The Boundaries of Most-Favoured Nation Treatment in International Investment Law

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1. Introduction

Contemporary international investment law is characterized by fragmentation.[2] Disputes are heard by a diversity of tribunals, often constituted solely for the purpose of hearing a single claim.[3] The law applicable in a dispute is usually found in a bilateral agreement applicable only between the two States connected to the dispute, rather than in a multilateral treaty or customary international law.[4] Moreover, the international investment community itself is profoundly divided on many issues of substantive law, meaning both that the interpretation given to international investment law by a tribunal will be determined largely by who sits on it, and that even the most authoritative texts are recognized as representing only the author's own views, rather than constituting a clarifying statement of the law as it actually stands.[5]

Given this context of fragmentation, it is perhaps unsurprising that States negotiating investment treaties have consistently incorporated one of the traditional means of bringing

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[2] *See generally* Anne Von Aaken, "Fragmentation of International Law: The Case of International Investment Protection", 17 Finnish Y.B. of Int'l L. 91 (2008). On the issue of fragmentation in international law more generally, see particularly the contributions to the symposium "Diversity or Cacophony? New Sources of Norms in International Law?", 25 Mich. J. Int'l L. 845 (2004).

[3] *See* generally Ruth Teitel & Robert Howse, "Cross-Judging: Tribunalization in a Fragmented but Interconnected Global Order", 41 N.Y.U. J. Int'l L. & Pol. 959, 977-81 (2009); Frank Spoorenberg, "Conflicting Decisions in International Arbitration", 8 L. & Prac. of Int'l Cts & Tribunals 91 (2009).

[4] *See, e.g.* The International Centre for Settlement of Investment Disputes, "The ICSID Caseload – Statistics", Issue 2010-1 (2010) (noting that multilateral treaties have served as the basis for only 11% of all cases brought to ICSID).

[5] For example, in the recent OGEMID "Of the Year" Awards, a survey of international investment arbitration specialists, 4 of the 6 decisions nominated for "Arbitration Decision of the Year" were also nominated for "Most

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uniformity to international obligations, the Most-Favoured Nation ("MFN") clause.[6] An MFN clause in an investment treaty is fundamentally a promise between the two States party to the treaty that neither State will give to investors[7] from any third State more favorable treatment than that given to investors from the other State party to the treaty.[8] If more favorable treatment is provided to investors from a third State an obligation arises to provide equivalent treatment to those investors benefitting from the MFN clause.[9]

While MFN clauses in investment treaties do not directly limit the fragmentation of international investment law, they can serve to harmonize the law under which foreign investors from different States operate.[10] Absent MFN clauses, States will compete with one another to ensure that their investors receive the most favorable treatment given by a particular State,

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Surprising or Controversial Arbitration Decision of the Year". Similarly, in 2008, the same decision won both categories.

[6] Marie-France Houde, "Most-Favoured-Nation Treatment in International Investment Law", in Organisation for Economic Co-operation and Development, International Investment Law: A Changing Landscape (2005), at 129 ("MFN treatment has been a central pillar of trade policy for centuries."); Georg Schwarzenberger, "The Most-Favoured Nation Standard in British State Practice", 22 Brit. Y.B. Int'l L. 96, 97 (1945) ("The m.f.n. standard forms one of the basic standards of international law, and it is not surprising that it can be traced back to the dawn of international law."); Jacob Viner, "The Most-Favored-Nation Clause in American Commercial Treaties", 32 J. Pol. Econ. 101, 101 (1924) (describing the use of MFN clauses as "a common practice of most nations since the beginning of the seventeenth century"); Stanley Hornbeck, "The Most-Favored-Nation Clause", 3 Am. J. Int'l L. 395, 395 (1909) (describing the MFN clause as the "corner-stone of all modern commercial treaties.").

[7] An MFN clause in an investment treaty may refer to "investors". However, it may refer instead to "investments", or even to both "investors" and "investments". For purposes of simplicity, this Article will refer simply to "investors" unless the difference between "investors" and "investments" is important to the analysis.

[8] Stephen Fietta, "Most Favoured Nation Treatment and Dispute Resolution Under Bilateral Investment Treaties: A Turning Point?". 8 Int'l Arb. Rev. 131, 132 ("Such provisions require each contracting state to accord to investors of the other contracting state treatment that is no less favourable than that accorded to the investors of third states."). *See also* Stephen D. Sutton, "Emilo Augustin Maffezini v. Kingdom of Spain and the ICSID Secretary-General's Screening Power", 21 Arb. Int'l 113, 119 (2005) ("The principles that apply are that any basic treaty containing the clause could attract provisions of another treaty signed by one of the parties containing elements that are more favourable to the beneficiary.") (quoting prominent international investment arbitrator Francisco Orrego Vicuna); Schwarzenberger, *supra* n. 6, at 96 ("Used in its technical sense, the m.f.n. standard may be defined as treatment on a footing not inferior to that of the most favoured third State.").

[9] Stephan Schill, "Multilateralizing Investment Treaties Through Most-Favoured Nation Clauses", 27 Berkeley J. Int'l L. 496, 502 (2009) ("MFN clauses oblige the State granting MFN treatment to extend to the beneficiary State the treatment accorded to third States in case this treatment is more favourable than the treatment under the treaty between the granting State and the beneficiary State.").

[10] Bryan Coutain, "The Unconditional Most-Favored-Nation Clause and the Maintenance of the Liberal Trade Regime in the Postwar 1870's", 63 Int'l Org. 139, 146 (2009) ("[A] bilateral treaty is to a certain extent converted into a multilateral treaty by the unconditional most-favored-nation principle.") (quotation marks omitted); Houde,

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thereby generating a diversity of legal regimes. MFN clauses, by contrast, ensure that whenever benefits are given to investors from one State, they must also be provided to investors from any other State with an applicable MFN clause, thereby ensuring equality of treatment.[11]

Nonetheless, while MFN clauses are potentially a means of reducing the level of fragmentation in international investment law, they carry a significant risk of over-interpretation.[12] MFN clauses are often described as being primarily a means of eliminating discrimination within a given market.[13] However defensible such a description is in general terms, however, a teleological interpretation of this type risks allowing the goal of market equalization to override the operation of the MFN clause itself.[14] That is, it encourages tribunals

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supra n. 6, at 129 (describing the MFN clause as "the multilateralisation instrument par excellence of the benefits accorded to foreign investors and their investments") (quotation marks and italics omitted).

[11] It has occasionally been argued that equality of commercial treatment is a basic principal of international law, and so does not need to be gained via a treaty clause. *See e.g.* William S. Culbertson, "Most-Favored-Nation Treatment", 31 Proc. Am. Soc. Int'l L. 73, 74 (1937) ("In making the representations which I did as a diplomatic representative of the United States I took the position that…equality of commercial treatment, as it is applied in the most-favored-nation principle…is a right of international common law and that a government has the obligation to grant that equality of treatment".); A. Mertens, "A Defense of the Most-Favored-Nation Clause", 156 Annals Am. Acad. Pol. & Soc. Sci. 107, 109 (1931) ("Most-favored-nation treatment is not only a condition of economic equilibrium; it is more and more coming to be identified with the regime of rights."). However, while a useful political stance, this view is ultimately inconsistent with international legal practice. Houde, *supra* n. 6, at 129 ("While MFN is a standard of treatment which has been linked by some to the principle of the equality of States, the prevailing view is that a MFN obligation exists only when a treaty clause creates it."); UNCTAD, "Most-Favored-Nation Treatment", UNCTAD/ITE/IIT/10 (Vol. III) (1999), at 2 (noting that "MFN is generally more than the minimum standard required under customary international law"); Schwarzenberger, *supra* n. 6, at103 ("[T]hough widely recognized in treaties by which States grant to each other reciprocal freedom of commerce, it cannot be admitted that that principle has as yet developed into a rule of customary international law.") (footnotes omitted).

