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Chapter XI
The Most-Favoured-Nation clause

A. Introduction

355. The Commission, at its sixtieth session (2008), decided to include the topic "The Most Favoured-Nation clause" in its programme of work and to establish a Study Group on the topic at its sixty-first session.[1322]

356. A Study Group, co-chaired by Mr. Donald M. McRae and Mr. A. Rohan Perera, was established at the sixty-first session (2009), during which it considered, *inter alia*, a framework that would serve as a road map for future work and agreed on a work schedule involving the preparation of papers intended to shed additional light on questions concerning, in particular, the scope of MFN clauses and their interpretation and application.[1323]

B. Consideration of the topic at the present session

357. At the present session, the Commission reconstituted the Study Group on The Most-Favoured-Nation clause, co-chaired by Mr. Donald M. McRae and Mr. A. Rohan Perera.

358. At its 3071st meeting, on 30 July 2010, the Commission took note of the oral report of the Co Chairmen of the Study Group.

1. Discussions of the Study Group

359. The Study Group held 3 meetings on 6 May and on 23 and 29 July 2010. It considered and reviewed the various papers prepared on the basis of the framework to serve as a road map of future work, which was decided upon in 2009, and agreed upon a programme of work for next year. It had before it several papers prepared by members of the Study Group: These papers serve as the background context that seeks to illuminate further the challenges of the MFN clause in contemporary times, by looking at the typology of existing MFN provisions, the areas of relevance of the 1978 draft articles, how MFN has developed and is developing in the context of the GATT and the WTO, other activities that have been carried out particularly in the context of the OECD and UNCTAD, where substantial work has been accomplished on the subject, as well as analyzing some of the contemporary issues concerning the scope of application of the clause, such as those arising in the *Maffezini* case.

(a) Catalogue of MFN provisions (Mr. D.M. McRae and Mr. A.R. Perera)

360. This paper provided a preliminary categorization of MFN clauses as they appear in various bilateral investment agreements (BITs) and free trade area agreements (FTAs). Rather than reproducing a catalogue of more than 3000 BITs and FTAs that had been

[1322] At its 2997th meeting, on 8 August 2008. (*Official Records of the General Assembly, Sixty third Session, Supplement No. 10* (A/63/10), para. 354). For the syllabus of the topic, see *ibid*., Annex B. The General Assembly, in paragraph 6 of its resolution 63/123 of 11 December 2008, took note of the decision.

[1323] At its 3029th meeting, on 31 July 2009, the Commission took note of the oral report of the Co Chairmen of the Study Group on The Most-Favoured-Nation clause (*ibid., Sixty fourth Session, Supplement No. 10* (A/64/10), paras. 211–216).

concluded, an analysis of trends reflecting MFN practice in select treaties and agreements was undertaken. It was considered that this typological approach could be more useful to the work of the Study Group. In this connection, the catalogue contained four broad categories, namely (a) a sampling of MFN provisions in BITs and FTAs giving general treatment; (b) MFN provisions in treaties that gave specific treatment; these were in turn sub-divided into provisions dealing with the post-establishment phase and the pre-establishment phase; (c) provisions of exceptions within the MFN provision; and (d) provisions of exceptions outside the specific MFN clause. This is an on-going exercise and the categorization may be subject to subsequent adjustments.

(b) The 1978 draft articles of the International Law Commission (Mr. S. Murase)

361. This paper reviewed, in a preliminary and non-exhaustive manner, the draft articles on MFN clauses adopted by the Commission in 1978, focusing on their contemporary utility, without making any suggestions for any concrete amendments. The working paper identified a number of relevant and closely interrelated factors of change bearing on the 1978 draft articles, which had occurred, including: (a) a shift in importance of MFN clauses from trade to investment; (b) the proliferation of bilateral investment treaties (BITs); (c) the strengthened multilateral framework of the WTO/GATT scheme for trade; (d) the failure of negotiations, conducted in 1995 through 1998, on a multilateral agreement on investment (MAI); (e) the development of regional integration, evidenced in EU, NAFTA and others regional frameworks; (f) the decline in enthusiasm for the New International Economic Order (NIEO); (g) closer cooperation among developing countries; and (h) the development of the dispute settlement mechanisms in the areas of trade and investment. Against this background of developments, the paper proceeded to examine the 1978 draft articles by clusters. Overall, it was concluded that some elements of the 1978 draft articles need to be re-examined, taking into account contemporary developments.[1324] It was suggested in the paper that the Commission, in collaboration with the Sixth Committee, should aim at drafting a new set of revised draft articles on MFN clauses in light of the review of the 1978 draft articles.

