UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

MOST-FAVOURED-NATION TREATMENT

UNCTAD Series on Issues in International Investment Agreements II

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NOTE

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The following symbols have been used in the tables:

Two dots (..) indicate that data are not available or are not separately reported.

Rows in tables have been omitted in those cases where no data are available for any of the elements in the row.

A dash (-) indicates that the item is equal to zero or its value is negligible.

A blank in a table indicates that the item is not applicable.

A slash (/) between dates representing years, e.g. 1994/1995, indicates a financial year.

Use of a hyphen (-) between dates representing years, e.g. 1994-1995, signifies the full period involved, including the beginning and end years.

Reference to "dollars" ($) means United States dollars, unless otherwise indicated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

Details and percentages in tables do not necessarily add to totals because of rounding.

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PREFACE

This volume is part of a series of revised editions – *sequels* – to UNCTAD's "Series on Issues in International Investment Agreements". The first generation of this series (also called the "Pink Series") was published between 1999 and 2005 as part of UNCTAD's work programme on international investment agreements (IIAs). It aimed at assisting developing countries to participate as effectively as possible in international investment rulemaking at the bilateral, regional, plurilateral and multilateral levels. The series sought to provide balanced analyses of issues that may arise in discussions about IIAs, and has since then become a standard reference tool for IIA negotiators, policymakers, the private sector, academia and other stakeholders.

Since the publication of the first generation of the Pink Series, the world of IIAs has changed tremendously. In terms of numbers, the IIAs' universe has grown, and continues to do so – albeit to a lesser degree. Also, the impact of IIAs has evolved. Many investor-State dispute settlement (ISDS) cases have brought to light unanticipated – and partially undesired – side effects of IIAs. With its expansive – and sometimes contradictory – interpretations, the arbitral interpretation process has created a new learning environment for countries and, in particular, for IIA negotiators. Issues of transparency, predictability and policy space have come to the forefront of the debate. So has the objective of ensuring coherence between IIAs and other areas of public policy, including policies to address global challenges such as the protection of the environment (climate change) or public health and safety. Finally, the underlying dynamics of IIA rulemaking have changed. A rise in South–South FDI flows and emerging economies' growing role as outward investors – also

vis-à-vis the developed world – are beginning to alter the context and background against which IIAs are being negotiated.

It is the purpose of the *sequels* to consider how the issues described in the first-generation Pink Series have evolved, particularly focusing on treaty practice and the process of arbitral interpretation. Each of the *sequels* will have similar key elements, including (a) an introduction explaining the issue in today's broader context; (b) a stocktaking of IIA practice and arbitral awards; and (c) a section on policy options for IIA negotiators, offering language for possible new clauses that better take into account the development needs of host countries and enhance the stability and predictability of the legal system.

The updates are conceptualized as *sequels*, i.e. they aim to complement rather than replace the first-generation Pink Series. Compared to the first generation, the *sequels* will offer a greater level of detail and move beyond a merely informative role. In line with UNCTAD's mandate, they will aim at analysing the development impact and strengthening the development dimension of IIAs. The *sequels* are finalized through a rigorous process of peer reviews, which benefits from collective learning and sharing of experiences. Attention is placed on ensuring involvement of a broad set of stakeholders, aiming to capture ideas and concerns from society at large.

The *sequels* are edited by Anna Joubin-Bret, and produced by a team under the direction of Jörg Weber and the overall guidance of James Zhan. The members of the team include Bekele Amare, Suzanne Garner, Hamed El-Kady, Jan Knörich, Sergey Ripinsky, Diana Rosert, Claudia Salgado, Ileana Tejada, Diana Ruiz Truque and Elisabeth Tuerk.

This paper is based on a study prepared by Alejandro Faya-Rodríguez and Anna Joubin-Bret. The paper was reviewed and benefited from comments made at the Ad hoc Expert Group Meeting on Key Issues in the Evolving System of International Investment Rules, convened by UNCTAD in December 2009, which was attended by numerous experts and practitioners in this field. The paper also benefited from an online debate on UNCTAD's network of IIA experts on the issue of most-favoured nation treatment.

Supachai Panitchpakdi
November 2010 Secretary-General of UNCTAD

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ABBREVIATIONS

BIT	bilateral investment treaty
DIAE	Division on Investment and Enterprise (UNCTAD)
DTT	double taxation treaty
EFTA	European Free Trade Association
EPA	economic partnership agreement
FDI	foreign direct investment
FET	fair and equitable treatment
FTA	free trade agreement
FTC	Free Trade Commission
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IIA	international investment agreement
ILC	International Law Commission
ISDS	investor–State dispute settlement
MFN	most-favoured-nation treatment
NT	national treatment
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Cooperation and Development
REIO	regional economic integration organization
RTA	regional trade agreement
TNC	transnational corporation
UNCITRAL	United Nations Commission on International Trade Law
WTO	World Trade Organization

EXECUTIVE SUMMARY

The inclusion of most-favoured-nation (MFN) treatment provisions in international investment agreements (IIAs) followed its use in the context of international trade and was meant to address commitments made by States in free trade agreements (FTA) to grant preferential treatment to goods and services regarding market access. However, in the context of international investment that takes place behind borders, MFN clauses work differently. In early BITs, as national treatment (NT) was not granted systematically, the inclusion of MFN treatment clauses was generalized in order to ensure that the host States, while not granting NT, would accord a covered foreign investor a treatment that is no less favourable than that it accords to a third foreign investor and would benefit from NT as soon as the country would grant it. Nowadays the overwhelming majority of IIAs have a MFN provision that goes alongside NT, mostly in a single provision.

The MFN treatment provision has the following main legal features:

- It is a **treaty-based obligation** that must be contained in a specific treaty.

- It requires a comparison between the treatment afforded to two foreign investors in like circumstances. It is therefore, a **relative standard** and must be applied to **similar objective situations.**

- An MFN clause is governed by the ***ejusdem generis* principle**, in that it may only apply to issues belonging to the same subject matter or the same category of subjects to which the clause relates.

- The MFN treatment operates without prejudice to the freedom of contract and thus, States have no obligation under the MFN treatment clause to grant special privileges or incentives granted

through a contract to an individual investor to other foreign investors.

- In order to establish a violation of MFN treatment, a **less favourable treatment** must be found, based on or originating from **the nationality** of the foreign investor.

In practice, violation or breaches of the MFN treatment *per s*e have not been controversial. However, an unexpected application of MFN treatment in investment treaties gave raise to a debate that has so far not found an end and that has generated different and sometimes inconsistent decisions by arbitral tribunals. The issue at stake is the application of the MFN treatment provision to import investor-State dispute settlement (ISDS) provisions from third treaties considered more favourable to solve issues relating to admissibility and jurisdiction over a claim, such as the elimination of a preliminary requirement to arbitration or the extension of the scope of jurisdiction.

In this context, and in order to provide negotiators and policy makers with informed options, this paper takes stock of the evolution of MFN treatment clauses in IIAs. It also reviews arbitral awards against the background of the cases that have followed the *Maffezini v. Spain* case of 2000 that was the first to apply the MFN treatment provision in this unexpected way.

