in the majority of international investment treaties. Although MFN treatment is a kind of treatment standard, but many countries -- especially developing countries connected it with the national equality principle. However, the mainstream view is that such obligation will be generated only when the treaty containing MFN clause. The obligation of MFN treatment comes from bilateral or multilateral treaties concluded or acceded to by one country.

MFN treatment in international investment law is implemented by the host country to foreign investors, the treatment is not less than treatment already given or will give the third countries investors. In international investment legal relationship, MFN treatment has a “multilateral” effect, once a State grants investors of another country better treatment, so that all other investors of third State under the terms of MFN treatment will be entitled such treatment. The intention of MFN treatment is to create fair competition between foreign investors in host country.

In bilateral investment treaties (BITs), MFN treatment usually have several forms: 1. Only provides MFN treatment principle; 2. Provision of both national treatment and MFN treatment, which can provide higher protection shall prevail; 3. Provides MFN treatment principle and clearly excludes its application to specific situation, generally the customs union, free trade zone, economic alliance or the international agreement with tax or arrangement. In addition, the scope of MFN treatment is limited, generally defined as “investment-related activities”.

## 2. The huge controversy caused by the development of MFN treatment

### 2.1 Emilio Agustín Maffezini v. Kingdom of Spain

The Claimant, Mr. Maffezini, a national of Argentina, initiated an ICSID arbitration against Spain under the provisions of the Argentina-Spain BIT. The dispute involved a chemical products joint venture (EAMSA), established in 1989 by Mr. Maffezini (70% shares) and a Spanish publicly owned entity SODIGA (30% shares). According to the 1991 Spain-Argentina BIT article 10, Mr. Maffezini must first seek judicial relief from Spanish court. Only after the local court decision or after 18 months still did not make a decision, Mr. Maffezini could turn to the ICSID for arbitration. And 1991 Spain-Chile BIT article 10 regulates no dispute settlement after six months negotiations, the contracting investor could turn the dispute to the ICSID. Spain-Argentina BIT article 4 MFN clause, “In all matters subject to this Agreement, this treatment shall be not less favorable than that extended by each Party to the investments made in its territory by investors of a third country.” Based on this term, Mr. Maffezini claimed that he should enjoy the provisions of the Spanish-Chile BIT more favorable procedural treatment, and directly filed an arbitration to the ICSID. Mr. Maffezini’s claim got the support of the arbitration Tribunal. The Tribunal found that, although Spain-Argentina BIT article 4 had not made it clear that MFN clause was suitable for dispute settlement, but “all matters subject to this Agreement” such broad wording shall include dispute settlement matters.

Although the Tribunal supported MFN clause in the dispute settlement matters, at the same time, the Tribunal also proposed an

important limitation on application of MFN treatment to investment dispute procedure, stress was laid on “public policy considerations”.

Four such specific situations were discussed in the award:

“Firstly, if one Contracting Party had conditioned its consent to arbitration on the exhaustion of local remedies, this requirement could not be bypassed by invoking the MFN Clause in relation to a third-party agreement that does not contain this element, since the stipulated condition reflects a fundamental rule of international law.

Secondly, if the parties had agreed to a dispute settlement arrangement which includes the so-called ‘fork in the road’, that is the choice between submission to domestic courts or to international arbitration, and where the choice once made becomes final and irreversible, such a stipulation could not be bypassed invoking the MFN Clause, as such a course of action would upset the ‘finality of arrangements’ that countries consider important as matters of public policy.

Thirdly, if the agreement provided for a particular arbitration forum, such as the ICSID forum, such option could not be changed by invoking the MFN Clause and refer the dispute to a different system of arbitration.

Fourthly, the Tribunal noted that if the parties had agreed to a highly institutionalized system of arbitration that incorporates precise rules of procedure (e.g. NAFTA), it will be clear that these mechanisms could not be altered by the operation of the clause, because these very specific provisions reflect the precise will of the contracting parties.”

## **2.2 Siemens A.G. v. Argentine Republic**

The Claimant, Siemens A.G. (“Siemens”), a German corporation, established SITS (a domestic Argentine company fully owned by Siemens) for the purposes of bidding for the provision of these services. SITS’ bid proved successful and in October 1998. Furthermore, as a result of the new Argentinean Government’s actions, the contract was terminated. In 2002, Siemens initiated ICSID arbitral proceedings under the Argentina-Germany BIT MFN clause.

Germany-Argentina BIT in article 3, MFN terms: “the contracting party grants to the other party national, company treatment of investment in its territory shall not be less than treatment given to nationals, companies or any third State.” Obviously, Germany-Argentina BIT article 3 the scope of MFN wording narrower than the limits prescribed by Argentina-Spain BIT, Argentina-Spain BIT wording is “all matters under this treaty”, but in Germany-Argentina BIT uses “treatment” one word. However, the Tribunal considered that, despite the extension of the term “treatment” is less than “all matters under this treaty”, but it was enough to include dispute settlement matters.

## **2.3 Plama Consortium Ltd. v. Republic of Bulgaria**

The investor Plama Consortium Limited (PCL, the Claimant), a Cypriot company, acquired shares of Plama AD, a privatized Bulgarian oil refinery. The Claimant said that, a few years after the establishment of investment, Bulgarian government and other public institutions deliberately set obstacles to its operation, and refused to correct it even unreasonably delayed the improper measures, so that caused substantial damage to the oil refinery. The Claimant filed a request for arbitration with ICSID against the respondent, Bulgaria. The request invoked the MFN Clause of the basic treaty, the Cyprus-Bulgaria BIT of 1987. The Claimant required of more favorable dispute settlement provisions of other Bulgaria’s BITs. It was asserted that the MFN Clause “must be construed as extending to more favorable dispute settlement mechanisms than those in the Bulgaria-Cyprus BIT, which are contained in other investment treaties concluded by Bulgaria.”

