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# *Establishing Jurisdiction Through a Most-Favored-Nation Clause*

Much has been said and written about the recent development of investment arbitration on the basis of investment protection treaties (see, for example, E. Gaillard, "L'arbitrage sur le fondement des traités de protection des investissements," 2003 Rev. Arb. 853; Ch. Schreuer, "Traveling the BIT [bilateral investment treaty] Route. Of Waiting Periods, Umbrella Clauses and Forks in the Road," 5 J. World Inv. & Trade 231 (April 2004)). This development has espoused—at times in a fashion perceived as groundbreaking — mechanisms and concepts of treaty law.

Some of the most debated treaty mechanisms, however, such as "umbrella" clauses and most-favored-nation (MFN) clauses, have yet to yield a consistent case law on their meaning and scope in investment arbitration.

The specific example of MFN clauses is of particular interest in light of the most recent case law (on umbrella clauses, see E. Gaillard, "Investment Treaty Arbitration and Jurisdiction Over Contract Claims. The SGS Cases Considered," in International Investment Law and Arbitration: Leading Cases From the ICSID (International Center for the Settlement of Investment Disputes), NAFTA (North American Free Trade Agreement), Bilateral Treaties and Customary International Law (T. Weiler ed.) 2005, at 325).

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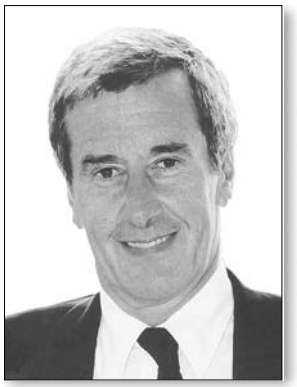

## The MFN Standard

Under an MFN clause, the beneficiary of the clause is entitled to a more favorable treatment that is accorded by the state parties to the treaty to the nationals of a third country. The clause is contained in what is defined as the "basic treaty," which governs the rights of the beneficiary of the MFN clause. The more favorable treatment is found in a "third-party treaty." To the extent the MFN standard is intended to protect beneficiaries in similar situations, it is generally admitted that, pursuant to the rule of ejusdem generis, the object of the basic treaty and that of the third-party treaty must not be different in nature, for example a treaty on the protection of investments and a treaty on the determination of a maritime boundary.

The purpose of the MFN standard is to prevent discrimination against the nationals of different countries and ascertain equality of treatment regardless of nationality. In the context of international investments, MFN clauses thus contribute to the harmonization of the level of protection accorded to foreign investors and their investments. A report established by the United Nations Conference on Trade and Development (UNCTAD) has defined the MFN standard as "a core element of international investment agreements….The MFN standard gives investors a guarantee against certain forms of discrimination by host countries, and it iscrucial for the establishment of equality of competitive opportunities between investors from different foreign countries (UNCTAD, Most-Favoured-Nation Treatment, 1999, at 1). As early as the *Anglo-Iranian Oil Company* case of 1952, the International Court of Justice had similarly considered MFN clauses as "maintain[ing] at all times fundamental equality without discrimination among all of the countries concerned" (Decision of Aug. 27, 1952, ICJ [International Court of Justice] Reports 1952, at 192).

The question of the scope of the protection accorded to the beneficiary of an MFN clause, which has been addressed in public international law, becomes particularly relevant in light of the dramatic development of investment arbitrations initiated on the basis of investment protection treaties.

## MFN Clause Apply to Jurisdiction?

The question of whether the beneficiary of an MFN clause may invoke the more favorable substantive rights of a third-party treaty raises little difficulty. The question however had been unresolved as regards the more favorable dispute settlement provisions of a third-party treaty. Different situations may exist in this respect. For example, when the basic treaty contains no dispute settlement provision at all, can the treaty's MFN clause be invoked by its beneficiary for a right of access to international arbitration contained in a third-party treaty? When the

basic treaty contains a dispute settlement clause but no choice is given to the investor as regards the type of arbitration, notably institutional arbitration such as ICSID, can the MFN clause be invoked to seek the benefit of the options offered in a third-party treaty? When the basic treaty—such as many of the BITs entered into by China—provides for international arbitration only as regards the determination of the amount of compensation for expropriation and not regarding the principle of the host state's responsibility, can an MFN clause contained in that treaty be invoked to benefit from a broad dispute settlement provision contained in a third-party treaty—for example, Article 9 of the Germany-China BIT signed on Dec. 1, 2003 and in the process of entering into force, or Article 10 of the Netherlands-China BIT entered into force on Aug. 1, 2004? When the basic treaty provides for particular conditions before an international arbitration proceeding can be initiated, for example, a cooling-off period varying from three to six months or the exhaustion of local remedies, can an MFN clause be invoked to benefit from the more-favorable conditions of a third-party treaty?