[12] Elizabeth Whitsitt, "Application of Most-Favoured-Nation Clauses to the Dispute Settlement Provisions of Bilateral Investment Treaties: An Assessment of the Jurisprudence", 27 J. Energy & Nat. Resources L. 527, 530 (2009) ("Thus, if MFN clauses are viewed as having the primary objective of promoting non-discrimination and harmonisation, then an adjudicator may considert hat the very purpose of the clause is to permit, indeed encourage, a comparison to other BITs to ensure that the most favourable rights, including procedural rights, are available.").

[13] *See, e.g.* Stephan W. Schill, "Most-Favored-Nation Clauses as a Basis of Jurisdiction in Investment Treaty Arbitration: Arbitral Jurisprudence at a Crossroads", 10 J. World Invest. & Trade 189, 210 (2009) ("the rationale of MFN clauses consists in creating a level playing field for foreign investors independent of their nationality"); Coutain, *supra* n. 10, at 146 ("The MFN clause was devised to reduce uncertainty by automatically preventing discrimination against treaty-powers and repetitive treaty renegotiations every time conditions are altered by a new commercial treaty.") (quotation marks omitted); UNCTAD, *supra* n. 11, at 4 ("In other words, the MFN standard seeks to prevent discrimination against investors from foreign countries on grounds of their nationality."); Hornbeck, *supra* n. 6, at 398 ("The object sought is uniform treatment without discrimination.").

[14] Moreover, portraying MFN clauses as a mechanism for eliminating discrimination ignores the fact that an MFN clause does not prevent discrimination *in favour* of the beneficiary of the clause, just against it. *See, e.g.* Schwarzenberger, *supra* n. 6, at 96 ("M.f.n. treatment does not exclude the grant by the promisor of additional

to lay aside technical arguments as to the operation of the clause, and simply interpret it in the way that will most effectively eliminate market discrimination. Indeed, this effect can already be seen in the discussions of MFN clauses given by some investment arbitration tribunals and commentators.[15]

The goal of this Article is to reduce the dangers inherent in such teleological interpretations by clarifying certain boundaries to the operation of MFN clauses in international investment law.[16] Of course, although MFN clauses are a common feature of international investment agreements,[17] the language in which they are expressed can differ significantly, and such differences will affect their operation.[18] Nonetheless, while attention must ultimately be paid to the specific language adopted in each clause, this does not entail that nothing can be said

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advantages beyond those conceded to the most favoured third Stated. M.f.n. treatment is compatible with preferential treatment of the beneficiary by the promisor.").

[15] *See, e.g.* Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, Decision on Jurisdiction, August 3, 2004 (allowing the claimant access to the more favourable aspects of a dispute resolution clause in a third State treaty, but excluding the less favourable aspects of that clause, on the ground that MFN clauses relate only to more favourable treatment).; Emilio Agustin Maffezini v The Kingdom of Spain, Award on the Merits, ICSID Case No. ARB/97/7, at ¶ 54. (Nov. 13, 2000) (holding that MFN clauses apply to dispute resolution procedures on the ground that [i]International arbitration and other dispute settlement arrangements...are essential...to the protection of the rights envisaged under the pertinent treaties"); Schill, *supra* n.9, at 568-9 ("MFN clauses therefore form part of the ongoing process of multilateralizing international investment relations and constitute one of the explicit normative bases of this development.").

[16] It is, of course, not being maintained that no previous work has been done on the operation of MFN clauses in international investment law. However, such work as has been done has been focused upon specific issues relating to MFN clauses, rather than addressing the operation of MFN clauses themselves. *See, e.g* Schill, supra n. 13; Alejandro Faya Rodriguez, "The Most-Favored-Nation Clause in International Investment Agreements: A Tool for Treaty Shopping", 25 J. Int'l Arb. 89 (2008); Mara Valenti, "The Most Favored Nation Clause in BITs as a Basis for Jurisdiction in Foreign Investor-Host State Arbitration", 24 Arb. Int'l 447 (2008); Scott Vesel, Clearing a Path Through a Tangled Jurisprudence: Most-Favored-Nation Clauses and Dispute Settlement Provisions in Bilateral Investment Treaties, 32 Yale J. Int'l L. 125 (2007); Ruth Teitelbaum, Who's Afraid of Maffezini? Recent Developments in the Interpretation of Most Favored Nation Clauses, 22 J. Int'l Arb. 225 (2005).

[17] Fietta, *supra* n. 8, at 131 ("The vast majority of [Bilateral Investment Treaties] in force around the world today contain some form of MFN provision."; UNCTAD, *supra* n. 11, at 39 (noting that MFN "is a core principle in international investment agreements").

[18] Nils Eliasson, "Invest-State Arbitration and Chinese Investors: Recent Developments in Light of the Decision on Jurisdiction in the Case of Mr. Tza Yap Shum v. The Republic of Peru", 2 Contemp. Asia Arb. J. 347, 361 (2009). *See also* Schwarzenberger, *supra* n. 6, at 103 ("It is well to keep in mind the warning voiced by Judge Anzilotti, and more recently by Sir Arnold McNair, that speaking strictly, there is no such thing as *the* most-favoured-nation clause: every treaty requires independent examination.") (footnotes and quotation marks omitted); Houde, *supra* n. 6, at 158 ("The proper application and interpretation of a particular MFN clause in a particular case requires a careful examination of the test of that provision undertaken in accordance with the treaty interpretation rules as set out in the Vienna Convention.").

regarding the operation of such clauses generally.[19] Rather, it simply means that any limitations described here can be eliminated or varied by States through the language they choose for their specific MFN clause.

Part 2 of this Article will discuss the historical development of MFN clauses in international agreements, in order to provide the background against which the current use of MFN clauses in international investment agreements should be understood. Part 3 then concludes the historical discussion by examining the place that MFN clauses have achieved in contemporary international investment law.

Part 4 then begins the analysis of MFN clauses themselves by discussing the limits to the operation of MFN clauses that have already been recognized by non-investment international tribunals. The limitations discussed in this Section are important to investment law not only because they have been expressly adopted by a series of investment arbitration tribunals, but because the operation of MFN clauses in international investment law is ultimately merely a specialized development of the operation of such clauses in international law more generally.[20] Consequently, although these limits were not originally recognized in the international

[19] As noted by one early commentator, "the parties concerned should clearly express their intention; but it might happen, and indeed it would often happen, that they did not do so. Provision must be made in international law, as in municipal law, for cases in which there was no stipulation in the text, and for cases in which the text was not clear and precise." Quincy Wright, "The Most-Favored-Nation Clause", 21 Am. J. Int'l L. 760, 762 (1927). *See also* Schwarzenberger, *supra* n. 6, at 104 ("Though there is no such thing as *the* m.f.n. clause, it is equally necessary to emphasize that there is such a thing as *the* m.f.n. standard."); UNCTAD, *supra* n. 11, at 6 ("There is no evidence that, by using different wording, the parties to these various agreements intended to give the MFN clauses a different scope. Whatever the specific terminology used, it does not change the basic thrust of MFN".); Zachary Douglas, "The MFN Clause in Investment Arbitration: Treaty Interpretation off the Rails", 2 J. Int'l Disp. Settlement 1, 3 (2011) ("'MFN' is a term of art in international law and treaty obligations employing this term of art have an ancient pedigree. When state parties enter into modern investment treaties with an MFN clause, they surely do not intend to relegate the received wisdom on the nature, scope and effect of such clauses to the dustbin of history.").

[20] On the relationship between international investment law and public international law, see generally the essays in Stephan W. Schill, International Investment Law and Public International Law (2010), as well as the report by the International Law Association's German Branch Sub-Committee on Investment Law, General Public International Law and International Investment Law: A Research Sketch on Selected Issues (2009).

investment law context, they are nonetheless applicable to MFN clauses in international investment agreements.

