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MOST FAVOURED NATION (MFN) TREATMENT IN INTERNATIONAL INVESTMENT LAW

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1. INTRODUCTION:

There is an international view that the treatment standards like MFN, National treatment, fair and equitable clause, umbrella clause are uniform in practice and finds place in every foreign investment. However, in practice the formation of standard treatment provisions are never uniform nor their interpretation by investment tribunals are inconsistent with each other. This ultimately creates a number of problems. "In brief, inclusion of MFN clause in investment treaties seems to be all encompassing shrinking the policy-making freedom of sovereign states."[1]The main aim of including MFN clause in the investment treaties is to provide the investor a more favourable situation inside the host state. Article 4 of ILC Draft Articles on MFN clause givethat, "*most-favoured-nation clause is a treaty provision whereby a State undertakes an obligation towards another State to accord most-favoured-nation treatment in agreed sphere of relations."*[2]

BILATERAL ENGAGEMENT

A list of major countries with which India has signed bilateral investment protection and promotion agreements

Country	Year of Agreement	Year of Enforcement
UK	1994	1995
Russia	1994	1996
Germany	1995	1998
Malaysia	1995	1997
Denmark	1995	1996
Italy	1995	1998
Israel	1996	1997
South Korea	1996	1996
Switzerland	1997	2000
France	1997	2000
Mauritius	1998	2000
China	2006	2007
The Netherlands	1995	1996

Source: Ministry of Finance

Figure 1[3]

The model India BIT also has the provision relating to MFN but it exist in combinationwith the national treatment provision. Article 4(1) of India's Model Bilateral Investment Treaty states that, "*Each Party shall not apply to investor or to investments made by investors of the other Party, measures that accord less favourabletreatment than that it accords, in like circumstances, to its own investorsor to investments by such investors with respect to the management, conduct, operation, saleor other disposition of investments in its territory*."[4]

2. **ORIGIN AND DEVELOPMENT OF MFN**:

The initial instances of MFN treaties can be traced back to the 13th century where the Roman Empire decided to award the same concession to the merchants from Marseilleas were being enjoyed by other states such as Genoa. This way parity was restored. The proper evolution of this policy started in the 18th and 19th centurieswith prominent examples such as the 1778 Treaty between US and France. Initially, ithad a sort of conditional character with implicit condition that the advantages being handed over byone state are reciprocated by the other beneficiary by giving similar value concessions. The wave of unconditional treaties was seen to emerge in the later phases of 18th century where prominent treaties such as the signing of Chevalier- Cobden treaty by Britain with France. In such treaties, it was not mandatory for the state receiving benefits to give back similar concessions. These sort of treaties remained the norm tillthe First World War in the beginning of 20th century. Commerce was governed by these treaties for a long time but it wasn't until the 1970s that the internationalcommunity actually began recognising it officially and formalising it. ILC was at the forefront of this codification and even proposed to the UN General Assembly to makeit mandatory for every state. Although Assembly didn't accept this proposal but the draft proposal which had been submitted by theILC even today continues to govern this principle throughout the world.

The principle of Most-favoured-nation treatment is not a new concept but has been in existence since the formation of economic treaties. The aim MFN treatment tries to achieve, parties treat each other in as much possible favourable terms as it treats other parties. In today's investment treaties, it is used widely considering the significance of MFN treatment. The clause of MFN treatment given under international trade law forms the basis of understanding the concept. Article I of GATT,

"*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 accordedimmediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties*."

Under international trade law, "the clause grants benefits wherever the parties have not previously agreed to liberalize their relations in the same way as that in a treaty witha third state."[5]However even if the concept is same, its treatment under Investment Lawis different from international trade law.

3. **MOST FAVOURED NATION TREATMENT IN INTERNATIONALINVESTMENT LAW:**

The Most Favoured Nation clause undertaken under the International Investment Agreements ensure that states giving like and same treatment to foreign investors as they give to the third country investors. This ensures a non-discrimination and prevents favouritism with relation to foreign investors. "The number of bilateralinvestment treaties (BITs) increased five-fold from 385 to 1,857 during the 1990s,and as of2013, there were at least 2,857 BIT."[6] As there was an increase in the BITs, the MFN clauses also became a very important part of these BITs. Just like the international tradelaw, its treatment gives equal competitive conditions to foreign investors of different countries "However, under the international trade laws, this is restricted to border measures of market access but under the international investment agreements, these areconducted within the territories of states, i.e. behind state borders."[7] Because of this reason the treatment under MFN has a different scope of application in International Investment Laws.