Section I of the paper contains an explanation of MFN treatment and some of the key issues that arise in its negotiation, particularly the scope and application of MFN treatment to the liberalization and protection of foreign investors in recent treaty practice. MFN treatment provisions are used in different phases or stages of investment and can apply to either pre-and/or post establishment phases of investment, MFN treatment can apply to investors and/or to their investments and treaties usually contain exceptions, either systemic (regional economic integration organization (REIO) or

taxation) or country-specific exceptions to pre-establishment commitments.

Subsequently, the paper analyses whether and under what conditions the application of the MFN treatment clauses contained in IIAs can be used by arbitral tribunals to modify the substantive protection and conditions of the rights granted to investors under IIAs to enter and operate in a host State. With some notable exceptions, arbitral tribunals have generally been cautious in importing substantive provisions from other treaties, particularly when absent from the basic treaty or when altering the specifically negotiated scope of application of the treaty.

When it comes to importing procedural provisions, mainly ISDS provisions from other treaties, arbitral tribunals have gone into divergent directions. A series of cases have accepted to follow the argument raised by the claimant that an MFN clause can be used to override a procedural requirement that constitutes a condition to bring a claim to arbitration. On a slightly different issue, namely jurisdictional requirements, a number of cases have however decided that jurisdiction can not be formed simply by incorporating provisions from another treaty by means of an MFN provision.

The paper finally provides policy options as regards the traditional application of MFN treatment to pre and/or post-establishment, to investors and/or investments. It identifies the systemic exceptions relating to REIO and taxation agreements or issues that have been used in IIAs to avoid extending commitments made under other arrangements. In recent treaty practice, States may choose to continue to extend MFN treatment to all phases of an investment or limit its application to post-establishment activities of investors.

The paper also identifies reactions by States to the unexpected broad use of MFN treatment, and provides several drafting options, such as specifying the scope of application of MFN treatment to certain types of activities, clarifying the nature of "treatment" under the IIA, clarifying the comparison that an arbitral tribunal needs to undertake as well as a qualification of the comparison "in like circumstances". Options are also given to States wishing to expressly allow or prohibit the use of MFN treatment to import substantive or procedural provisions from other treaties. The last option is to avoid the granting of MFN treatment given the open ended and uncertain application that can be made in the case of disputes.

While identifying options for a new generation of IIAs, the paper also addresses how to deal with MFN treatment provisions of existing treaties that are based on several different models. Possible options consist of clarifying either bilaterally or even unilaterally through interpretative statements, the scope and application of MFN treatment in IIAs.

INTRODUCTION

In 1999, when the first edition of the UNCTAD Series on issues in international investment agreements (IIAs) paper on most-favoured-nation (MFN) treatment was issued, the vast majority of IIAs concluded by States by that time included a provision whereby the parties to the agreements were granting MFN treatment to the investors (and/or investments) of the other contracting party. However, major developments have taken place since then, both at the level of treaty practice and in the development of arbitral interpretations (UNCTAD 1999a).

Although a common feature of public international law and treaty practice, the inclusion of MFN treatment in international economic law emerged in the context of international trade and was meant to address commitments made by States in free trade agreements (FTA) to grant preferential treatment to goods and services regarding market access. MFN treatment became the central pillar of the international trading system, in order to ensure that member countries would not discriminate between their trading partners. MFN treatment has been defined as the "cornerstone" of the World Trade Organization (WTO)[1] and the "defining principle" of the General Agreement on Tariffs and Trade (GATT) (WTO 2004).

Under IIAs, national treatment (NT) is the essential treatment standard that States grant to ensure equal competitive opportunities behind the border of the host State to foreign investors. MFN treatment is used in IIAs as a secondary treatment standard. It has generally preceded in time the granting of NT by host States and comes as an additional guarantee of equality and non discrimination. Early bilateral investment treaties (BITs) would generally not contain NT commitments and countries would grant MFN treatment to ensure that once NT would be granted under another treaty, it would apply also to the investors covered under earlier treaties.

Classical BITs focus on the protection of investors and their investments made in accordance with the laws and regulations of the host country and grant NT and MFN to investors and investments once established. Certain types of BITs, however, and more generally free trade agreements or economic partnership agreements (EPAs) provide also for the liberalization of investment flows. They do so by granting NT and MFN to foreign investors in the pre-establishment phase, i.e. a right to make an investment in conditions no less favourable than those that apply to nationals of the host country (NT) or nationals of any third country (MFN). Under this approach NT and MFN (although more notably the former) are the treatment standards used in IIAs to make commitments to reduce barriers and remove restrictions to the entry of foreign investments and therefore, their application is essential to fostering liberalization.

When discussing MFN treatment in IIAs, negotiators would focus on economic or policy considerations: for instance, the scope of application (to i.e. investors/investments and to pre/post-establishment) as well as the use of exceptions (generic or country specific), including clauses that would preserve preferential regional deals and avoid "free riders" who could seek to benefit from them. MFN was generally considered non-controversial and negotiators as well as investment officials were more concerned by the potential interpretation and application of other rules and standards.

The application of the MFN treatment to investor-State dispute settlement (ISDS) provisions by arbitral tribunals to solve issues relating to jurisdiction over a claim was not contemplated in the negotiation or implementation of IIAs and particularly BITs that formed the majority of IIAs until a claim was brought by an Argentinean investor against the Kingdom of Spain in 2000 (the *Maffezini v. Spain* case,[2] see Section II.C.2). In 1990, in the first BIT claim, *AAPL v. Sri Lanka*[3] (see Section II.B.), the claimant attempted to borrow a substantive liability standard from a third

treaty, but since this attempt failed, the application of MFN did not draw much attention.

The decision on jurisdiction in *Maffezini v. Spain* highlighted a possible application of MFN treatment to ISDS provisions and gave raise to a strong debate that has so far not found a conclusion. The *Maffezini* case was the first of a series of arbitral decisions regarding the application of the MFN treatment clause to import ISDS provisions from third treaties considered more favourable by claimants. Some of these claims have dealt with an expansion of the scope of application of ISDS provisions while others, like *Maffezini v. Spain* itself, focused on the elimination of a preliminary requirement to arbitration. Such awards have further strengthened the debate, particularly given the fact that tribunals have been rather inconsistent in their reasoning and conclusions. Consequently, States began reacting or expressing concern about the growing uncertainty.

Following the *Maffezini v. Spain* case, claimants have also been seeking to use the MFN treatment clause included in the basic treaty (the treaty concluded between their home State and the host State against which they are bringing the arbitration) to claim a more favourable substantive protection. For example, they have sought to import a fair and equitable treatment (FET) provision that would not be available in the same conditions under the basic treaty, or substitute a qualified protection provision of the basic treaty for an unqualified provision of the same sort contained in a third treaty.