Part 5 of the Article will then present the original analysis of MFN clauses offered by this article, explaining certain limitations that must be recognized to the operation of MFN clauses in international investment law. These boundaries will be identified as (i) the general inapplicability of such clauses to treaty provisions already in place when the MFN clause was adopted, (ii) the need to evaluate the alleged "favorability" of treatment by referring to the broad class of investors from the Home State,[21] rather than the particular investor invoking the MFN clause, and (iii) the ability of an MFN clause to deprive an investor of access to the terms of the Basic Treaty.[22]

2. Historical Development of MFN Treatment

Study of the historical development of MFN clauses in international agreements is of more than academic interest for any attempt to clarify the boundaries within which such clauses must operate. Proponents of the non-discrimination interpretation of MFN clauses, after all, routinely cite to this history as evidence of the over-riding anti-discrimination purpose of MFN clauses.[23] As will be shown below, however, a close examination of this history reveals a very different use of MFN clauses by States, in which MFN clauses are used tactically as a means of gaining advantage over competitors, rather than due to any idealistic commitment to non-discrimination. Consequently, while a correct understanding of the historical development of MFN clauses cannot of itself demonstrate that the non-discrimination interpretation of

[21] "Home State" will be used in the present Article to refer to the State from of which a foreign investor has nationality.
[22] "Basic Treaty" will be used in the present Article to refer to the treaty containing the MFN clause.

contemporary MFN clauses is incorrect, it does serve to remove a convenient justification for adoption of this approach. Moreover, an awareness of the varied purposes a State can have in adopting an MFN clause underlines clearly the need to attend to the specific details regarding each MFN clause, rather than relying for interpretative purposes on some pre-decided teleological conclusion.

Although MFN clauses have come to particular prominence in the economic sphere, nothing about their operation restricts them to economic matters, and indeed their original genesis appears to have been in a far broader socio-political context. While the precise origin of the MFN clause is still contested, one commentator has traced its use back as far as the early Holy Roman Empire,[24] while others cite its development as occurring sometime in the medieval period.[25] Realistically, however, as an MFN clause fundamentally constitutes just a promise from one State to another that no third State will receive better treatment in some specific substantive field, no conclusive "birthdate" is likely to be ascertainable. Such promises have, after all, likely been made for as long as States have entered into agreements with one another.

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[23] *See, e.g.* Schill, *supra* n. 9, at 512 (arguing that the adoption of the MFN clause "was closely connected to the free trade movement in the Nineteenth and early Twentieth Centuries").

[24] Schwarzenberger, *supra* n. 6, at 97 (referring to "Imperial grants of customs privileges to cities within the Holy Roman Empire on the basis of favours obtained 'by whatsoever other town'"). *See also* Eugene J. Conroy, "The American Interpretation of the Most Favored Nation Clause", 12 Cornell L. Q. 327, 329 (1926) ("There had been occasional crude quasi-most favored nation clauses in antiquity, and a few among the commercial cities of the Mediterranean during the Middle Ages, but the clause did not come into any sort of regular use until the seventeenth century, with the rise of the mercantile system, and the bitter competition for trade and colonies that it brought in.").

[25] *See, e.g.* Houde, *supra* n. 6, at 129 ("It can be traced back to the twelfth century, although the phrase seems to have first appeared in the seventeenth century."); UNCTAD, *supra* n. 11, at 14 ("The first example of an MFN clause was when King Henry V of England signed a treaty (Treaty for Mercantile Intercourse with Flanders on 17 August 1417) with Duke John of Burgundy in Amiens, according to which English vessels were granted the right to use the harbours of Flanders 'in the same way as French, Dutch, Sealanders and Scots."); Schwarzenberger, *supra* n. 6, at 97 ("[T]he principles of m.f.n. and national treatment make their first appearance in international law proper in the commercial treaties concluded during the twelfth century between England and the Continental powers and cities."); Stanley Hornbeck, *supra* n. 6, at 398 (arguing that the use of MFN clauses can be traced to as early as 1226, when Emperor Frederick II of the Holy Roman Empire signed a treaty granting concessions to the citizens of Marseille that had previously only been available to citizens of Pisa and Genoa).

Nonetheless, whatever the origins of the MFN clause, it was unquestionably with the rise of international commerce that they gained their importance for international law.[26] While the expression "most-favoured nation" only became common in the 17th Century, the rise of international commerce in the late medieval period saw States adopting MFN clauses as a means of ensuring that their traders would compete in foreign markets on at least equal terms with traders from third States.[27]

What is important for present purposes, however, is not the long history of the MFN clause, but the limited form taken by early instances of the clause. While contemporary MFN clauses are generally recognized as being applicable to any benefit granted within a specified substantive area, including those granted after the MFN clause comes into effect,[28] early MFN clauses referenced specific benefits already being received by specific third parties, and constituted solely an agreement to extend those specific privileges to the beneficiary of the MFN clause.[29] That is, MFN clauses were initially not generalized promises that no third State would at any time be treated more favorably than the beneficiary of the MFN clause. They were, rather, grants to the beneficiary of the MFN clause of specific benefits already received by specific third States.

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[26] Indeed, according to one commentator, by the 19th century use of the MFN clause was central enough to the international commerce that it can be viewed as having had a primary role in "the maintenance of a liberal world economy in the turbulent 1870's." Coutain, *supra* n. 10, at 139.
[27] John M. Kline and Rodney D. Ludema, "Building a multilateral framework for investment: comparing the development of trade and investment accords", 6 Transnational Corporations 1, 6 (1997) ("The term 'most favoured nation' appears to have originated with the 1692 treaty between Denmark and the Hanse cities."); Hornbeck, *supra* n. 6, at 395 ("The phrase 'most-favoured-nation' first appeared in commercial treaties toward the close of the seventeenth century.").
[28] Committee of Experts for the Progressive Codification of International Law, "The Most-Favoured-Nation Clause, 22 Am. J. Int'l L. 133, 134 (1928) ("[T]he provision known as the most-favoured-nation clause was devised to ensure to the contracting States not only the benefit of concessions previously made but also those subsequently to be made by either of the contracting States." (quoting William Smith Culbertson, International Economic Policies).
[29] Hornbeck, *supra* n. 6, at 399-400 ("In the beginning, this extension of favors was made but to one or two specified states…The next step was to extend the advantages to include such favors as should be granted to certain other specified nations; then to include advantages granted to any nation whatsoever.").

Early MFN clauses, that is, were "unilateral", "specific" and "retrospective". Rather than constituting an agreement by both States that each would provide MFN treatment to the other, they were instead an agreement by one State alone to extend MFN treatment to the other (i.e., they were "unilateral"). Moreover, they were not a generalized promise that no third State would receive better treatment than that given to the State benefitting from the MFN clause. Rather, they identified specific benefits that were already being provided to a third State, and constituted an undertaking that these same benefits would also be provided to the State benefitting from the MFN clause (i.e., they were "specific"). Finally, because they applied only to the specific benefits identified in the clause, they applied solely to treatment already being given to one or more third States. They did not, that is, require the State offering MFN treatment to maintain the equality of the State benefitting from the MFN clause by also extending to it any benefits granted to third States in the future (i.e., they were "retrospective").

Early MFN clauses, then, did not reflect any form of principled commitment to equality of treatment, or impose serious constraints upon the freedom of a State to control its economic policies. Instead, they served solely as a mechanism for a sufficiently important trading partner to secure from a State benefits that were currently being received by major competitors. The State granting MFN treatment, however, remained completely free to provide more favorable treatment to States not mentioned in the clause, and also to provide additional benefits to the named States in the future. MFN clauses at this time, then, were used only as a means of expansive drafting in a context of limited information, ensuring that the beneficiary State received *all* benefits currently received by its major competitors, rather than only those of which it was at that time aware.