(c) MFN in the GATT and the WTO (Mr. D.M. McRae)

362. This paper provided an analysis of the way in which MFN had been interpreted and applied in the context of GATT and WTO agreements, focusing more on the practice in relation to WTO agreements and in particular the interpretation of those agreements through WTO dispute settlement.[1325] The general assessment was that in all the areas of the

[1324] The provisions included, *inter alia*, draft articles concerning: definitional rules (draft articles 1 to 6), the *ejusdem generis* rule (draft articles 7 to 8), compensation (draft articles 11 to 15), bilateral and multilateral agreements (draft article 17), special consideration for developing countries (draft articles 23 to 24 and 30). Moreover, the customs union exception which was not treated in the draft articles would have to be reconsidered. The draft articles on national treatment (draft articles 18 to 19), MFN rights (draft articles 20, para. 1; 21, para. 1) and domestic law (draft article 22) appeared to be self-evident propositions and served as reminders, which were relevant today. However, they were not worthy of in-depth discussion at this stage. Further, the other remaining draft articles (draft articles 27 to 29) were essentially without prejudice clauses, and did not appear to require special consideration at this stage.

[1325] WTO Appellate Body Report, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS246/AB/R (adopted 20 April 2004) [*EC – Tariff Preferences*]; *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R, WT/DS142/AB/R (adopted 19 June 2000) [*Canada – Autos*]; GATT Panel Report, *European Economic Community – Imports of Beef from Canada*, L/5099, adopted 10 March 1981, BISD 28S/92 [*EEC – Imports of Beef*]; GATT Panel Report, *United – Denial of Most-Favoured-Nation Treatment*

WTO agreements to which MFN applied — goods, services and intellectual property — MFN treatment had been treated as essential, fundamental, or as the cornerstone. It had been interpreted in a way as to give it maximum effect. This broad application appeared to draw no distinction between procedural and substantive benefits.[1326] It was also noted that there was nothing in the jurisprudence relating to MFN under GATT to suggest that procedural rights would be excluded from the application of MFN.[1327] Moreover, the application of MFN under the WTO seemed to be the same regardless of the different ways in which the principle had been formulated. The interpretation of MFN clauses under the WTO had been influenced more by a perception of the object and purpose of the provision, rather than by its precise wording.

363. At the same time, the scope of MFN was significantly curtailed by exceptions, both in general terms (e.g. those relating to customs unions and free trade areas) and, specifically (e.g. the carve-out in respect of trade in services that WTO Members were able to annex to GATS Article II). The breadth of such exceptions meant that the range of application of MFN could be in fact quite limited. As a result of the burgeoning of customs unions and FTAs, the majority of tariffs today were not applied on an MFN basis; they were applied under regional and other preferential GATT-exempt arrangements. The approach of the Appellate Body had been to interpret many of the exceptions narrowly.[1328] However, even with such a restrictive interpretation of individual applications of the exceptions, the substantive scope of the exceptions was far ranging and thus MFN under the WTO had more limited substantive application than the statement of the principle and its characterization as "fundamental" would suggest. The conclusions drawn were tentative; there was as yet insufficient jurisprudence on the interpretation of the MFN provisions under the WTO to be too definitive.

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as to Non-Rubber Footwear from Brazil, DS18/R, adopted 19 June 1992, BSD 39S/128 [*US – MFN Footwear*]; GATT Panel Report*, Spain – Tariff Treatment of Unroasted Coffee*, L/5135, adopted 11 June 1981, BISD 28S/102 [*Spain – Unroasted Coffee*]; WTO Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R (adopted 25 September 1997) [*EC – Bananas*]; WTO Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products*, WT/DS34/AB/R (adopted 19 November 1999) [*Turkey – Textiles*]; WTO Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R (adopted 6 November 1998*)* [*US – Shrimp*]; WTO Appellate Body Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/AB/R (adopted 24 March 2006) [*Mexico – Soft Drinks*]; WTO Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R (adopted 1 November 1996) [*Japan – Alcohol*]; WTO Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R (adopted 5 April 2001) [*EC – Asbestos*]; GATT Panel Report, *Belgian Family Allowances*, G/32, adopted 7 November 1952, BISD 1S/59 [*Belgium – Family Allowances*]; WTO Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R (adopted 23 July 1998) [*Indonesia – Autos*]; WTO Panel Reports, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/R/ECU, WT/DS27/R/MEX and WT/DS27/R/USA (circulated 22 May 1997); WTO Appellate Body Report, *United States – Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R (adopted 2 January 2002) [*US – Section 211*].