The universe of BITs, to date composed of over 2,700 treaties, is atomized and lacks consistency mainly as a result from the negotiation process of treaties.[4] So far, arbitral tribunals have taken different and sometimes inconsistent approaches. Therefore the possibility for one IIA to contain looser or more stringent commitments of protection than others is a concrete reality for many

countries that have been signing IIAs with different treaty partners. It is important to have a clear understanding of the way MFN treatment clauses have been applied by arbitral tribunals to import allegedly better treatment and then to assess whether this is a desired outcome of IIAs. It is also important to take stock of the way treaty practice has evolved and to what extent States have reacted to the debate on MFN treatment. This would allow States to:

- Make better-informed decisions for drafting and negotiating purposes (more precise scope, wording, exceptions, etc. in MFN clauses);
- Administer their international commitments (through negotiation, re-negotiation, issuance of joint interpretations or other ways such as unilateral statements); and
- Be aware on the arguments that may fail or succeed in the context of arbitration.

It should be noted at the outset that access by foreign investors to international arbitration as provided by the ISDS clauses of a vast majority of IIAs is a specific feature that has no equivalent in other areas of international economic law. This benefit granted to foreign investors is of extraordinary legal nature insofar as it derogates from customary international law, which requires that any acts or measures taken by the State must be challenged before the national jurisdictions of the State. Only after the investor has exhausted local remedies can the State from which it derives its nationality file an action against the host State, but never the investor himself. Derogating from this basic principle of international law comes with strong implications considering the exposure of States to international responsibility and it is therefore not surprising that broadening the base for international arbitration (formed by explicit consent) by applying MFN treatment clauses has generated debate and concern on the part of the States.

It is also noteworthy here to remind that ISDS provisions in IIAs seek essentially to compensate investors for damages and losses arising from acts or measures taken by the State. In most MFN treatment claims, tribunals have been directly applying the allegedly better treatment as opposed to finding a violation and compensating for the damage created by this violation. It may not be within the role of investment tribunals to enforce commitments or secure their compliance. For instance, they could not force a State to admit an investment in the host State through an MFN treatment clause but only compensate for damages if selective and discriminatory liberalization were established.

In the context of international investment, the current debate is not centered on alleged violation or breaches of the MFN treatment *per s*e. Instead it focuses on the possibility for claimants to pick from third treaties allegedly more favourable provisions relating to protection standards or ISDS and thereby derogate from or modify provisions of the basic treaty. Such application of MFN treatment has been designated in certain arbitral awards and by some commentators as "treaty shopping". The term is generally understood in the context of investments being structured or set up in a given country to seek the benefits of double-taxation treaties or BITs (more seldom), when in reality the investors have little or no commercial activities there. In the context of MFN treatment, however, "treaty shopping" has been used to refer to the import practice of provisions from third treaties concluded with the home country of the TNC and does not presuppose in and by itself a negative connotation.[5]

International and national frameworks for investment have generally evolved towards more certainty and predictability in the conditions relating to the entry and operation of foreign investors in host countries. The surge of investor-State disputes since the early 2000 and the interpretation of IIAs by arbitral tribunals (although

not a formal source of international law) have shed some light on the actual content and practical application of IIAs. In the case of MFN treatment however, the awards have not provided clear guidance for negotiators or beneficiaries of the treaties, rather they have generated contradictory decisions (not necessarily justified by differences in wordings) and different conceptual understandings on how MFN treatment operates. States negotiating and concluding IIAs, policymakers shaping investment policies and investors investing and operating in foreign countries are seeking predictability with respect to the scope of their commitments and benefits. Negotiators need to know in advance which obligations they are in fact undertaking when including an MFN treatment clause in their IIAs. In the context of arbitration, both States and investors would have reason for concern when seeing that the same argument may succeed one day and fail the next. The current discussion regarding the scope and content of MFN treatment is therefore of particular importance.

In this context, and in order to provide negotiators and policy makers with informed options, this paper seeks to take stock of the evolution of MFN treatment clauses in IIAs. It will also look into arbitral awards against the background of the cases that have followed the *Maffezini v. Spain* case of 2000. Section I contains an explanation of MFN treatment and some of the key issues that arise in its negotiation. It will look into the purpose, as well as their scope and application to the liberalization and protection of foreign investors in recent treaty practice and gives an overview of the legal qualifications of MFN treatment in IIAs.

Specifically, the paper will take stock of recent treaty practice and look into the application of MFN treatment to different phases or stages of investment. It will look into the scope of application of MFN treatment to pre-and/or post establishment phases of investment, the various approaches taken in IIAs as far as the application of MFN treatment to investors and/or to their

investments is concerned, and the exceptions used to limit the scope of application of the MFN treatment provision, whether systemic (regional economic integration organization (REIO) or taxation) or country specific exceptions to pre-establishment commitments.

Subsequently, the paper will analyse whether and under what conditions the application of the MFN treatment clauses contained in IIAs can modify the substantive protection and substantive conditions of the rights granted to investors under IIAs to enter and operate in a host State, taking stock of recent arbitral decisions.

The paper will then seek to identify in recent treaty practice reactions by States and the way the application and interpretation of MFN treatment has been dealt with so far in IIAs.

The final section will consider implications of the application of the MFN treatment clause and its possible effects on the design and implementation of development policy of the host country. By looking into the general objectives of MFN treatment in the context of IIAs and the overall effects and value of making MFN commitments relating to liberalization and protection among States concluding IIAs, the study will offer options for negotiators in order to match and implement their policy objectives and priorities. The paper will also offer some options from the perspective of the system of IIAs and the way States may wish to address, clarify, limit or further develop the impact of MFN clauses on the system itself.

Notes

1 WTO Report of the Appellate Body, Canada – Autos, 31 May 2000, para. 69; WTO Report of the Appellate Body, EC – Tariff Preferences, 7 April 2004, para. 104; WTO Report of the Appellate Body, United States – Section 211 Appropriations Act, 2 January 2002, para. 297.

2 *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on the Objections of Jurisdiction, 25 January 2000.

3 *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Final Award, 27 June 1990.

4 For an analysis of the BIT/IIA universe see UNCTAD 2010, pp. 81-90.

5 See further Teitelbaum 2005, McLachlan 2007, Muchlinski 2007, Rubins 2008.

I. EXPLANATION OF THE ISSUE

A. Historical context

While MFN treatment clauses can be traced back to the twelfth century, they became common features of many friendship, commerce and navigation treaties during the eighteenth and nineteenth centuries. The early clauses were quite broad, applying to a wide range of issues such as "rights, privileges, immunities and exceptions" with respect to trade, commerce and navigation, or to "duties and prohibitions" with respect to vessels, importation or exportation of goods, as illustrated by the examples in box 1.

Box 1. Examples of early MFN clauses

Treaty of Amity and Commerce between the United States and France (1778)

Art. 3.d

The Subjects of the most Christian King shall pay in the Port Havens, Roads, Countries, Lands, Cities or Towns, of the United States or any of them, no other or greater Duties or Imposts of what Nature soever they may be, or by what Name soever called, than those which the Nations most favoured are or shall be obliged to pay; and they shall enjoy all the Rights, Liberties, Privileges, Immunities and Exemptions in Trade, Navigation and Commerce, whether in passing from one Port in the said States to another, or in going to and from the same, from and to any Part of the World, which the said Nations do or shall enjoy.