However, a significant change occurred to the structure of MFN clauses in the 17th and 18th Centuries, by which time the growth in global trade and commerce had resulted in their becoming a standard feature of international economic agreements.[30] While, as just described. earlier MFN clauses had been unilateral, creating benefits for only one of the parties to the agreement, they began at this time to be predominantly "bilateral" in operation, creating benefits for both States concerned.[31] In addition, they were now also usually both "general" and "prospective", applying to any benefit given to any third State within a particular substantive field,[32] usually tariffs, and to both already-existing benefits and those given in the future.[33]

Nonetheless, while States were now using MFN clauses as a generalized means of ensuring that their traders were not discriminated against in particular markets, it is important to emphasize that it nonetheless remains inaccurate to describe MFN clauses of this time as reflecting an attempt by States to eliminate market discrimination. MFN clauses were, after all, even at the height of "free trade" fervor in the mid-19th Century, used tactically by States. They were incorporated into agreements when doing so would provide benefits, and excluded when it would not.[34]

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[30] Houde, *supra* n. 6, at 129 ("MFN treaty clauses spread with the growth of commerce in the fifteenth and sixteenth centuries."); Hornbeck, *supra* n. 6, at 401 ("During the nineteenth century, the use of the clause increased and became so common, in one or another of its various forms, that its appearance came to be looked upon almost as a matter of course.");
[31] Conroy, *supra* n. 24, at 330 ("[T]he unilateral clause is exceptional, and its presence indicates a position of hopeless inferiority in the promisor nation.").
[32] Schwarzenberger, *supra* n. 6, at 97 ("The privileges granted to the beneficiary are no longer necessarily defined with reference to one or several specifically named countries"); UNCTAD, *supra* n. 11, at 13 ("It was only in the seventeenth century that the point of reference for MFN was no longer a limited number of named countries, but any third state.").
[33] Committee of Experts for the Progressive Codification of International Law, *supra* n. 28, at 134 ("[T]he provision known as the most-favoured-nation clause was devised to ensure to the contracting States not only the benefit of concessions previously made but also those subsequently to be made by either of the contracting States." (quoting William Smith Culbertson, International Economic Policies).
[34] Robert Pahre, "Most-Favored-Nation Clauses and Clustered Negotiations", 55 Int'l Org. 859, 873 (2001) (noting that "MFN must be understood as a regime norm chosen for political reasons independent of the tariff bargaining problem.").

This tactical use of MFN clauses became most explicit in the treaty-making activities of the United States in the 19th Century.[35] On its emergence into international commerce in the late 18th Century, the United States had found itself in an international market heavily geared against it.[36] As a producer of largely agricultural products, it relied on agricultural exports in order to generate the income necessary to pay for the importation of manufactured products from Europe.[37] However, European nations had erected large tariff barriers against the importation of agricultural products, and unless the United States could negotiate lower tariffs, its products could not compete in European markets.[38] Negotiating lower tariffs was certainly possible, but if the United States agreed to include MFN clauses in its treaties, as had become standard by that time, each negotiated reduction would automatically be transferred to every other nation with which the United States had an MFN clause.[39] In effect, the United States would gain tariff reductions from just one country, while giving them away freely to every other European State.

The solution adopted by the United States was what came to be known as the "conditional" MFN clause.[40] Prior practice regarding MFN clauses had established that as soon

[35] Tactical use of MFN clauses can, of course, also be seen in later periods and in the treaty practice of other States. Moreover, MFN clauses have at times even been used as a tactical tool for exerting purely political pressure, rather than merely gaining economic advantage. *See, e.g.*, Theodore C. Sorensen, "Most-Favored-Nation and Less Favorite Nations", 52 Foreign Aff. 273, 273 (1974) (discussing a bill proposed to the U.S. Congress that would "deny to any 'nonmarket economy country' eligibility for most-favored-nation tariff treatment…during any period in which that country denies to its citizens the right or opportunity to emigrate, specifically by imposing more than a nominal tax or other charge.").

[36] Conroy, *supra* n. 24, at 337-38 ("The introduction and rose of the conditional form of the clause was due to…an attempt by the United States to break down the impossible tariffs and ironclad monopolies which the mercantile system, then at its height, had established in Europe.").

[37] *Id.* at 339.

[38] *Id.* at 339.

[39] That the United States' approach to the MFN clause arose from an American concern with control over its negotiating positions, rather than a protectionist opposition to low tariffs, is indicated by the fact that even while insisting on the use of conditional MFN clauses, the U.S. was quite liberal in its voluntary reductions in tariffs. Carl Kreider, "Book Review: The Most-Favored-Nation Clause", 39 Am. Econ. Rev. 1039, 1041 (1949).

[40] The earliest known conditional MFN clause appeared in a treaty concluded between the United States and France in 1778. Richard Snyder, "The MFN Clause and Recent Trade Practices", 55 Poli. Sci. Quart. 77, 80 (1940); Viner, *supra* n. 6, at 101. *See also* Richard Pomfret, The Economics of Regional Trading Arrangements 18 (2003) ("From its first commercial treaty, with France in 1778, until 1923 the USA maintained that MFN pledges must be interpreted as conditional, even when the precise wording of a treaty was unclear.").

as more favorable treatment was provided to any third State, the State benefitting from the MFN clause immediately gained the right to the same treatment, without having to offer anything in return. That is, MFN clauses were "unconditional" in their operation.[41] The "conditional" MFN clauses included within American treaties, however, required that in order for the State benefitting from the MFN clause to gain access to any more favorable treatment granted to a third State, it had to offer the United States a concession equivalent to that given by the third State.[42] If no equivalent compensation was offered, no obligation to extend the more favorable treatment to the beneficiary arose.[43] Since the United States was the ultimate judge of what constituted equivalent value, the "conditional" MFN clause was effectively just an invitation to renegotiate the terms of the original treaty.[44]

The justification publicly offered by the United States for its insistence on the use of "conditional" MFN clauses was that providing a benefit to a State via an MFN clause without securing equivalent compensation to that given by the original recipient of the benefit actually

[41] Meinhard Hilf & Robin Geiß, "Most Favoured Nation Clause", in Max Planck Encyclopedia of Public International Law (2010), at ¶ 13 ("Until the late 18th century the clause was exclusively drafted in an unconditional manner, ie the right to most-favoured-nation treatment would inure automatically as soon as a third State was more favourably treated than the beneficiary State with regard to the subject matter comprised by the clause.").

[42] Committee of Experts for the Progressive Codification of International Law, *supra* n. 28, at 135-36 ("The unconditional form simply provides that every favour extended by one contracting party to a third party shall be immediately and unconditionally extended to the other party: the conditional provides that every favour extended by one contracting party to a third party shall be extended to the other party freely if the concession was freely made, or by allowing the same compensation is the concession was conditional.") (quotation marks omitted).

[43] Hilf & Geiß, *supra* n. 41, at ¶ 14 ("This type of clause lacks the automatism entailed in the unconditional version as the most-favoured-nation treatment is only extended on the condition that the beneficiary State agrees to grant compensation equivalent to that given by the third State."); Chester Lloyd Jones, "The American Interpretation of the 'Most Favored Nation' Clause", 32 Annals Am. Acad. Pol. & Soc. Sci. 119, 123 (1908) ("Even when the second nation offers the same nominal concessions as given by the first it cannot secure identical treatment under the clause unless the treaty-making power considers the second sacrifice actually equal to the first.").

[44] Viner, *supra* n. 6, at 101 ("The grantor of concession to one country for compensation is itself the judge of the equivalent compensation offered for the same concessions by other countries. If it does not wish to extend its concession to third countries, it need only deny the equivalence of the compensation offered."); Jones, *supra* n. 43, at 123 ("What is the character of the concessions which will be considered an equivalent is to be left entirely to the treaty-making powers of the respective states. The mutual concessions are 'to be honorably determined by the governments concerned."); Conroy, *supra* n. 24, at 336 (1926) ("The claiming of a favour under the conditional clause necessitates a great deal of negotiation.").

privileged the beneficiary of the MFN clause.[45] It therefore created precisely the inequality of treatment that MFN clauses were intended to eliminate.[46] More realistically, of course, the true explanation for the United States' adoption of this policy is likely found in the power it gave to the United States to decide for itself when it would and would not give MFN treatment.[47]

Contrary to any understanding of MFN clauses of this period as reflecting a commitment to non-discrimination, European States had no objection in principle to conditional MFN clauses.[48] Indeed, although it was the United States that came to be identified with the use of the conditional MFN clause,[49] it was in fact France that had initially proposed to the United States

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[45] *See, e.g.*, the statement made by John Jay to Congress in 1787, that "[w]here a privilege is gratuitously granted, the nation to whom it is granted becomes in respect to that privilege a favored nation…but where the privilege is not gratuitous, but rests on compact, in such case the favor, if any there be, foes not consist in the privilege yielded, but in the consent to make the contract by which it is yielded…The favor, therefore, of being admitted to make a similar bargain, is all that in such cases can reasonably be demanded under the article." Quoted in Viner, *supra* n. 6, at 104. *See also* Hornbeck, *supra* n. 6, at 395 ("The United States argued for a more specific equivalent, saying that if they were to give France freely that for which England had paid, France would be enjoying a treatment more favored that [sic] that of the most-favored nation. This was the position held by Mr. Adams, President Monroe, and Mr. Gallatin, whose notes have been repeatedly quoted by United States Secretaries.").