1326 GATT Panel Report, *United States Section 337 of the Tariff Act of 1930*, L/6439, adopted November 1989, BISD 36S/345.

1327 Arguably, in the case of TRIPS this might be seen to flow from the broad meaning given to the term "protection" under TRIPS Article 3 and 4.

1328 As the case in GATT Article XXIV in *Turkey – Textiles*, and to the chapeau to GATT Article XX, in *US – Shrimp* (see above, note 1325).

(d) The Work of OECD on MFN (Mr. M. Hmoud)

364. This paper considered and reviewed the substantial work that has been carried out within the OECD, drawing attention in particular to several instruments that had been negotiated in order to achieve the goals of the OECD, including the liberalization of capital movements and the free movement of goods.[1329] It also considered negotiations on the draft Multilateral agreement on investment (MAI) and issues raised therein, including the MFN clause whose scope covered the pre-establishment and post-establishment phases of investment, the work of the OECD on the terms "In like circumstances" and on issues such as the scope of the MFN treatment in relation to privatisation, intellectual property, investment incentives, monopolies and state enterprises, investment protection, and exceptions (general and specific) to MFN provision. It was noted that the work done by the OECD could offer useful guidance for the Study Group in its work.

(e) The Work of UNCTAD on MFN (Mr. S.C. Vasciannie)

365. This paper examined two substantial publications of UNCTAD,[1330] and considered other aspects of its work in collecting and analyzing State practice on the MFN standard in investment agreements. In particular, the paper discussed issues concerning the scope and definition of the MFN standard, the role of the MFN standard in protecting investors, different ways in which the standard has been formulated in various agreements and exceptions to the standard, including the provisions on regional economic integration organizations (REIOs), the reciprocity requirements and intellectual property considerations. It also identified certain issues concerning the MFN standard that had not been fully explored by UNCTAD, noting that some of these issues, including the status of the MFN standard in customary international law, the legal interpretation of different formulations of the standard and the relationship between treaty provisions and municipal law practice could be further considered. In reviewing the UNCTAD papers reference was also made to various policy questions such as the "free rider" and identity issues, pre-entry and post-entry clauses and the relationship between the MFN treatment standard and other standards of investment protection.

(f) The Maffezini *problem under investment treaties* (Mr. A.R. Perera)

366. This paper reviewed the development relating to the broad interpretation given by arbitral tribunals to the MFN clause in investment agreements, in a series of decisions relating to investment disputes starting with the *Maffezini* case. The principal problem arising out of the case was the question whether it could be determined with any certainty, what obligations a contracting party had undertaken when including the MFN clause within an investment treaty and in particular the relationship of the MFN clause to provisions relating to dispute settlement. A related question was whether substantive rights and protection standards contained in a treaty with a third State, which were more beneficial to an investor, could be relied upon by such an investor to his advantage, by virtue of the MFN clause.[1331]

[1329] The Code of Liberalisation of Capital Movements, covering direct investment and establishment, the OECD Code of Liberalisation of Invisible Operations concerning services; work on the draft Multilateral Agreement on Investment (1995–1998), as well as a series of published working papers related to international investments.

[1330] The UNCTAD Series on Issues in International Investment Agreements ("Issue Papers"); and the UNCTAD Follow-up Series on International Investment Policies for Development ("Follow-up Papers").

[1331] Cases following a cautious approach include, for example, *Tecmed v. Mexico* (Award), ICSID Case No. ARB/(AF)/00/2, 29 May 2003. See also *Salini* and *Plama* arbitrations; *CMS Gas Transmission*

367. The analysis of arbitral awards dealt with two types of claims where the MFN clause in the basic treaty was sought to be invoked to expand the scope of the dispute settlement provisions of such treaty, namely (a) to override the applicability of a provision requiring the submission of a dispute to a domestic court for a "waiting period" of 18 months, prior to submission to international arbitration; and (b) to broaden the jurisdictional scope in the basic treaty that restricted the ambit of the dispute settlement clause to a specific category of disputes, such as disputes relating to compensation for expropriation.[1332]

368. Following a review of recent arbitral practice, including *Maffezini* and subsequent developments, the paper stated that one of the important conclusions was that the particular form in which a MFN clause was drafted in a particular agreement mattered and depending on the wording of the applicable clause, a dispute could lead to different outcomes, giving rise to the need for legal certainty. Accordingly, some guidelines could assist States to determine with some degree of certainty whether they were granting broad rights or whether the rights they were granting were more circumscribed when they include an MFN clause in an investment treaty. Another underlying issue which arose from these decisions was the difficulty which surrounded any attempt to ascertain the intention of the parties. Although the criteria identified by the tribunals were helpful, there were still left open crucial issues which required discussion in determining possible guidelines on the scope of application of the MFN clause, whether in relation to existing treaties or future treaties.