Art. 4

"The Subjects, People and Inhabitants of the said United States, and each of them, shall not pay in the Ports, Havens Roads Isles, Cities & Places under the Domination of his most Christian Majesty in Europe, any other or greater Duties or Imposts, of what Nature soever, they may be, or by what Name soever called, that those

/…

Box 1. (concluded)

which the most favoured Nations are or shall be obliged to pay; & they shall enjoy all the Rights, Liberties, Privileges, Immunities & Exemptions, in Trade Navigation and Commerce whether in passing from one Port in the said Dominions in Europe to another, or in going to and from the same, from and to any Part of the World, which the said Nation do or shall enjoy."

Source: http://avalon.law.yale.edu/18th_century/fr1788-1.asp.

Amity, Navigation and Commerce Treaty (the Jay's Treaty) between the United States and Great Britain (1794)

Article 15
It is agreed, that no other or higher Duties shall be paid by the Ships or Merchandize of the one Party in the Ports of the other, than such as are paid by the like vessels or Merchandize of all other Nations. Nor shall any other or higher Duty be imposed in one Country on the importation of any articles, the growth, produce, or manufacture of the other, than are or shall be payable on the importation of the like articles being of the growth, produce or manufacture of any other Foreign Country. Nor shall any prohibition be imposed, on the exportation or importation of any articles to or from the Territories of the Two Parties respectively which shall not equally extend to all other Nations […].

Source: http://avalon.law.yale.edu/18th_century/jay.asp.

These early clauses were often conditional, meaning that the benefits granted by one State were dependant on the granting of the same concessions by the beneficiary State. The unconditional approach emerged during the second half of the eighteen century. The Treaty of Commerce signed in 1869 between Great Britain and France (the Chevalier-Cobden Treaty) is a prominent example.

This trend was reversed after World War I and during the 1929 economic depression, when protectionist approaches prevailed. Nonetheless, after World War II, prompted by new efforts of multilateralism, the unconditional approach to MFN treatment was revived in the context of the Havana Charter (which was negotiated in 1949, but never came into force). It was reproduced in the GATT of 1947, when unconditional MFN became the pillar of the multilateral trading system (see box 2).

Box 2. MFN in the GATT

Article I
General Most-Favoured-Nation Treatment

1.With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded* ***immediately and unconditionally*** *to the like product originating in or destined for the territories of all other contracting parties.* [Emphasis added]

Source: WTO.

Today, MFN treatment in WTO agreements extends beyond its original application to trade in goods also to the areas of trade in services and trade-related aspects of intellectual property rights.[1]

Meanwhile, in the 1970s the International Law Commission (ILC) acknowledged the importance of MFN treatment in

international law, by preparing the "Draft Articles on Most-Favoured-Nation" in 1978 (the Draft Articles on MFN). The ILC recommended that the General Assembly of the United Nations adopt a Convention, which was however never done. This instrument attempted to both codify and develop the use of the MFN provisions contained in treaties between States. The draft articles explore, inter alia, matters concerning definitions, scope of application, effects deriving from the conditional or unconditional character of the clause, source of treatment and termination or suspension.[2]

The very first BIT concluded between Germany and Pakistan in 1959 included MFN treatment clauses and it was generalized in the negotiation and conclusion of subsequent BITs. In these early BITs, NT was not granted systematically by the contracting parties, given the protectionist policies being implemented in many countries at that time. MFN treatment was considered less problematic (due to the rare use of selective intervention amongst foreigners "behind the border") and included in treaties in order to guarantee a level playing field amongst foreign investors of different nationalities. The inclusion of MFN treatment clauses in BITs preceded in time the generalized granting of NT in the early 1980s and can be found nowadays in the overwhelming majority of IIAs. A sample of 715 IIAs reviewed by UNCTAD reveals that only 19.6 per cent did not include a reference to MFN. After the Declaration on International Investment and Multinational Enterprises, adopted in 1976 by the Governments of the OECD Member countries, BITs and other FTAs/EPAs concluded by these countries would all include NT and MFN treatment clauses, featuring both under the Treatment provisions of the treaty. Wording and approaches among OECD member countries grew apart significantly however with the proliferation of IIAs.

The network of BITs continues to grow rapidly: the total number rose to 2,750 at the end of 2009. Moreover, in the second

half of the 1990's, especially after the entry into force of the North America Free Trade Agreement (NAFTA) (1992), international investment provisions began to appear as part of FTAs or EPAs (as of end 2009, there were 295) (UNCTAD 2010).

B. Definition, purpose and scope of MFN treatment clauses

1. Definition

MFN treatment is defined by the Draft articles on MFN as the:

> "[…] *treatment accorded by the granting State to the beneficiary State, or to persons or things in a determined relationship with that State, not less favourable that treatment extended by the granting State to a third State or to persons or things in the same relationship with that third State*."[3]

And an MFN clause as:

> "*…a treaty provision whereby a State undertakes an obligation towards another State to accord most-favoured treatment in an agreed sphere of relations*."[4]

In the context of investment, MFN treatment ensures that a host country extends to the covered foreign investor and its investments, as applicable, treatment that is no less favourable than that which it accords to foreign investors of any third country.

2. Purpose of an MFN clause

In the context of international trade, MFN treatment is essential for ensuring a level playing field between all trading partners and is therefore the central pillar of the international trading system. Likewise, MFN treatment in IIAs is meant to ensure an equality of competitive conditions between foreign investors of different

nationalities seeking to set up an investment or operating that investment in a host country. Foreign investors seek sufficient assurance that there will not be adverse discrimination which puts them at a competitive disadvantage. Such discrimination includes situations in which competitors from other foreign countries receive more favourable treatment. The MFN standard thus helps to establish equality of competitive opportunities between investors from different foreign countries. It prevents competition between investors from being distorted by discrimination based on nationality considerations.

The MFN treatment clause is a treaty tool that follows very closely the objective and purpose of the IIA itself. The MFN treatment clause will play the role of ensuring equality of treatment and conditions between foreign investors, whether the IIA seeks to liberalize conditions to entry and operation of foreign investors and/or offers protection to investors and their investments without any commitment to make these conditions easier, more liberal or less restrictive. In practice, the impact of MFN treatment will be quite different if it is used, in combination with NT, to:

- Ensure the right of entry and establishment for the foreign investors and the conditions that apply to the pre-establishment phase of the investment; or
- Ensure that the treatment will not be different for investors and their investments established and operating in accordance with the host State's laws and regulations.[5]

In the Germany-Egypt BIT (2005), the Parties give a detailed list of treatment that can be deemed less favourable within the meaning of the Treatment of Investments article of the BIT. The Parties list, in particular: unequal treatment in the case of restrictions on the purchase of raw or auxiliary materials, of energy or fuel or of means of production or operation of any kind, unequal treatment in the case of impeding the marketing of products inside or outside the country, as well as any other measures having similar effects.