[46] In the words of the U.S. Minister to Argentina in 1897: "It is clearly evident that the object sought in all the varying forms of expression [of MFN clauses] is equality of commercial treatment, protection against the will of the commercial interests of one nation over another. But the allowance of the same privileges and the same sacrifice of revenue duties to a nation which makes no compensation that had been conceded to another nation for an adequate compensation instead of maintaining destroys that equality, which the 'most favored nation' clause was intended to secure." (quoted in Jones, *supra* n. 43, at 123).

[47] *See, e.g.* Henri Hauser, "The Most-Favored-Nation Clause: A Menace to World Peace", 156 Annals Am. Acad. Pol. & Soc. Sci. 101, 101 (1931) ("[T]he United States maintains that the rule of reciprocity does not preclude the granting of special favors to contiguous states, i.e. to Canada and Mexico, nor does it prevent the United States from granting whatever privileges it desires to its 'protectorates' in the Caribbean.")

[48] Although they certainly did have very strong objections to the way that they were used by the United States. *See, e.g.* Viner, *supra* n. 6, at 126-27 ("European countries, irritated by the repeated refusal of the United States to acknowledge obligations under its most-favored-nation pledges and by the extraordinary heights to which American protectionism was carrying import duties on European products, began to denounce their most-favored-nation treaties with the United States, to consent to new tariff arrangements only on a temporary basis, and openly and otherwise to discriminate in their customs legislation against American products.").

[49] Pomfret, *supra* n. 40, at 18 ("The sole important practitioner of conditional MFN treatment was the United States."); Hornbeck, *supra* n. 6, at 405-6 ("This form appears in most of the treaties of the United States. It also appears in nearly all Japanese treaties, and is followed by certain South American states."); Jones, *supra* n. 43, at 122 (noting Japan's use of the conditional MFN clause); Committee of Experts for the Progressive Codification of International Law, *supra* n. 28, at 137 (noting the use of the conditional MFN clause in Latin America). Excellent coverage of Japan's practice with regard to the MFN clause can be found in Shinya Murase, "The Most-Favored-Nation Treatment in Japan's Treaty Practice During the Period 1854-1905", 70 Am. J. Int'l L. 273 (1976).

that a conditional MFN clause be adopted for their 1778 treaty.[50] Consequently, it is unsurprising that for a short period the conditional clause became the norm even within Europe.[51]

Nonetheless, in reality the United States was the only State that truly benefited from conditional MFN treatment, with the conditional MFN clauses adopted by European States ultimately having the same substantive effect as unconditional clauses.[52] While the inability of European States to benefit from conditional MFN clauses is partly explained by the relatively few instances of more favorable treatment being given within Europe at that time, a more fundamental obstacle arose from the fact that all the major trading nations other than the United States were already enmeshed in an extensive network of unconditional MFN clauses when they began adopting conditional clauses. The problem this created is that a single unconditional MFN clause will completely undermine the operation of a conditional MFN clause.[53]

By way of example, presume that Germany signs a series of treaties incorporating conditional MFN clauses. As a result of these clauses, if Germany provides a benefit to, for example, Italy, then that same benefit must also be provided to those States benefitting from applicable MFN clauses, upon payment of the same compensation originally paid by Italy. As a result, Germany gains benefits that it would not have gained had its MFN clauses been unconditional.

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[50] Vernon G. Setser, "Did Americans Originate the Conditional Most-Favored-Nation Clause?", 5 J. Mod. Hist. 319 (1933) (presenting the evidence supporting the view that the conditional MFN clause in the treaty was originally proposed by France, not the United States). *See also* Pahre, *supra* n. 34, at 873 ("France had political reasons for wanting a conditional MFN clause included in the France-American commercial convention of 6 February 1778. To keep Britain isolated from the rest of Europe, France wanted to avoid the suggestion that it was fighting a war of aggrandizement, and it preferred to pose as protecting the colonies against British oppression.").
[51] Schill, *supra* n.9, at 511 (noting that the conditional MFN clause "also prevailed in Europe until 1860").
[52] Pomfret, *supra* n. 40, at 17 ("In Europe the conditional form was often used between 1820 and 1860, but was similar in effect to unconditional MFN treatment because of the prevalence of single-schedule tariffs and rarity of special concessions.").

However, if Germany also has in place a treaty with Finland that includes an unconditional MFN clause, then Finland has the right to receive the benefit in question without paying any compensation. The difficulty this creates for Germany is that while it initially provided the benefit to Italy for a cost, it has now provided the same benefit to Finland for free. Consequently, all the States with which Germany has applicable conditional MFN clauses can also claim the benefit for free, this being the compensation paid by Finland.

Because of this effect of unconditional MFN clauses on conditional clauses, a State that has signed even a single MFN clause will gain no benefit from negotiating conditional MFN clauses. Only the fact that the United States was a new State, entering into its first round of treaties, allowed it successfully to adopt conditional MFN clauses, and only a continued insistence on this policy allowed them to remain effective.[54] Indeed, the one time that the United States was forced to admit that an MFN clause to which it had agreed was unconditional, it terminated the treaty as soon as the first claim was made under it.[55]

While European States were ultimately prevented from following the American policy of conditional MFN clauses, however, this did not preclude them from approaching unconditional MFN clauses tactically.[56] For example, although unable to insist on compensation for the

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[53] Pomfret, *supra* n. 40, at 17 (noting that "a single treaty with an unconditional clause rendered inoperative any conditionality in MFN clauses of treaties involving the same countries"). *See also* Viner, *supra* n. 6, at 119; Schwarzenberger, *supra* n. 6, at 102.

[54] Notably, it was not just the treaty-making powers of the United States that underwrote the consistency of the U.S. adoption of the condition MFN clause. The United States Supreme Court also interpreted ambiguously drafted MFN clauses in treaties as constituting conditional forms of the clause. *See, e.g*. Whitney v. Robertson, 124 U.S. 190 (1888).

[55] Pomfret, *supra* n. 40, at 18 ("In the only case where the USA recognized that an unambiguously unconditional MFN pledge had been granted (the 1850 treaty with Switzerland), as soon as other countries claimed privileges granted by the USA for compesation to one country by then granted freely to Switzerland, the United States refused further gratuitous extension of the privileges and served notice of termination of the clause in the Swiss treaty.").