The Tribunal examined the treaty and concluded that MFN clause in the treaty did not cover dispute settlement provisions. The Tribunal stressed that the intention to incorporate dispute settlement provisions must be “clearly and unambiguously expressed”, and that the main pre-requisite for arbitration is an agreement between the parties to arbitrate. “An MFN provision in a basic treaty does not incorporate by reference dispute settlement provisions in whole or in part set forth in another treaty, unless the MFN provision in the basic treaty leaves no doubt that the Contracting Parties intended to incorporate them.” Thus rejected the request of the Claimant.

## **3. MFN treatment could extend to procedural rights**

The cases like Maffezini have influenced the decision of the Tribunals. More and more investors, especially in the latest ICSID arbitration practice, sought to take advantage of the general provisions of MFN clause in bilateral investment treaties in an attempt to enjoy more favorable treatment for dispute settlement in third treaties. As for the attitude of ICSID, most cases are positively supported. Accordingly, the determination that MFN clause may be applied to the dispute settlement procedure and MFN treatment could extend to procedural rights seems reasonable and is beginning more rooted.

Concerning the issues of application of MFN clause in procedural matters, the provisions of MFN in investment treaties can be divided into four situations:

(1) Provision of MFN treatment clearly includes dispute settlement procedures, such as UK BIT model law article 3(3), in order to avoid the doubts, the treatment prescribed in paragraph 1 and 2 is suitable for the agreement to article 1 of article 11, including the terms of the dispute settlement (article 8 and article 9).

(2) Broad wording in the MFN clause, such as “all matters”, “all rights”, “treatment”, while not specify the terms whether includes dispute settlement procedures, such as Argentina-Spain BIT, article 4(2).

(3) The list to limit its application in the MFN clause, but not to point out whether including dispute settlement matters, such as NAFTA article 1103, “①Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments. ②Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”

(4) Provision of MFN clause clearly excludes dispute settlement procedures, such as the 2003 American free trade agreement

template article 5, provisions of MFN treatment, at the same time, the reference to the template illustrates a common understanding and the intention of the contracting parties is that “such provisions shall not include the international dispute settlement mechanism”.

As said above, the first and fourth one make it clear whether MFN clause includes the dispute settlement procedures. The controversy is mainly caused by broad wording of MFN clause in situation 2 and 3. Maffezini case and Plama case belong to situation 2. Siemens case belongs to situation 3.

MFN treatment is a necessary condition for foreign investors to compete, and the purpose is to provide investors with level playing field. Because the obligation of investment agreements is to protect the interests of investors, thus that whether MFN clause could be applied to procedural matters, decides whether agreements could give investors more favorable procedural rights.

Starting from the function of MFN treatment, if the rights to submit to arbitration regards as procedural rights, MFN would provide investors substantive protection as well as procedural protection. Substantive rights and procedural rights are inseparable, the latter is critical to grant the rights of investment. If investors from one country have more favorable procedural protection than other investors, it would give the investors more competitive such as has the right to submit the arbitration or submitted to arbitration more convenient, then its investors will gain a competitive advantage.

In summarize, the evidences that MFN clause could extend to procedural rights in the following aspects:

(1)MFN would provide investors substantive protection as well as procedural protection. Substantive rights and procedural rights are inseparable.

(2)It will give investors fair competition when MFN treatment extends to procedural rights.

(3)BITs are aimed to promote international investment. Dispute settlement mechanism is the key to promote international investment and protect foreign capital, and allowing to extend MFN treatment to dispute settlement procedure offers more apply opportunities resolve more international investment disputes, so that realize the purpose of BITS.

#### **4. The limitation of MFN clause in dispute settlement procedures**

MFN treatment may be applied to dispute settlement procedures, and the determination that MFN treatment extends to procedural rights is reasonable. But complicated situation of each case, it is necessary to interpret MFN clause to eventually determine MFN treatment could be applied to dispute settlement procedure. So there should be some limitation when bringing MFN treatment into procedural rights as proposed by the Tribunal in Maffezini case.

##### **4.1 MFN clause could not create non-existent arbitration agreement.**

The interpretation of the application of MFN should not violate the basic principles of treaty interpretation, namely cannot deviate from the original intent of contracting parties, or it will affect the stability and predictability of international legal system.

Vienna Convention on the law of treaties, article 31, “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.” This rule emphasizes priority of the context of the treaty when interpreting, while considering the external evidence of both parties’ intentions and the purpose of the treaty. When interpreting MFN clause, the arbitration tribunal should take two elements: one is the meaning of the context of the treaty; two is the purpose of the treaty. If there are clear guidelines that MFN treatment could be applied to procedural matters, the intention of parties is undoubtful. If the treaty does not specify that MFN could be applied to procedural matters, it should be interpreted combining with intention of the parties.

##### **4.2 Shall not evade substantial pre-conditions.**

The request that MFN is applied to the procedural matters is based on the content of host countries in BITs. Dispute settlement provisions in the majority of investment treaties require investors must negotiate with host countries. Some provide after limited time, still cannot reach agreement, the dispute could be submitted to international arbitration and some may require exhaustion of local remedies.

The case Plama points out, “No matter in the domestic and international law, the content of countries must be clear not fuzzy.”

The claimant cannot expand the scope of MFN treatment. In case Mr. Tza Yap Shum, the arbitration tribunal has the jurisdiction over the amount of compensation disputes.

##### **4.3 Shall not damage public policy.**

Some special terms in BITs may be out of important public policy consideration. MFN treatment gives investors options. But if this option derogates the consideration of public policy, it may make the BITs failed. In addition, the arbitration tribunals think the economy or foreign policy on sensitive matters can be exception of application of MFN.

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