This list of measures – also called operational measures, performance requirements or trade-related investment measures – in the context of the multilateral trading system illustrates the type of treatment that investors can not be subjected to and where the MFN treatment comes into play. The Egypt-Germany BIT (2005) also mentions "*Measures that have to be taken for reasons of public security and order, public health or morality*" and provides that they "*shall not be deemed 'treatment less favourable' within the meaning of this Article*".[6] As illustrated by box 3, States can treat foreign investors through different types of acts or measures and the MFN treatment clause targets these acts or measures.

Box 3. What is "treatment"?

The most common vehicle for States for fulfilling their obligations under an IIA is through positive acts of State organs such as the legislative, executive or judiciary, whether taken at the central, regional or subregional level.[a/] States interfere or affect investors by means of "measures" or the absence thereof, which include the enactment and implementation of any laws and regulations, practice and any form of regulatory conduct.

Under IIAs, States are bound by two sets of obligations: obligations to provide protection and obligations to provide a certain level of treatment.

- Obligations to grant protection to the foreign investor generally combine an obligation to grant FET (or a minimum standard of treatment) and full protection and security, to guarantee the free transfer of funds relating to the investment, to refrain from expropriating or nationalizing rights or property belonging to the investor except if the measure is taken for public purpose,

/…

Box 3 (continued)

non-discriminatory and against the payment of compensation.

These obligations reflect principles of international law and the State's international responsibility may be invoked for a wrongful act when "conduct" consisting of an action or omission is attributable to the State under international law and constitutes a breach of an international obligation.

- A conventional obligation deriving from the treaty itself to ensure a level of treatment to the foreign investor that is no less favourable than that applied to the nationals of the State (NT) or to nationals of any third State (MFN). The treatment refers to all measures applying specifically to foreign investors (investment-specific measures) or to measures of general application that regulate the economic and business activity of the investor and his investment throughout the duration of the investment.

Examples of investment-specific measures include:[b/]

- Limits or conditions to participate in specific economic activities or sector;
- Limits on equity participation in local companies;
- Prior approval requirements for the acquisition of equity or assets;
- Prior approvals for the operation of a business/investment;
- Limits or conditions for the acquisition of land or real estate;
- Performance requirements such as local content, trade-balancing or foreign-exchange controls;
- Specific commitments pertaining to employment, research, transfer of technology or investment amounts;
- Requirements to establish a joint-venture with a local partner or minimum threshold requirements of domestic equity participation;

/…

Box 3 (concluded)

- Disclosure of information for statistical purposes; and
- Regulation on grounds such as national security, public order and culture.

Examples of measures of general application include:

- Starting/closing a business;
- Corporate and commercial regulation;
- Taxation;
- Labour, social security and employing workers;
- Acquisition/registration of property;
- Finance, securities and access to credit;
- Government procurement rules;
- Intellectual property rights;
- Competition;
- Immigration;
- Customs and exporting/importing goods or services;
- Environmental and consumer's protection;
- Enforcement of contracts and obligations through local courts;
- Concessions, licenses and permits; and
- Sectoral regulation such as telecommunications, energy, transport and financial services.

Source: UNCTAD.

[a/] See Articles 1, 2 and 4 of the International Law Commission's Draft Articles on Responsibilities of States for International Wrongful Acts.

[b/] During the last decade the trend has been to eliminate or reduce measures of this sort, as countries have been seeking to liberalize their investment regimes and make them more conducive to FDI flows.

However, as mentioned earlier, MFN treatment has rarely been invoked to challenge the actual level of material treatment given to

foreign investors as regards establishment, access or competitive conditions in host States. Rather, it has been used by investors/claimants seeking to import (allegedly) more favourable ISDS or substantive provisions from a third-party treaty into the basic treaty. Whether such a practice is beneficial to the development of the system of international investment law, part of the normal functioning of MFN treatment or within the original intent of the contracting parties is at the heart of the current debate.

The scope of application of an MFN treatment clause needs to be considered both in its subject-matter coverage and in its substantive coverage. Substantive coverage is generally established by the text itself by defining the covered beneficiaries, the covered phases of investment and any applicable exceptions.

More specifically, the scope of application of the clause will depend on whether MFN treatment covers:

- Investors; or/and
- Their investments.

And whether it covers:

- The post-establishment phase; or
- Both the pre/post-establishment phases.

Moreover, this basic construction may include:

- Generic exceptions; or/and
- Country-specific exceptions.

Furthermore, the MFN treatment clause may include specific qualification or clarification in order to provide certainty and guidance so as to facilitate its interpretation and application as intended by the Contracting Parties.

(i) Subject-matter scope: investors/investments

MFN treatment under IIAs generally extends to investors and their investments. However, the MFN treatment clause may restrict the beneficiaries, for instance, by extending MFN treatment only to investors. The approach taken has important consequences given that investors and investments, although directly interlinked, are formally different subjects and may enjoy different rights under the IIA.

(ii) Substantive scope: pre/post-establishment

Pre-establishment MFN treatment covers the entry conditions of investment, conferring rights to the investor both at the moment the investment is effectively materializing and prior to that point, i.e. while it is still in the making. The host State shall accord the covered foreign investor treatment which is no less favourable than that it accords to any third foreign investor of different nationality as regards any such entry conditions (for instance, access to given sectors of the economy or limits of foreign equity participation in specific activities). The obligation applies across the board, which means that no existing or future measures may discriminate the covered investor *vis-à-vis* another foreigner, unless specific reservations are taken by the Contracting Parties. The conditions applicable to entry and establishment will be defined by the IIA and not be subjected to the domestic framework. From the investor's perspective, the conditions to entry become more transparent and predictable, as the entry regime is regulated by the IIA itself and not subject to changes.[7] MFN treatment in the pre-establishment phase seeks to avoid preferential access or a selective liberalization that would benefit some foreign investors and not others. Excluding some investors from the benefit of MFN treatment, could create unnecessary economic distortions to the host State's economy.

By contrast, post-establishment MFN treatment applies only once the investment is established. Therefore, the protection covers the life-cycle of the investment after entry (which is governed by domestic law, regulations, policies and other domestic measures), from start-up to the liquidation or disposition of investments. MFN treatment hence protects a covered foreign investor that has made an investment in the host State, by not putting it at a competitive disadvantage *vis-à-vis* a foreign investor of a third country, in many occasions a likely competitor, as far as treatment is concerned.

(iii) Exceptions

MFN treatment provisions in IIAs typically come with exceptions, some being systemic exceptions, directly linked with the nature of MFN treatment and some being country-specific, for example sectors of the economy where MFN treatment would not apply or measures non-conforming to the commitment by the State to provide MFN treatment to foreign investors. MFN treatment provisions may give rise to the so-called "free-rider" issue that arises when benefits from customs unions, free trade agreements or economic integration organization agreements are extended to non-members (UNCTAD 2004a).

In order to avoid this result, many IIAs exclude the benefits received by a Contracting State Party to a regional economic integration organization from the scope of MFN treatment obligations through a REIO exception. In the case of taxation issues, exceptions target particular benefits arising from double-taxation treaties (UNCTAD 2000a) or more generally from taxation measures. These are the classical exceptions found in post-establishment IIAs.