[56] *See, e.g*. Pahre, *supra* n. 34, at 867 (noting that in 1881 Britain terminated re-negotiation of a treaty with France because France had refused to give Britain the tariff reductions it sought, and Britain hoped to gain the same reductions automatically through the application of an MFN clause in the British-French treaty to a French-Belgian treaty currently under negotiation); Jones, *supra* n. 43, at 122 (noting England's endorsement of the view that imposing higher tariffs on imports subsidized by a foreign government did not violate MFN clauses, as it merely

provision of benefits through an MFN clause, European States would at times grant tariff reductions crafted to apply to a very specific type of product. They would then argue that the reduction in question was not given in violation of any applicable MFN clause, as any State could meet the criteria in question, even though only one happened to do it currently.[57] Similarly, on at least one occasion an agreed tariff reduction was kept secret until treaty negotiations were concluded with States that were entitled to receive that reduction via an unconditional MFN clause. This allowed the States granting the reduction to negotiate compensation for providing the reduction via treaty, even though obligated to provide it for free via an MFN clause.[58] More generally, European States would attend closely to the order in which they negotiated treaties, as a means of controlling the benefits that they would gain or give through any applicable MFN clauses.[59]

As a result of such practices, by the end of the 19th Century the MFN clause had largely fallen out of favor with States.[60] Indeed, hostility to the MFN clause was so strong in France that

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eliminated a form of competitive discrimination introduced by the foreign government in question); Hauser, *supra* n. 47, at 101 (describing the incorporation of an MFN clause into a Franco-German treaty as having "a purely protectionist origin"); Olivier Accominotti & Marc Flandreau, "Bilateral Treaties and the Most-Favored-Nation Clause: The Myth of Trade Liberalization in the Ninetheenth Century", 60 World Pol. 147, 150 (2008) ("British negotiators felt that MFN would enable Britain to rely on France to make concessions to third parties; and Britain in turn would benefit without making further concessions itself.").

[57] Committee of Experts for the Progressive Codification of International Law, *supra* n. 28, at 143-44 ("In order to be able to confer a favour upon certain selected districts or persons, or respecting particular objects, without extending it to all States with which the favouring nation has treaties containing most-favoured-nation clauses, resort is sometimes had to conditions or limitations imposed upon the favour, which those whom it is designed to benefit will meet but which will exclude all others."); Viner, *supra* n. 6, at 109 (noting the use of "specialisation", or "the fine classification of commodities and rates in tariff schedules" as a means of avoiding the impact of MFN clauses).

[58] Pahre, *supra* n. 34, at 886 (noting an instance in 1891 in which Austria and Germany kept tariff concessions secret until negotiations with Italy, Switzerland and Belgium were completed).

[59] *Id.* at 887 ("[S]tates were certainly aware of the distributional consequences of MFN treaties. This awareness made them attentive to the sequence by which they negotiated treaties with other states.").

[60] *Id.* at 884 ("[T]he next question is whether politicians worried about the distributional effects of MFN. It is not surprising that they did."); Hauser, *supra* n. 47, at 102 (noting that "[f]rom about 1880 to 1914, this clause embittered the relations of France with practically every foreign power"); Pomfret, *supra* n. 40, at 20, 25 (2003) ("Between 1870 and 1914 trade became less free and discrimination became more common…On the whole the decade after Versaille continued the post-1870 trend of increasing tolerance for discriminatory trade policies.").

all its treaties containing MFN clauses were denounced, and a law was passed forbidding the French government entering into any future treaties containing MFN clauses.[61]

Nonetheless, this hostility to the MFN clause was relatively short-lived, and MFN clauses regained their popularity in the period between the two World Wars.[62] Indeed, in 1923 even the United States came to endorse the unconditional form of the MFN clause.[63] Notably, though, this was not because of a new-found appreciation of the benefits of multilateral non-discrimination, but because its continued use of conditional MFN clauses had become counter-productive in the face of the hostility of its trading partners.[64] As a result, a practice of bilateral, prospective, general and unconditional MFN clauses was begun that has remained the dominant approach to the present day.[65]

As the above discussion has shown, MFN clauses have simply never been the generalized non-discrimination provisions that some contemporary commentators have portrayed them as being. They were originally developed as a means of gaining specific advantages already offered to specific third States, and even when the generalized form of MFN treatment became

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[61] Hauser, *supra* n. 47, at 102; Richard Pomfret, *supra* n. 40, at 27.

[62] Hilf & Geiß, *supra* n. 41, at ¶ 17 ("Subsequently, in the immediate aftermath of World War I, the destructed European economy as well as the ensuing depression of 1921–24 necessitated the adoption of a more restrictive economic policy and led to a temporary decline in the use of the most-favoured-nation clause. However, with gradual economic recovery and increasing stabilization, the clause again became a common feature of commercial treaties."). *But see* Louis Martin Sears, "Book Review: The Most-Favored-Nation Clause", 262 Ann. Am. Acad. Pol. & Soc. Sci. 196, 196 (1949) (noting that as of 1949 "the importance of the clause has diminished").

[63] Culbertson, *supra* n. 11, at 77 ("In 1923…[the United States] adopted the unconditional form of the most-favored-nation clause.") (italics omitted).

[64] Pomfret, *supra* n. 40, at 23 ("The United States, with the conditional MFN bargaining tool, received less favourable treatment for exports to continental Europe than did free trade Britain, which had nothing to offer in return for MFN treatment."); Viner, *supra* n. 6, at 125 ("While the United States succeeded in a few instances in getting special concessions for which some other country had originally given compensation, it failed, after 1890, with its conditional most-favored-nation practice and with its elaborate reciprocity negotiations, to obtain as favourable tariff treatment from Continental Europe as a whole as was enjoyed by Great Britain with its unconditional practice and with no concessions to make in return.").

[65] Committee of Experts for the Progressive Codification of International Law, *supra* n. 28, at 137 (noting that "[t]he unconditional form is practically universal now").

dominant the clause was used tactically as a means of ensuring market benefits, rather than as a principled means of promoting multilateral non-discrimination.

The above discussion, however, has almost exclusively focused on the application of MFN clauses to tariff barriers, as until very recently this was its almost exclusive role.[66] With the rise to importance of international investment law, however, MFN clauses have moved into a very different context, and one that is particularly problematic for the teleological non-discrimination interpretation of their operation. As the following section of the Article will emphasize, international investment law by its nature has far greater effects upon State action than does the mere setting of tariff levels for imported products. Consequently, failing to recognize the appropriate limits on the operation of MFN clauses within international investment law, and interpreting them solely in accordance with pre-determined teleological goals, risks seriously impacting the appropriate regulatory activities of States.

3. MFN Clauses and Bilateral Investment Treaties

While the previous section of the Article has addressed the development of MFN clauses in international agreements, no attention has yet been given to their specific role within international investment law. Indeed, the exclusive focus on the use of MFN clauses in international trade characterizes most commentary on MFN clauses, for the simple reason that tariff-reduction was traditionally the almost-exclusive context in which such clauses were used.[67]

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[66] Conroy, *supra* n.24, at 329 ("[T]he most favored nation clause is a sort of residual clause covering all favors not otherwise provided for; but the chief purpose in practice, and the only purpose of any importance, is to govern tariff relations.").

[67] *Id.* There was, though some early recognition that MFN clauses would ultimately come to have importance within the field of foreign investment. *See, e.g.* Wright, *supra* n. 19, at 761 ("It thus seems probable that as opportunities for foreign investment by their nationals become a more important interest of states, they will make efforts to assure most-favored-nation treatment in this regard.").

The growth of international investment law in the second half of the 20th Century, however, has created a new field in which MFN clauses have just as central a role as in the regulation of tariffs.[68] Since a treaty will usually take years to renegotiate, a State with an investment treaty that does not include an MFN clause risks shackling its investors to an agreement that has since been superseded by more favorable agreements negotiated with other States.[69]

Of course, as the obligation to provide MFN treatment only arises from treaties, it was not until international investment law came to be dominated by treaties that MFN clauses achieved their current importance within the field. Traditionally, international investors had been protected through the operation of customary international law, which contained restrictions limiting the freedom of Host States[70] in their treatment of foreign investors.[71] The effectiveness of this law, however, depended to a significant degree upon the identity that initially existed between those States serving as the sources of foreign investment and those serving as the recipients. That is, because States receiving foreign investments also had citizens and corporations of their own investing in other countries, each State actively participating in international investment had an interest in agreeing to at least minimal protections of foreign investors.