There are three legal features of MFN with regards to its application:

A. Treaty based obligation: It can be prominently seen from the international practices that the inclusion of MFN clause is a universal practice but this obligation is undertaken by the states. Under article 7 of ICL (International Law Commission) draft articles on MFN it is stated that "*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*."[8] Therefore it is considered as a treatybased obligation.

B. Non-applicability of Ejusdem Generis principle: The MFN treatment standardsare only applied in cases where there are like subject matters or divisions described and given under the treaty in question, so interpretation of words canonly be done within a specified sphere. One example can be"Depending on thesubstantive scope of an MFN clause, the MFN treatment can be applied extensively to all matters of the investment or just to anindividual stage of the investment such as investment access or investment protection."[9]

C. Relative Standard: There is no exact definition or standard of MFN treatment and under International Investment Laws, require a test for comparison of treatments between foreign investors in like circumstances. So, under like circumstances the situation of two different foreign investors have to be compared in order to decide whether there is an MFN violation. This raises a question as to "whether the investments or investors in question are comparable(in the same relationship) and whether there has been less favourable treatment."[10]

In order to prove a MFN violation under International Investment Agreements the question of whether the host state has provided less favourable treatment to theinvestors in comparison to what is provided to the state parties, is to be considered. Therefore in

comparison to International trade law in place, "difference in treatment with regards to dispute settlement provisions in two BIT's would not be enough to constitute a breach instead there needs to be a competitive disadvantage associated withthe difference in treatment."[11]

4. **TYPES OF MFN CLAUSES ADOPTED IN TREATY PRACTICE**:

Under the treaty practices, varied types and versions of Most Favoured Nation standardare applied. Every clause is interpreted and applied on its own term depending on the adopted treaty practice. "Each Most Favoured Nation clause is a world in itself, which demands an individual interpretation to determine its scope of application"[12]There are different approaches:

A. German Model Treaty: This is a classical approach given under Article 3 of the German Model Treaty.

"(1) Neither Contracting State shall subject investors of the other Contracting State, as regards their activity in connection with investments in its territory, to treatment lessfavourable than it accords to its own investors or to investors of any third State.

(2) Neither contracting state shall subject investors of the other Contracting State, as regards their activity in connection with investors in its territory, to treatment less favourable than it accords to its own investors or to investors of any third state."[13]

Under this model, there is a combination of Most Favoured Nation treatment with thatof National Treatment standard. This clause gives the foreign investors option to choosefrom different kinds of treatments available to them. "The investors may either choose to be treated as a local investor would be or as a foreign investor of a third state if they enjoy better rights and protections."[14]

A very interesting case with this regard is **CME Czech Republic BV v. Czech Republic**[15]. Under this case, CME, a company from Netherlands, had an equityinterestof 99 percent in a company in the Czech Republic called CNTS. CME had bought up this interest between 1994 and 1997. CNTS and a local Czech company called CET21took permission from the Media Council of Czech Republic to beginthe country'sfirst private TV station known as TV NOVA. The council granted this license to CET 21 and CNTS was supposed to be the operator of this station. CNTS could doeverything except programming and independence in editing work. This wasto please the local public and to counter the perception that a foreign entity iscontrolling their TV station. This joint venture turned out to be a huge success and CNTS did the production work of programs as well as purchased them. Advertising time was sold toCET 21 which mere was a holder of the license. The terms were tweaked in 1996 underthe insistence of the Media Council but still under the new agreement also, CET 21 wasbeing provided with the broadcasting services of CNTS. In 1999, CET 21 terminated the service agreement and removed CNTS as the exclusive broadcasting serviceprovider and brought in new other content providers. CME contested in the Arbitrationproceedings that their investments in the CNTS company and this business had been completely destroyed and all of this had happened due to the inaction of the Media council which was supposed to govern these licenses and agreements. They claimed damages of over 500 million dollars for this breach of BIT.