In addition to systemic exceptions, such as REIO or taxation exceptions, States granting pre-establishment rights through NT and MFN treatment also negotiate country-specific exceptions, in the form of lists of reserved sectors or measures non-conforming to NT

or MFN attached to the treaty. These IIAs may also include MFN-specific exceptions regarding areas such as public procurement and subsidies.

(iv) Qualifications/clarifications

An MFN treatment clause may also include specific qualifications or clarification. However, these are not meant to limit the scope of application *per se* but constitute mere guidance and clarification on how the clause is supposed to be applied. Qualifications of this sort are sometimes part of the MFN treatment clause itself. For instance, recent IIAs are putting emphasis on the conditions of application of the MFN treatment clause, for example by defining the method for comparing the treatment afforded to foreign investors of different nationalities ("like circumstances") or by indicating the specific activities within the covered phase to which the treatment applies (e.g. "operation", "management", "maintenance", etc.). In other occasions the qualification may be placed separately "for greater certainty" purposes. For instance, recent treaties clarify that the MFN treatment does not apply to ISDS provisions. An exceptional case are early United Kingdom treaties that define the articles of the treaty to which MFN treatment specifically applies.

C. Legal nature of an MFN treatment clause

In order to facilitate the stocktaking exercise that follows, to better understand the different exceptions to MFN treatment as they apply as well as the current debate on the scope of application (particularly substantive protection provisions or provisions relating to ISDS contained in third treaties), it is important to briefly review the legal qualifications of MFN treatment (UNCTAD 1999a).

1. It is a treaty-based obligation that must be contained in a specific treaty

The legal basis for an MFN treatment clause is always a specific treaty (the "basic treaty") that contains the MFN treatment clause. The clause may take the form of a specific provision or a combination of various provisions of the treaty. Even though thousands of IIAs currently in force contain an MFN treatment clause, it remains a treaty-based obligation. It is a conventional obligation and not a principle of international law which applies to States as a matter of general legal obligation independent of specific treaty commitments. Even though MFN treatment may be rightly seen as a general and constant treaty practice when it comes to IIAs, it is clear that countries grant this benefit and acquire this obligation in the context of a specific (reciprocal) clause contained in a binding treaty.

As Article 7 of the Draft Articles on MFN establishes:

> "*Nothing in the present articles shall imply that a State is entitled to be accorded most-favoured-nation treatment by another State otherwise than on the basis of an international obligation undertaken by the latter State*."

The commentaries to the MFN Draft Articles[8] in this respect are clear:

> "*In practice, such an obligation cannot normally be proved otherwise than by means of a most-favoured- nation clause, i.e. a conventional undertaking by the granting State to that effect*….
>
> *… Although the grant of most-favoured-nation treatment is frequent in commercial treaties, there is no evidence that it has developed into a rule of customary international law. Hence it is*

widely held that only treaties are the foundation of most-favoured-nation treatment."

A distinction must be made, however, between the non-discriminatory content of MFN treatment and the general requirement of non-discrimination contained in international law. The fact that States have the sovereign right to discriminate and regulate the entry and operation of aliens within their territory does not mean that such discretion is unlimited and not subject to international law. MFN treatment, as explained throughout the paper, requires the host State to accord a covered foreign investor treatment that is no less favourable than that it accords to a third foreign investor. It requires a comparison between two foreign investors in like circumstances, being therefore a comparative test not contingent to any arbitrariness or seriousness threshold. Non-discrimination under international law, by contrast, constitutes an absolute standard (it is due no matter how other investors are treated) and refers to gross misconduct, or arbitrary conduct that impairs the operation of the investment. It may involve, for instance, discrimination based on arbitrariness, sexual or racial prejudice, denial of justice or unlawful expropriation.

2. It is a relative standard

The MFN treatment provision is a relative standard, which means that it implies a comparative test. Conversely, absolute standards require treatment no matter how other investors are treated by the host State.

MFN treatment operates in the same conditions as NT and it requires a comparison as well as the finding of more favourable treatment granted to investors of a given nationality as opposed to the investors covered by the basic treaty. For that reason, the standard lacks a content defined *a priori* and it would not prevent or

target arbitrary acts where all foreign investors receive similarly bad treatment (without prejudice that other violations may be found).[9] Any assessment of an alleged breach calls not only for the finding of an objective difference in treatment between two foreign investors, but also for a competitive disadvantage directly stemming from this difference in the treatment. This finding must be assessed through a comparison. Thus a comparison and an objective test of less favourable treatment are required in order to assess the violation of an MFN treatment clause.[10]

3. It is governed by the *Ejusdem Generis* principle

The MFN clause is governed by the *Ejusdem Generis* principle, in that it may only apply to issues belonging to the same subject matter or the same category of subjects to which the clause relates. This principle, consistently affirmed by practice and jurisprudence (domestic and international), was highlighted in the *Ambiatelos*[11] decision and later further explained by the Draft Articles on MFN (see box 4). In the area of investment, the principle has been highlighted by the *Maffezini* decision and not challenged by the many other cases that followed suit.

This principle circumscribes the application of the MFN treatment clause to those subject matters regulated by the basic treaty. For instance, the MFN treatment clause of a commercial treaty between States A and B could not apply to or attract a benefit conferred by State A to State C (for the benefit of State B) related to diplomatic immunity or to aviation or to taxation benefits.

In IIAs, the subject/beneficiary is the investor and the subject matter is investment. Depending on the scope of the treaty, the subject matter can be investment promotion, investment protection, investment liberalization and/or a combination thereof. The MFN

Box 4. The draft articles on MFN and the

***Ejusdem Generis* principle**

Article 9. Scope of rights under a most-favoured-nation clause

1. Under a most-favoured-nation clause the beneficiary State acquires, for itself or for the benefit of persons or things in a determined relationship with it, only those rights which fall within the limits of the subject-matter of the clause.
2. The beneficiary State acquires the rights under paragraph 1 only in respect of persons or things which are specified in the clause or implied from its subject-matter.

Article 10. Acquisition of rights under a most-favoured-nation clause

1. Under a most-favoured-nation clause the beneficiary State acquires the right to most-favoured-nation treatment only if the granting State extends to a third State treatment within the limits of the subject-matter of the clause.
2. The beneficiary State acquires rights under paragraph 1 in respect of persons or things in a determined relationship with it only if they:
(a) belong to the same category of persons or things as those in a determined relationship with a third State which benefit from the treatment extended to them by the granting State and
(b) have the same relationship with the beneficiary State as the persons and things referred to in subparagraph (a) have with that third State.

Source: ILC (1978).

treatment clause will apply to the "investment" and/or the "investor" depending on its substantive scope of application and the specific wording. Thus, the MFN clause may only deal with treatment

related to the covered person/beneficiary or the asset enterprise as listed in the investment definition.

4. It requires a legitimate basis of comparison

In order to compare subject matters that are reasonably and objectively comparable, an MFN treatment provision must be applied to similar objective situations. Providing MFN treatment does not require that all foreign investors have to be treated equally irrespective of their concrete business activities or circumstances. Different treatment is justified amongst investors who are not legitimate comparators, e.g. do not operate in the same economic sector or do not have the same corporate structure. The MFN treatment clause requires that the host State does not discriminate – *de jure* or *de facto*[12] – on the basis of nationality. For instance, MFN treatment does not impede host countries from according different treatment to different sectors of the economic activity, or to differentiate between enterprises of different size, or businesses with or without local partners.