2. Consideration of future work of the Study Group

369. The Study Group held wide-ranging discussions, on the basis of the papers before it, as well as developments elsewhere including within the context of MERCOSUR. Its central focus is on the issue of how MFN clauses are being interpreted, particularly in the context of investment relations and whether some common underlying guidelines could be

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Company v. Argentina, ICSID Case No. ARB 701/08, Award of 25 April 2005. Cases reflecting a liberal approach importing substantive protection standards, see for example *Siemens* arbitration; *MTD Equity Bhd v. Chile* (Award), ICSID Case ARB/01/7, 25 May 2004; *Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Decision on Jurisdiction, 14 November 2005. For treaty practice reacting to the liberal interpretation, the formulations in *the Chile-Columbia FTA of 27 November 2006* and the *Maffezini Note* in the *Draft Free Trade Agreement of the Americas*, FTAB.TRC/w/133/Rev.3, 21 November, 2003.

[1332] *Emilio Agustín Maffezini v. Kingdom of Spain* (Decision of the Tribunal on Objections to Jurisdiction), ICSID Case No. ARB 97/7, 25 January 2000. (2002) 5 ICSID Rep. p. 396. For cases following the reasoning in *Maffezini* and its implications, see for example: *Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic* (Decision on Jurisdiction), ICSID Case No. ARB/03/17, 16 May 2006*; Siemens A.G. v. The Argentine Republic* (Decision on Jurisdiction), ICSID Case No. ARB/02/8, 3 August 2004; *Gas Natural SDG, S.A. v. The Argentine Republic* (Decision of the Tribunal on Preliminary Questions of Jurisdiction), ICSID Case No. ARB/03/10, 17 June 2005; *RosInvestCo UK Ltd. v. The Russian Federation* (Award on Jurisdiction), Arbitration Institute of the Stockholm Chamber of Commerce, October, 2007. For cases contrary to the *Maffezini* reasoning and their implications, see for example: *Salini Costruttori S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan* (Decision on Jurisdiction), ICSID Case No. ARB/02/13, 29 November 2004; *Plama Consortium Limited v. Republic of Bulgaria* (Decision on Jurisdiction), ICSID Case No. ARB/03/24, 8 February, 2005; *Vladimir Berschader and Moise Berschader v. The Russian Federation*, Arbitration Institute of the Stockholm Chamber of Commerce, Case No. 080/2005, Award of 21 April 2006; *Telenor Mobile Communications A.S. v. The Republic of Hungary* (Award), ICSID Case No. ARB/04/15, 13 September 2006. See also *Tza Yup Shum v. The Republic of Peru* (Decision on Jurisdiction and Competence), ICSID Case No. ARB/07/06, 19 June 2009; *Renta 4 S.V.S.A. et al v. The Russian Federation*, Arbitration Institute of the Stockholm Chamber of Commerce, Case No. 079/2005, Award of October 2007.

formulated to serve as interpretative tools or in order to assure some certainty and stability in the field of investment law. The general sense of the Group was that it was premature at this stage to consider the option of preparing draft articles or a revision of the 1978 draft articles.

370. It was also considered that the Group could study further issues concerning the relation between trade in services and in intellectual property, in the context of MFN in the GATT and WTO and its covered agreement, and investment, which remains the focus of the Study Group.

371. Moreover, it was found necessary to identify further the normative content of the MFN clauses in investment, and to undertake a further analysis of the case law, including the role of arbitrators, factors that explain different approaches to interpreting MFN provisions, the divergences, and the steps taken by States in response to the case law. More specifically, it was felt that there should be a systematic attempt to identify areas of conflict and determine whether general patterns could be distilled from the way in which the case law has proceeded in making determinations in respect of MFN-based jurisdiction questions.

372. It was thought necessary to review the types of MFN clauses that have been applied, the types of questions that have been the subject of determination in respect of the MFN clause, as well as to examine the outcomes in the arbitral awards, in light of the rules of treaty interpretation in the Vienna Convention on the Law of Treaties. It was considered that the Study Group had a role to play in contributing to the interpretation of treaties, in particular focusing on the Vienna Convention on the Law of Treaties, as well as in respect of future developments in this field.

373. Against the background work already carried out, further work will be undertaken under the responsibility of the Co-Chairmen of the Study Group to address the issues highlighted above and to put together an overall report, including a framework of questions to be addressed, for consideration of the Study Group next year.