The legal question on standard of compensation dealt with some interesting issues. BIT states in Article 5 if an investing entity should be justly compensated if it is deprived of its investment and such damages must take into consideration what the genuine valueof these affected investments was. "Even tribunal was of the opinion that if the state is taking over some investment of an outside investor, just compensation is a must. The international law also clarifies that full reparation needs to be done by the State responsible for such an action."[16] Tribunal also focused on the similar doctrine of 'Chorzow' and said that the State of Czech Republic needs to rightall the wrongs emerging from the illegal acts and inactions of the Media Council. For the purposes of calculating CME's compensation, the fair market value of theirinvestment would be taken into consideration and the date from which it would be calculated would be the date when the actual damage occurred. This date in question was decided to be the one in 1999 when CET proceeded with the termination of the contract of service with CNTS despite their being various scattered instances ofbreaches of proper conduct. This was the date when CNTS's investment was actually rendered obsolete. Some of these phrases considered above were not present verbatimin the BIT Agreement or other consulted statutes but their similar concepts were present. It was held that such restitution of the foreign investor by the affecting state is guaranteed by almost all international legal principles.

The tribunal rules that Most favoured Nation clause under the Netherlands- Czech Republic BIT gave the investor a better standard to apply compensation than USA- Czech Republic BIT, so they enjoy a better rights and protection if the previous treaty is applied. Therefore, they have the right to choose a better protection.

B. All matters subject to agreement: In these kind of approach it's not about sametreatment given to foreign investors but relates

to no less favourable treatment of all matters subject to the particular agreement. " In all matters subject to this Agreement, the treatment shall be no less favourable than that extended byeach party to the investments made in its territory by investors of a third country."[17]

C. Limited application: This trend is mostly seen in recent treaties, where the Most Favoured Nation clause is specified in particular articles so that their applicationis limited to those areas under the agreement. The areas are clearlydesignated where the clause is meant to be applied and this clause will nothave anoverall application. "United Kingdom has some treaties where the MFN clause is designated to the areas like management, maintenance, use, enjoyment, disposal etc."[18] This usually depends on the circumstance, terms, conditions and the negotiations to which both the parties have agreed. "Under the Argentina-Panama BIT, it was agreed that the MFN clause is not applicableto the arbitration and dispute resolution clause under the treaty."[19]

5. **JURISDICTIONAL APPLICATION OF MFN CLAUSE**:

In today's world all most all the BITs contain some or other form of Most Favoured Nation provision but the wording and the writing of this particular clause may vary from treaty to treaty. Therefore, the scope and application of this clause can also vary. There are many cases who address the problem of jurisdiction of international tribunalon the basis of MFN clause. But before that the interpretation of the scope of this particular clause should be understood.

5.1. INTERPRETATION OF MFN CLAUSE:

The International Law Commission for the topic of MFN clauses has agreed on certain point:

"The fundamental questions about MFN clauses are matters of public international law.The central issue is how should MFN clauses be interpreted. And while this may appear to be a narrow question, in reality it is a broad question involving both treaty interpretation and the nature and extent of obligations undertaken by States under the ambit of an MFN clause. It engages our understanding of the role and function of MFN clauses and of their relationship to the principle of non-discrimination in international law."[20]

According to the accepted rules of customary international laws, all treaties areinterpreted by following the approach given under Art. 31 of Vienna Convention on Law of Treaties.

"A treaty shall be interpreted in good faith in accordance with the ordinary meaningto be given to the terms of the treaty in their context and in the light of its object and purpose."[21]

This clearly states that a treaty clause should be interpreted in exact meaning written under the terms of the treaty. "It is also widely accepted that the rules of interpretation laid down in the VCLT will also apply to an MFN clause."[22] Another principleregardinginterpretation which is relevant in this case is the principle of ejusdem generis[23]. "But itshould also be kept in mind that while applying this principle, MFN clause will only attract the matters belonging to same category of subjects as that to which the clause itself relates."[24] So, it is usually the combination of both the principles while any interpretation of MFN clause is done.

THE MAFFEZINI CASE

Before this case came into picture, the parties were not permitted to modify the jurisdictional mandate of an international tribunal and especially the extension of MFNclause to jurisdictional matters.[25]However this case was the first one where the parties relied upon MFN clause to jurisdictional matters.