[68] Gabriel Egli, "Don't Get Bit: Addressing ICSID's Inconsistent Application of Most-Favored-Nation Clauses to Dispute Resolution Provisions", 34 Pepp. L. Rev. 1045, 1065 (2006) ("In fact, the majority of BITs currently in force around the world contain some form of MFN clause); UNCTAD, *supra* n. 11, at 1 ("The most-favoured-nation treatment (MFN) standard is a core element of international investment agreements."); Eduard Kunstek, "Procedural Effects of BITs' Most Favoured Nation Clauses on ICSID Arbitration", 15 Croat. Arbit. Yearb. 97, 98 (2008) ("Bilateral investment treaties…almost with no exceptions contain MFN clauses."); Houde, *supra* n. 6, at 158 (referring to the "prevalence in investment treaties" of MFN clauses").
[69] George Schwarzenberger, International Law as Applied by International Courts and Tribunals 243 (3rd ed. 1957) ("[The MFN clause] contributes greatly to the rationalization of the treaty-making process and leads to the automatic self-revision of treaties which are based on the most-favoured-nation standard.") (quoted in Houde, *supra* n. 6, at 142, n.36).
[70] "Host State" is used in this Article to refer to the State in which a foreign investment is made.

Moreover, even where a developing State was the recipient of foreign investment, the activities of the investors in question were often governed by the developed State from which the investors came, rather than the developing State in which they were investing. This was because the vastly superior bargaining power of capital-exporting States allowed them to insist upon consular jurisdiction treaties, in accordance with which nationals of a developed State would remain under its sole jurisdiction even when operating in a developing State.[72] Consequently, the investor-friendly policies of developed States would apply even where the Host State in question applied fundamentally different rules to its own investors.

The growth of genuinely global business in the 20th Century, however, combined with the rise to influence of socialist thought and the wave of decolonizations that occurred immediately after World War II, to produce the collapse of the largely pro-investor consensus that had long underwritten the customary law on the protection of international investments.[73] The decades immediately after World War II, therefore, saw a series of actions taken by a variety of States, particularly those newly independent from colonial powers, that would previously have been regarded as inconsistent with international law.[74]

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[71] Andrew Newcombe & Lluis Paradell, Law and Practice of Investment Treaties 11 (2009) ("By the early 1900s, there was general agreement amongst international lawyers in Europe and the US that there existed a minimum standard of justice in the treatment of foreigners.").

[72] Sutton, *supra* n. 8, at 118 ("The rule that aliens fall under the territorial supremacy of the local state until relatively recently found an exception with regard to a considerable number of states on the ground that their institutions were inferior to or different from those of European and American states and of Japan. Many states entered into treaties (sometimes called 'capitulations') with Asian and African states as the result of which subjects, when entering into the territory of Asian and African states, remained wholly under the jurisdiction of their home states, and their consuls exercised jurisdiction over their fellow subjects.").

[73] Andrew T. Guzman. "Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties", 38 Virginia J. Int'l L. 639, 641 (1998) ("In the years that followed World War II, however, developing countries questioned the Hull rule, claiming the right to determine how they would treat investors and the standard of compensation that should apply if that treatment was sufficiently harmful. This challenge to the Hull Rule proved successful, and by the mid 1970s (and perhaps sooner), the Hull Rule had ceased to be a rule of customary international law.").

[74] Newcombe & Paradell, *supra* n. 71, at 18-19 ("Disputes over the treatment of foreign investment increased and intensified after WWII as the process of decolonization resulted in colonial territories becoming states. Many of these newly independent states, along with the Eastern European communist states, adopted socialist economic policies, including large scale nationalizations of key sectors of their economies.").

It was against this background that, from the late 1950s, States wishing to ensure protection for their citizens investing abroad ceased relying primarily upon customary international law and turned instead to the signing of Bilateral Investment Treaties ("BITs").[75] While BITs generally act as a supplement to customary international law, rather than as a replacement for it, investors operating under the protection of a BIT need not rely on the vague and elementary protections offered by customary international law, and can instead point to specific promises made by the Host State regarding the treatment they will receive.[76] In addition, if the BIT includes consent to direct investor-State arbitration for any alleged violation of its terms, as is now standard, investors have the additional certainty that the rights granted in the BIT can indeed be enforced, even against an unwilling State.[77] This system of BITs has proven so effective that there are now over 2,000 BITs in force, enshrining individualized agreements regarding investor protection between countries from all corners of the world, and representing all levels of economic development.[78]

Nonetheless, while the innovation of BITs gave any two States the ability to tailor promised investment protections to the specific relationship existing between them, it also

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[75] Rudolf Dolzer & Margrete Stevens, Bilateral Investment Treaties 10-11 (1995). The first ever BIT was concluded between Germany and Pakistan on 25 November 1959. UNCTAD, The Entry into Force of Bilateral Investment Treaties, *available at* http://www.unctad.org/en/docs/webiteiia20069_en.pdf. A short but useful account of the historical development of the contemporary BIT regime is available in Egli, *supra* n. 68, at 1048-53.

[76] Antonio Parra, "Applicable Law in Investor-State Arbitration", in Contemporary Issues in International Arbitration and Mediation 6 (Arthur Rovine, ed., 2008) ("Nowadays, almost all of the ICSID Convention cases that are being initiated concern such treaty claims. The tribunals have, in these newer cases, all applied, to the merits of the disputes, the provisions of the underlying treaties, as well as general international law rules.").

[77] Joshua Boone, How Developing Countries Can Adapt Current Bilateral Investment Treaties to Provide Benefits to Their Domestic Economies, *forthcoming*, Global Business Law Review (2011) ("[A]lmost all of these treaties provide alternative dispute resolution provisions that allow states to bring claims regarding the interpretation or application of a treaty provision, as well as, allow investors to bring claims against states for treaty violations, often referred to as investor-State Arbitration."); Susan D. Franck, "The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future?", 12 U.C. Davis J. Int'l L. & Pol'y 47, 53-54 (2005) ("BITs also provide procedural rights that permit the enforcement of the substantive rights…[I]nvestors can directly bring a claim against a Sovereign for violation of a treaty, functioning in a manner similar to private attorneys general in the protection of the public interest.").

created yet another forum in which States could compete for advantage. After all, as the goal of a BIT is to encourage foreign private investment, it cannot achieve its purpose unless foreign investors know of both its existence and its contents.[79] Consequently, BITS are routinely widely publicised and publicly available.[80] The consequence of this publicity is that each BIT negotiation is conducted with both States fully aware of the terms of the other BITs that its potential treaty-partner has already signed.[81] Any State negotiating a BIT will, therefore, do so with full knowledge of what it must do in order to ensure that its investors are treated at least as well as, and ideally better than, those of any third State.

The high level of publicity attached to BITs, therefore, largely eliminates their usefulness as a means of securing already-existing treatment, as such treatment can easily be identified and specifically requested. However, it makes even more important their role as protector against future more favorable agreements, as the public availability of the contents of a BIT will ensure that States negotiating future agreements with either State party to the original BIT will attempt to achieve more favourable terms than the original BIT included.[82] Consequently, it is unsurprising that BITs characteristically include MFN clauses.[83]

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[78] Jeswald W. Salacuse & Nicholas P. Sullivan, "Do BITs Really Work?: An Evaluation of Bilaterial Investment Treaties and Their Grand Bargain", 46 Harv. Int'l L.J. 67, 67 (2005) ("From 1959 to 2002, nearly 2200 individual BITs were formed.").

[79] It should be emphasised, however, that this statement does not mean that encouraging foreign investment is the only purpose of BITs, or that it means the purpose of a BIT is to encourage foreign investment of any type under any circumstances. Such an expansive interpretation of the object and purpose of BITs would lead to precisely the type of teleological reasoning criticised in this article with respect to the interpretation of MFN clauses.

[80] *See, e.g.* the extensive index of investment treaties, many available in full-text and in more than one language, collected by the United Nations Conference on Trade and Development, available at http://www.unctadxi.org/templates/docsearch____779.aspx (last accessed February 22, 2011).

[81] Of course, it is always possible that a particularly incompetent treaty negotiating team will not be aware of the investment treaties already signed by the State with which they are negotiating. But given the easy accessibility of such information, it would be unreasonable to presume such ignorance absence clear evidence.