In other words, the question is whether an MFN clause applies to dispute settlement mechanisms and questions of jurisdiction. This issue was addressed for the first time, in the context of investment arbitration, in *Maffezini v. Spain* (Decision on jurisdiction of Jan. 25, 2000, available on the ICSID Web site). In that case the claim was based on the Argentina-Spain BIT, which dispute settlement clause for investment disputes provided for a six-month negotiation phase before the dispute could be submitted to the competent courts of the host State and, failing the settlement of the dispute after the expiration of a period of eighteen months, to international arbitration. The claimant invoked the MFN standard of the Argentina-Spain BIT contained in the clause providing for fair and equitable treatment and according to which "in all matters subject to this Agreement, this treatment shall not be less favorable than that extended by each Party to the investments made in its territory by investors of a third country." On the basis of this clause, the claimant sought to benefit from the more favorable dispute resolution mechanism contained in the Chile-Spain BIT which did not provide for the settlement of disputes through domestic courts for a period of 18 months, but rather for international arbitration after a six-month negotiation period. Having examined the language of the MFN clause, which provided for a more favorable treatment regarding "all matters" subject to the treaty, the *Maffezini* Tribunal held that:

> [T]he Tribunal considers that there are good reasons to conclude that today dispute settlement arrangements are inextricably related to the protection of foreign investors…if a third-party treaty contains provisions for the settlement of disputes that are more favorable to the protection of the investor's rights and interests than those in the basic treaty, such provisions may be extended to the beneficiary of the most favored nation clause… (paras. 52-56).

## 'Siemens v. Argentina'

This principle was similarly adopted by the *Siemens v. Argentina* Tribunal, which had to decide whether the investor could initiate an arbitration after the six-month negotiation phase as provided for in the Chile-Argentine BIT rather than after exhausting the local remedies during an 18-month period as provided for by the applicable Germany-Argentina BIT (Decision of Aug. 3, 2004, available on www.asil.org). Noticeably, unlike in *Maffezini*, the MFN clause in *Siemens* did not allow for more favorable treatment as regards "all matters" subject to the basic BIT. The *Siemens* Tribunal decided, however, that the basic BIT had "as a distinctive feature special dispute settlement mechanisms not normally open to investors. Access to these mechanisms is part of the protection offered under the Treaty. It is part of the treatment of foreign investors and investments and of the advantages accessible through an MFN clause." It further held that "the term 'treatment' and the phrase 'activities related to the investments' are sufficiently wide to include settlement of disputes." (*Siemens*, paras. 102-103).

The first two key decisions addressing the question of the applicability of MFN clauses to dispute settlement arrangements thus admitted that such arrangements are part of the substantive protection extended to the beneficiary of the clause.

## Limits to Jurisdiction

• *What Limits to Jurisdiction Through MFN Clauses?* Importantly, however, the *Maffezini* Tribunal set out a few limitations to the principle of the applicability of MFN clauses to dispute resolution mechanisms, on the basis of public policy considerations:

> Notwithstanding the fact that the application of the most-favored nation clause to dispute settlement arrangements in the context of investment treaties might result in the harmonization and enlargement of the scope of such arrangements, there are some important limits that ought to be kept in mind. As a matter of principle, the beneficiary of the clause should not be able to override public policy considerations that the contracting parties might have envisaged as fundamental conditions for their acceptance of the agreement in question, particularly if the beneficiary is a private investor, as will often be the case. The scope of the clause might thus be narrower than it appears at first sight. (para. 62)

The limitations thus defined by the *Maffezini* Tribunal concern such "public policy considerations" as the exhaustion of local remedies, the stipulation of a fork-in-the-road clause (i.e., an irreversible option offered to the investor between the courts of the host state and international arbitration), the provision of a particular arbitration forum such as ICSID, or the parties' agreement to have a highly institutionalized system of arbitration.

The justification of such limitations is, however, lacking. In addition, it would be an ineffective exercise of treaty interpretation if one were to construct an MFN clause and subsequently narrow the scope of that clause on the basis of perceived limitations that have not been expressly stipulated by the parties.