In the case of Maffezini v Kingdom of Spain[26],

An investor from Argentina founded and invested in a chemical producing company called EAMSA in Spain. It was a joint venture with another company known as SODIGA which cooperated with the monetary part also.This venture flunked and the investing person claimed in front of the arbitration tribunal that SODIGA had projected significantly lower costs to him. These incorrect projections were further inflated by excess expenditures such as an Environmental assessment. He also claimed that his firm was forced to start construction before the EIA was completed which resulted in further inflation in project costs. Spain reverted back that it wasn't responsible for the actions of a private entity and that the investor himself should have taken due diligence in ensuring that it was feasible to acquire gains from this venture. Tribunal decided that firstly due to the varied nature of functions of SODIGA, itneeds to independently examine each and every function of SODIGA so as to find outtill

what extent can they hold the Spain government liable. On the issue that theadvices upon which the project's costs inflated and it incurred losses, it was held thatthese advices weren't a public function of SODIGA and it was held that the failurehere was completely attributable to purely business reasons. Every normal businessinvestment has its own risks and for that treaties can't be invoked every single time to protect the interests of the investors. Most likely the investor was aware that an assessment is mandatory but still went ahead with the construction regardless. And even if it wasn't the case, the investor himself should have been aware that setting upa chemical plant would require an EIA. Hence, the government of Spain could not beheld liable for any damages here.

RELEVANCE: The claimant wanted to avoid the submitting of dispute to Spanish courts for 18 months as given under Argentina-Spain BIT before going to international arbitration. It was argued that the MFN clause under Argentina-Spain BIT should allowthe import of dispute settlement provision from Chile-Spain BITand the requirement under Chile-Spain BIT was that the investor should follow a 6 months negotiation period before going to arbitration. However, Spain here argued that the MFN clause was limited to the investor's substantive treatment and did not include the procedural matters. The tribunal held that

''if a third-party treaty contains provisions for the settlement of disputes that are more favourable ... than those in the basic treaty, such provisions may be extended to the beneficiary of the [MFN] clause as they are fully compatible with the ejusdem generis principle''[27]

The dispute settlement procedures are always more inclined towards the protection of investors. So, the MFN clause can be applied in this case to give the benefit if Chile- Spain BIT because that gave easier access to international arbitration. Therefore the MFN clause in the treaty can include both procedural and substantive matters.

However, there are certain exceptions discussed by the tribunal which mostly deals with the public policy considerations. For example, the procedure given under the treaty should be followed, requirement of exhaustion of local/domestic remediesgiven as a pre-condition for submission of dispute for arbitration, clause providing submission ofdispute to a particular arbitration forum or institution, No requirement of borrowing if the nations have previously agreed upon certain conditions through heavy negotiated procedures.[28]

5.2. THE PLAMA CASE:

The case of Plama Consortium Limited v Republic of Bulgaria[29] saw a divergence from the Maffezini case. Here the claimant wanted to establish ICSID tribunal's jurisdiction over the dispute with Bulgaria. The tribunal took the view that MNF clause is only applied in the substantive matters and also by the general principle of international law the consent to arbitration must be clear. It was mentioned that : ''dispute resolution provisions in a specific treaty have been negotiated with a view toresolving disputes under that treaty. Contracting states cannot be presumed to haveagreed that those provisions can be enlarged by incorporating dispute resolution provisions from other treaties negotiated in an entirely different context''.[30]

With regard to the discussion regarding Maffezini case, it was stated that this was acase with exceptional circumstances.

"the principle with multiple exceptions as stated by the tribunal in the Maffezini case should instead be a different principle with one, single exception: an MFN provisionin 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''.[31]

It was finally concluded that the tribunal did not have jurisdiction to apply the arguments given by claimant in the given circumstance. ''An MFN provision in a basictreaty does not incorporate by reference dispute settlement provisions in whole or in part set forth in another treaty, unless MFN provision in the basic treaty leavesno doubt that the Contracting Parties intended to incorporate them''.[32]

Therefore from the above discussion it is clear that this difference in interpretation is one of the major concern in international investment law. The case laws fluctuate somewhere between investor's interest and the interest of the states, depending on the tribunal. So, it is assumed that the text written under the Treaty will have an overriding effect on how the dispute regrading jurisdiction will be decided.

6. SUBSTANTIVE PROTECTION OF MFN CLAUSE:

It is accepted very widely that MFN clauses can work as a substantive protection measure in the realm of International Investment agreements but because of the wording, structure of how these clauses are formed, give rise to a number of interpretation and application. To understand this better, there is one case which can behighlighted.

The case is MTD v Chile[33], the case was filed under Malaysia-Chile BIT. MTD entered into an agreement with Chile for construction of commercial complex and along with this there was another agreement with a private party for a site project.