During the MAI negotiations[13] some delegations indicated that they understood both MFN treatment and NT to implicitly require a comparative context to be applied. Other delegations considered it necessary to specifically include the formula "in like circumstances". Currently, as we shall see in Section II, some IIAs explicitly include a reference to "like circumstances", "like situations" or similar wordings, while others remain silent. Irrespective of the precise wording, the proper interpretation of a relative standard requires that the treatment afforded by a host State to foreign investors can only be appropriately compared if they are in objectively similar situations. However, it is important to note that by not making a specific reference to "like circumstances" or any other criteria for comparison, the Contracting Parties do not intend to dispense with the comparative context, as it would distort the entire sense and nature of the MFN treatment clause.

There are not many arbitration cases dealing with the actual comparison between the treatment two foreign investors receive from the host State in given circumstances. There is therefore little guidance to be found in arbitral awards on how the comparison should be made. However, assessing a possible violation of MFN treatment may be done by borrowing from findings of violation of NT. Indeed, both treatment provisions share the same comparison requirement (the only difference being that under NT the applicable comparator of the foreign investor/investment is a national investor/investment). In this connection several awards rendered under NAFTA (1992) have consistently established that an assessment of an alleged breach of NT requires an identification of the comparators and a consideration of the treatment each of them receives. Tribunals have used a variety of criteria for comparison depending on the specific facts and the applicable law of each case. They include: same business or economic sector,[14] same economic sector and activity,[15] less like but available comparators[16] and direct competitors.[17] Flexibility has prevailed, with the aim of comparing what is reasonably comparable and considering all the relevant factors.

5. It relates to discrimination on grounds of nationality

Both MFN treatment and NT are designed to prevent discrimination for reasons of or on the grounds of nationality. In order to establish a violation of MFN treatment, the difference in the treatment must be based on or caused by the nationality of the foreign investor. After a reasonable comparison has been made amongst appropriate comparators, there are factors that may justify differential treatment on the part of the State among foreign investors, such as legitimate measures that do not distinguish, (neither *de jure* nor *de facto*) between nationals and foreigners.[18] In *Parkerings v. Lithuania*, the tribunal established that, to constitute a violation of international law, discrimination had to be unreasonable

or lacking proportionality, and that an objective reason may justify differentiated treatment in similar cases.

6. It requires a finding of less favourable treatment

With the exception of foreign-investment-specific laws and regulations, the domestic legal framework of the host State applies to all economic actors and operators in the same manner, whether foreign or national. It therefore applies to the investor and its investment, irrespective of his nationality. States do not differentiate treatment granted to foreign investors of different nationalities once established and operating in the host State's economy. However, in the pre-establishment phase, difference in the treatment afforded to investors of different nationalities is likely, depending on the treaty commitments made with the home State of these investors.

Treatment is primarily materialized through "measures", that is, State laws, regulation and conduct. The universe here is vast: basically, all measures that may affect the course of business – e.g. laws and regulations on business law, corporate and other forms for doing business, taxation, labor, environment, bankruptcy, access to financing, financial regulation, land ownership, use or lease, regulatory or other barriers to entry, competition, horizontal and sectoral regulations (see box 3). The foreign investor covered by an MFN treatment clause is entitled to receive any more favourable treatment that a third foreign investor is receiving in any of these areas of the laws and regulations of the host State, whether of general application or foreign-investment-specific.

Arguably, while laws and regulations within the domestic framework are critical for the course of an investment, differences of content amongst the various IIAs do not imply *per se* that one foreign investor is being put at a disadvantageous competitive position *vis-à-vis* a third country foreign investor. For instance, while in principle an investor will prefer to be covered by an IIA that includes a FET provision than by an IIA that does not, the mere

absence of such provision does not affect the investor assuming that the host State never breaches the provision. Similarly, even though the investor may prefer to submit a claim to arbitration directly than having to resort to domestic courts as a preliminary step for 6 or 18 months, one cannot presuppose without rigorous analysis that such direct access is more beneficial in and by itself, the amount of compensation the investor would potentially receive being based on the date the damage occurred.

Different treatment does not necessarily mean less favourable treatment, and less favourable treatment rests on objective premises, not on perception.

7. It operates without prejudice to the freedom of contract

As was pointed out in the first edition on MFN (UNCTAD 1999a) if a host country grants special privileges or incentives to an individual investor through a contract, there would be no obligation under the MFN treatment clause to treat other foreign investors equally. The reason is that a host country cannot be obliged to enter into an individual investment contract. In this case, "freedom of contract prevails over the MFN clause" (UNCTAD 1999a). Furthermore, the foreign investor that did not enter into a contract is not in "like circumstances" with the third foreign investor that did conclude the contractual arrangement with the host State.

8. It works differently from the MFN clause in the trade context

As noted above, the MFN treatment emerged and developed in the context of international trade before it was used in investment treaties. However, even though the rationale behind MFN treatment in trade and investment may be similar (ensuring equality amongst the actors concerned) its application is not. While in investment the NT provision constitutes the provision that has driven both

liberalization and protection, in trade MFN is the pillar provision, the cornerstone of the international trading system. While MFN treatment in the trade context is linked to the free circulation of goods and services and their access to markets, MFN treatment in IIAs applies to "investors" and/or their "investments" constituted in accordance with the host State's laws. Regulation of goods and services is more specific, targeted and measurable, while investors and investments are subject to a much greater regulatory universe behind the border. MFN in trade applies to "like products or like services" whereas MFN in investment treaties applies to investors/investments in "like circumstances". MFN in trade was mainly designed to target barriers "at the border" while MFN in most BITs has traditionally applied to measures "behind the border" (given that most BITs take the post-establishment approach). In general, the barriers to entry and after entry of goods and investments tend to be of a different nature.

Indeed, "the scope of operation of the MFN standard is much broader when applied to foreign investment when one considers the regulatory nature of barriers facing foreign investors" (Kurtz 2005). Hence any analogy in the application and the identification of a violation of the commitment must be handled with care. Some tribunals have even rejected the notion. For instance, in *Methanex v. United States*, when assessing the NT claim the tribunal found guidance in the text of the underlying treaty and decided that "trade provisions were not to be transported to investment provisions".[19]

9. It has to be interpreted in the light of general principles of treaty interpretation

Treaty provisions have to be interpreted pursuant to the Vienna Convention on the Law of Treaties (the Vienna Convention), whether required by the instrument itself or by (customary) international law on treaty interpretation. Article 31 of the Vienna Convention (see box 5) contains one general rule of interpretation.