## 'Salini v. Jordan'

Adopting a somewhat different approach, the Arbitral Tribunal in *Salini v. Jordan* decided that the MFN clause under

consideration did not apply to dispute settlement arrangements on the basis of the specific language of that clause:

> The current Tribunal shares the concerns that have been expressed in numerous quarters with regard to the solution adopted in the *Maffezini* case. Its fear is that the precautions taken by authors of the award may in practice prove difficult to apply, thereby adding more uncertainties to the risk of 'treaty shopping.' The Tribunal also observes that bilateral investment treaties carry varying provisions that address this issue. Some of those treaties provide expressly that the most-favored-nation treatment extends to the provisions relating to settlement of disputes…. In other treaties, the MFN clause does not contain such a provision, but refers to 'all rights' contained in the agreement, or to 'all matters' subject to the agreement…. The Tribunal observes that the circumstances of this case are different. Indeed, Article 3 of the BIT between Italy and Jordan does not include any provision extending its scope of application to dispute settlement. It does not envisage 'all rights or all matters covered by the agreement.' Furthermore, the Claimants have submitted nothing from which it might be established that the common intention of the Parties was to have the most-favored-nation clause apply to dispute settlement…. From this, the Tribunal concludes that Article 3 of the BIT does not apply insofar as dispute settlement clauses are concerned. (Decision of Nov. 29, 2004, available on the ICSID Web site, paras. 115-118).

Similarly, the *Plama v. Bulgaria* Tribunal, which was requested to decide whether the investor could rely on the dispute settlement provision contained in a third-party treaty and providing for ICSID arbitration whereas the arbitration clause contained in the basic treaty provided for ad hoc arbitration, stated being "puzzled as to what the origin of [the *Maffezini*] 'public policy considerations' is" and further held that, save for exceptional circumstances that were justified in the *Maffezini* case, "an MFN provision in a basic treaty does not incorporate by reference dispute settlement provisions in whole or in part set forth in another treaty, unless the MFN provision in the basic treaty leaves no doubt that the Contracting Parties intended to incorporate them" (Decision of Feb. 8, 2005, available on the ICSID Web site, paras. 221 and 223).

In the case at hand, the Tribunal referred to the circumstances of the conclusion of the BIT, i.e., the existence of a communist regime in Bulgaria at that time limiting the protection of foreign investors (see paras. 195-197), and concluded that the contracting parties did not intend to extend the dispute settlement provisions through the MFN clause. The *Plama* Tribunal also decided that a state's agreement to arbitrate its investment disputes had to be clear and unambiguous and that, accordingly, the incorporation by reference of dispute resolution mechanisms had also to be clear and unambiguous. The Tribunal found that no such intention could be established in the circumstances of the case (at paras. 198, et seq.) and thus held that the MFN clause could not be interpreted "as providing consent to submit a dispute under the Bulgaria-Cyprus BIT to ICSID arbitration" (para. 227).

## The Language of the Clause

All these cases in reality show that the question of the applicability of an MFN clause to dispute settlement arrangements is chiefly determined by the language of the clause.

When an MFN clause expressly provides for limitations, such limitations must be given effect. For example, Article 1103(2) of NAFTA provides for more favorable treatment "with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments." The settlement of disputes not being part of this enumeration, it is thus excluded from the scope of the clause. Similarly, the MFN clause contained at Article 5 of the U.S. Draft Model FTAA of November 2003, which is formulated in similar words, is also accompanied by a footnote 13 clarifying the contracting parties' intention as follows: "the Parties note the recent decision of the arbitration tribunal in *Maffezini*… which found an unusually broad most-favored nation clause in an Argentina-Spain agreement to encompass international dispute resolution procedures…. By contrast, the Most-Favored-Nation Article of this Agreement is expressly limited in its scope to matters 'with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.' The Parties share the understanding and intent that this clause does not encompass international dispute resolution mechanisms…and therefore could not reasonably lead to a conclusion similar to that of the *Maffezini* case."

Equally, when the contracting parties have expressly included dispute settlement arrangements in the scope of an MFN clause, such intention must be given effect. For example, the MFN clause contained at Article 3(3) of the model UK BIT provides that "for the avoidance of doubt it is confirmed that the treatment provided for in paragraphs (1) and (2) above shall apply to the provisions of Article 1 to 11 of this Agreement," thereby expressly including the dispute settlement provision contained at Article 8 of the BIT.

## Intention of Parties

Therefore, and logically, the interpretation question of whether dispute settlement arrangements constitute a substantive right that can be extended to the beneficiary of an MFN clause arises when the clause is broadly phrased and the contracting parties to the treaty have neither expressly excluded dispute resolution mechanisms nor clarified their intention of including such mechanisms in the protection that is accorded to the beneficiaries of the clause. In those situations, the intention of the contracting parties can reasonably be interpreted to include the whole range of the rights accorded to the investors of a third country, including the right to the neutral and effective settlement of their investment disputes through international arbitration rather than through the judicial organs of the host state itself.