Regarding the agreement with the private party, MTD filed an application with the Chile's Foreign Investment Commission for its approval. The initial proceeding was completed with signing of contract but later there was a reluctance seen from the localauthorities side for further approval. It was finally declared that the project proposal was not in consistence with the urban development policy and rejected the project. The Malaysia-Chile BIT had a fair and equitable treatment clause, where the MFN clause was also combined. Therefore, MTD invoked this particular clause with that ofprotections given under Chile-Croatia BIT and Chile-Denmark BIT and claimed that it was entitled to the benefits given under these provisions.

The question that came before the tribunal was 'whether the clauses under Chile- Croatia BIT and Chile-Denmark BIT that deals with the obligation to award permits subsequent to approval of an investment and to fulfilment of contractual obligations, respectively, can be considered to be part of fair and equitable treatment.'[34]The tribunal took the view that Chile should accord MTD treatment as provided under Chile-CroatiaBIT and Chile-Denmark BIT.

" Under BIT , the fair and equitable standard of treatment has to be interpreted in the manner most conducive to fulfil the objective of the BIT to protect investments and create conditions favourable to investments. To include the part of protection of BIT those included in article 3(1) of the Denmark BIT and article 3(3) and (4) of Croatia BIT is in consonance with this purpose."[35]

It was however held by the tribunal that there was no breach of any standard of protection as Chile has not acted inconsistently with Chile-Denmark BIT.

6.1. **MFN CLAUSE AS SUBSTANTIVE PROTECTION STANDARD**:

A. The MFN provisions are used mostly to add or expand the treatment standard already present in base treaty. Example in as case, it was submittedthat "the FET obligation ought to be interpreted as encompassing the customary international law minimum standard of treatment, a prohibition on discrimination, and a requirement that therespondent provide effective means of asserting claims and enforcing rights with respect to investments."[36]

B. The MFN provisions can be invoked in addition to the standards of treatment given under the base treaty. The claims of an entirely new obligations have been made in many treaties where the success depends on the wording and formation of that particular MFN clause.[37]

C. The MFN clause can sometimes be invoked due to overcoming the unfavourable provisions of the base treaty. For example in a case, "the claimant invoked the MFN clause to overcome a necessity exception provided in the base treaty, on the basis that other treaties concluded bythe respondent did not contain a similar exception and were thus more favourable."[38]

D. The MFN clause has also been used in their own right as a substantive protection standard under the base treaty. " While this function of MFN clauses is

overwhelmingly accepted in principle, no investor has yet succeeded in such a claimbefore an ICSID tribunal."[39]

After discussing the substantive protection standard of MFN it is still not clear as to what is exactly the extent or limit of such clause. There are two alternative views, one is the clause can be invoked in such a manner that would change the regime with regards to the base treaty containing that particular clause. Another view would be taking the literal interpretation where the MFN clause can be extended to all areas of the treaty. The answer still remains ambiguous as to the exact position because it atthe end it depends on the tribunal along with the way the MFN provision is written.

7. **CONCLUSION:**

With the increase in use of MFN clauses in BITs over the years, have made the states aware that these obligations are creating some unnecessary hindrance in their obligations towards other state. Therefore, slowly there is a trend to limit the scope of application of this provision like in Model India BIT the national treatment provision is clubbed with the MFN provision. Even with the widespread and common use of these provisions in BITs, their application, formation etc. vary from treaty to treaty. It is alsothat the tribunals are regime specific, sometimes they interpret the MFNclauses including both the substantive and procedural issues and sometimes it is not the same.This somehow create uncertainty in the outcome of results like in the cases of Maffeziniand Plama. "It has further highlighted that, in drafting and negotiating MFN provisions, States retain a key role in setting the scope of protection that might be conferred by such clauses in the future."[40] The question always comes down to what is exactly written in the treaty. The world trend shows that the states are day by day excluding theuse of MFN clauses because of the extra burden along with the persistent problem of not maintaining a uniformity. There is also no mechanism in the international investment laws to address such issues, because of which it comes down to the more engagement of states in the form of negotiations, more participation of legalscholars to find alternative approaches, regulating the BITs even more by someinternational organizations etc.

However it should not be forgotten that the ideabehindhaving MFN clause will never be a strict interpretation or compulsion to include the same as the BITs are treaties negotiated between two countries for their own convenience depending on the circumstances and situation of the countries.

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