Box 5. Vienna Convention on the Law of Treaties

Article 31
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.*

The rule is to perform one single combined operation. "One must therefore consider each of the three main elements in treaty interpretation – the text, its context and the object and purpose of the treaty" (Aust 2000). Under this rule the "ordinary meaning" is not constructed in a vacuum, rather it has to be seen in the context of the treaty and in light of its object and purpose. Even if the words are clear, if applying them leads to a manifestly unreasonable result, another interpretation must be sought.[20] At the same time, "object and purpose" do not constitute an independent basis for interpretation, but are linked to the text set forth in the treaty. This comprehensive approach is particularly helpful when the text is unclear or admits different interpretations. Given that text, object and purpose are interlinked (Koskenniemi 1989), as the latter rest on subjective premises, recurring to the Contracting Parties' intent constitutes a valid (sometimes necessary) tool, especially when it comes to economic bilateral arrangements and party-driven commitments.[21] However, the exercise should be confined to the premises of the text itself so as to establish but not to create content.

In this context, it is useful to recall that MFN treatment refers to material treatment in the economic sphere and concerns the rules that establish the competitive conditions and opportunities to foreign investors and their investments. By prohibiting differentiated treatment as regards the competitive framework, the MFN treatment clause establishes a level field amongst the relevant players and avoids market distortions, favouring a sound competitive environment, thus contributing to the economic objective of the IIA. MFN treatment means subjecting all foreign investors to the same rules and operational and transactions costs they face in their regular activities, as well as offering them the same market access and operational conditions and opportunities.

Whether the object and purpose of the MFN treatment clause refers to the material treatment given by State measures or acts to foreign investors or extends as well to provisions contained in third

investment treaties forms an essential part of the current debate about the scope, application and interpretation of MFN treatment in IIAs.

Notes

[1] See Article 2 of the General Agreement on Trade in Services (GATS) and Article 4 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

[2] The Draft Articles on MFN constitute useful material for interpretative purposes but have also important limits. A substantial body of treaty practice and cases has emerged after 1978, particularly in the area of International Economic Law. Moreover, the instrument is general in its application and does not specifically address MFN treatment in investment protection and liberalization treaties. The instrument was discussed in the context of the ILC's work on treaty law and sought to explore MFN treatment as a "legal institution" from a broad perspective. It also avoided trying to solve matters of "technical economic nature". See Report of the Commission to the General Assembly on the work of its thirtieth Session" (UN Doc. A/33/10) in *Yearbook of the International Law Commission* 1978 [reference: Paragraph 62]. The Commission has been cognizant of matters relating to the operation of the most-favoured-nation clause in the sphere of international trade, such as the existence of the GATT, the emergence of State-owned enterprises, the application of the clause between countries with different economic systems, the application of the clause vis-à-vis quantitative restrictions and the problem of the so-called "antidumping" and "countervailing" duties. The Commission has attempted to maintain the line it set for itself between law and economics, so as not to try to resolve questions of a technical

economic nature, such as those mentioned above, which pertain to areas specifically assigned to other international organizations.

3 See Article 5 of the Draft Articles on MFN.

4 See Article 4 of the Draft Articles on MFN.

5 See further Brownlie 2003.

6 Unless otherwise noted, all instruments and BITs' texts cited in this report may be found in UNCTAD's online collection of BITs and IIAs at www.unctad.org/iia.

7 NT and MFN are the key pre-establishment drivers. However, there are other disciplines that may contain pre-establishment conditions, such as Performance Requirements and Senior Management and Board of Directors.

8 See ILC 1978.

9 "…*The grant of most-favoured nation treatment is not necessarily a great advantage to the beneficiary State. It may be no advantage at all if the granting State does not extend any favours to third States in the domain covered by the clause. All that the most-favoured-nation clause promises is that the contracting party concerned will treat the other party as well as it treats any third State—which may be very badly. It has been rightly said in this connection that, in the absence of any undertakings to third States, the clause remains but an empty shell*." Ibid., p. 29.

10 See further Dolzer and Schreuer 2008.

11 *Ambiatelos Claim (Greece v. United Kingdom)*, 2 March 1956 (1956 *International Law Reports* 306).

12 There is discrimination "*de jure*" when the measure formally targets the covered foreign investor. There is discrimination "*de facto*", when the measure, while apparently being of general application, only affects the covered foreign investor.

13 See OECD 1998.

14 In *SD Myers v. Canada* the tribunal established that "…article 1102 [National Treatment] invites an examination of whether a non-national investor complaining of less favourable treatment is in the

same business sector or economic sector as the local investor…" See *S.D. Myers Inc. v. Canada*, UNCITRAL, 2002.

15 The *Feldman v. Mexico* tribunal made a distinction between producers and resellers of cigarettes; the *Champion Trading v. Egypt* tribunal made a distinction between cotton companies operating in the free market or in fixed-price governmental programs; the *UPS v. Canada* tribunal made a distinction between postal and courier services; and the *ADF v. United States* tribunal made a distinction between steel producers in general and those who could participate in a highway project. See *Marvin Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, Award, 16 December 2002. See *Champion Trading Company Ameritrade International, Inc. v. Republic of Egypt*, ICSID Case No. ARB/02/09, Award, 27 October 2006. See *United Parcel Service of America Inc. v. Government of Canada*, Award on the Merits, 24 May 2007.

16 In *Methanex v. United States* the tribunal established that "…it would be as perverse to ignore identical comparators if they were available and use comparators that were less like, as it would be perverse to refuse to find and apply less like comparators when no identical comparators exist". See *Methanex Corporation v. United States of America*, UNCITRAL, Final Award on Jurisdiction and Merits, 3 August 2005.

17 In *ADM v. Mexico* the tribunal established that ALMEX and the Mexican sugar industry were in like circumstances. "Both are part of the same sector, competing face to face in supplying sweeteners to the soft drink and processed food markets". See *Archer Daniels Midland Company v. the United Mexican States*, ICSID Case No. ARB(AF)/04/05, Award, 21 November 2007. In *CPI v. Mexico*, the tribunal concluded that "where the products at issue are interchangeable and indistinguishable from the point of view of the end-users, the products, and therefore *the* respective investments,

are in like circumstances. Any other interpretation would negate the effect of the non-discriminatory provisions…" See *Corn Products International Inc. v. the United Mexican States*, ICSID Case No. ARB(AF)/04/01, Decision on Responsibility, 15 January 2008.

18 The *Pope & Talbot v. Canada* tribunal established that "Differences in treatment will presumptively violate Article 1102(2), unless they have a reasonable nexus to rational government policies that: (i) do not distinguish, on their face or de facto, between foreign-owned and domestic companies..." See *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2, 10 April 2001.

19 See *Methanex Corporation v. United States of America*, UNCITRAL, Final Award on Jurisdiction and Merits, 3 August 2005, para. 27 Part IV.

20 Ibid.

21 "…An approach limited to the intentions of the negotiators of the treaty may be appropriate with a bilateral treaty concerning trade and commerce. However, an objective approach, where current international law concepts are considered, is generally used where multilaterals treaties dealing with human rights or maritime territory are in issue, being areas where international law has developed rapidly…" (Dixon and McCorquodale 2003). It also has been said that the MFN clause "can only operate in regard to the subject-matter which the two States had in mind when they inserted the clause in their treaty" (ILC 1978, op. cit, p. 27).