[82] This does not mean, of course, that there will be no natural limits on the favorability of treatment included in a BIT. After all, if the BIT imposes equivalent obligations on both States party to it, then one State may be willing to accept less favorable treatment than is already being received by another State, simply because it is itself unwilling to grant that more favorable treatment.

[83] UNCTAD, *supra* n. 11, at 13 ("With regard to investment, the development of MFN became common in the 1950s with the conclusion of international investment agreements, including BITs. The MFN standard was included

MFN clauses in BITs, however, are of a particularly voracious variety. Although in some treaties they will be restricted in their operation to a particular Article, MFN clauses in BITs are overwhelmingly generalized promises of MFN treatment with respect to all areas addressed by the BIT, modified sometimes by certain limited carve-outs.[84]

The difficulty this generality of MFN clauses in BITs creates is that contemporary international investment agreements address an enormously wide variety of potential government actions, and are framed in very broad and vague language.[85] Consequently, there are few, if any, areas of governmental regulation that can be said to be beyond the reach of a contemporary BIT. As a result, while the traditional promise of MFN treatment with respect to tariffs only constrained governmental action in a very narrow field, a generalized MFN clause in a BIT can potentially be applicable to any action taken by a government that affects a foreign investor.[86] In their move from the world of trade and tariffs to the protection of international investments, that

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in such treaties from the beginning".); Houde, *supra* n. 6, at 130 ("The inclusion of MFN clauses became a general practice in the numerous bilateral, regional and multilateral investment-related agreements which were concluded after the [Havana[Charter failed to come into force in 1950).

[84] Pia Acconci, "Most-Favoured-Nation Treatment", in The Oxford Handbook of International Investment Law 368-69 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds. 2008) ("As a rule, the most-favoured national clauses included in investment treaties are…often unrestricted…These clauses are also indeterminate since they are unlimited *ratione materiae*, *ratione personae*, and *ratione temporis*…On the other hand…investment treaties tend to provide for exceptions and reservations to the most-favoured-nation treatment standard."); UNCTAD, *supra* n. 11, at 2 ("Although international investment agreements allow for exceptions from MFN, it seems that contracting parties have hitherto not used this freedom to discriminate among foreign investors from different countries beyond those policy areas where differential treatment is explicitly recognized (for instance, taxation, intellectual property or mutual recognition).").

[85] UNCTAD, *supra* n. 11, at 4 ("MFN applies both in the trade and the investment fields. However, contrary to trade, where the MFN standard only applies to measures at the border, there are many more possibilities to discriminate against foreign investment.").

[86] Moreover, there is clear empirical evidence that widespread application of MFN clauses to tariff schedules provides benefits to countries of all sizes and economic power. *See, e.g.* Kamal Saggi, "The MFN Clause, Welfare, and Multilateral Cooperation Between Countries of Unequal Size", 88 J. Dev. Econ. 132 (2009). *See also* Madanmohan Ghosh, Carlo Perroni, and John Whalley, "Developing-Country Benefits from MFN Relative to Regional/Bilateral Trade Arrangements", 11 Rev. Int'l Econ. 712, 726 (2003) "small countries are better off under the MFN as it does not allow bilateral bargaining"); Kamal Saggi & Frank Sengul, "On the Emergence of an MFN Club: Equal Treatment in an Unequal World", 42 Can. J. Econ. 267, 269 (2009) ("We find that the formation of an MFN club enhances aggregate world welfare, and the larger the club, the more desirable it is from a world welfare perspective…This implies that adoption of the MFN rule by WTO members is of value, even when it is *not* accompanied by any trade liberalization among them."). Similar evidence has yet to be generated with respect to MFN clauses in investment treaties.

is, MFN clauses have gained the power to impact significantly upon the broad policy-making freedom of States.[87]

The importance of MFN clauses has, of course, long been clear, and attempts to standardize the interpretation of MFN clauses by means of international agreements have already twice been undertaken. In the 1920s the forerunner of the International Law Commission ("ILC"), the Committee of Experts for the Progressive Codification of International Law, undertook the first examination of the possibility of a multilateral convention on the operation of MFN clauses.[88] Ultimately, however, the Committee concluded that "international regulation of these questions by way of a general convention, even if desirable, would encounter serious obstacles", and decided not to proceed.[89] Similarly, the ILC itself addressed the operation of MFN clauses in a project commenced in 1967,[90] resulting in 1978's Draft Articles on Most-Favoured-Nation Clauses.[91] However, despite several attempts to develop the draft articles into a multilateral treaty, no formal action was taken, and again the idea of a treaty on the operation of MFN clauses was ultimately abandoned.[92]

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[87] Efraim Chalamish, "The Future of Bilateral Investment Treaties: A De Facto Multilateral Agreement?", 34 Brook. J. Int'l L. 303, 305 (2009) ("Through their inclusion of most-favored-nation ('MFN') clauses, these agreements form a complex network that resembles a de facto multilateral agreement."); UNCTAD, *supra* n. 11, at 1 ("The MFN standard may also have implications for host countries' room for manoeuvre in respect of future investment agreements, because it can create a so-called 'free rider' situation".).

[88] Committee of Experts for the Progressive Codification of International Law, *supra* n. 28.

[89] *Id.* at 133.

[90] "First report on the most-favoured-nation clause, by Mr. Endre Ustor, Special Rapporteur" (UN Doc. A/CN.4/213) in Yearbook of the International Law Commission 1969, vol. 2 (1970).

[91] Houde, *supra* n. 6, at 139 ("In 1978, the ILC adopted the Draft Articles on Most-Favoured-Nation Clauses and recommended to the General Assembly of the United Nations that they be used for a Convention on the subject."). The Draft Articles as adopted in 1978 are available online at http://untreaty.un.org/ilc/texts/instruments/english/draft%20articles/1_3_1978.pdf. The entire report presented to the General Assembly can be found in Yearbook of the International Law Commission, 1978, vol. II, Part Two.

[92] Stephen Zamora, "International Relations and Development", in The United Nations and International Law 232, 239 (Christopher C. Joyner ed. 1997); Houde, *supra* n. 6, at 139 ("The General Assembly did not act upon this recommendation and took no substantive action on the draft articles.").

While the work of both these Committees is certainly important, in neither case did the work pay any attention to the role of MFN clauses in international investment agreements, focusing instead primarily on their role in international trade.[93] This was an understandable emphasis, as international investment law did not attain its current position of importance until after the ILC had concluded its work. Nonetheless, the significantly different context provided by international investment law limits the usefulness of the work produced by these two Committees for the interpretation of MFN clauses in BITs. Indeed, it was in recognition of the new importance of international investment law, and the importantly different context it provides for MFN clauses, that the ILC decided in 2008 to resume its work on MFN clauses, with particular consideration given to their operation in international investment agreements.[94]

The Article up to this point has argued that the teleological "non-discrimination" interpretation of MFN clauses is both inconsistent with the reality of the MFN clause's history, and potentially enormously problematic when imported into international investment law. Nothing has yet been said, however, regarding the boundaries within which MFN clauses should be understood to operate in international investment law. The remainder of the Article will be dedicated to clarifying these limits. Part 4 of the Article will focus upon the limitations on the functioning of MFN clauses that have already been recognised by tribunals applying public international law. The decisions of these tribunals have been recognised as also applicable within international investment law, and thus provide the already-existing limitations on the teleological interpretation of MFN clauses that dominates that field. Part 5 of the Article will

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[93] Houde, *supra* n. 6, at 139 ("In determining to proceed with the project, the ILC acknowledged the importance of the role of the mast-favored-nation treatment obligation in the sphere of international trade.").

[94] 2009 Yearbook of the International Law Commission (2009), at ¶ 216. The centrality to this decision of the impact of MFN clauses on dispute resolution in investment arbitration is made clear through the incorporation within the ILC's research programme of the topic of "The *Maffezini* Problem under Investment Treaties", under the supervision of co-rapporteur Rohan Perera. *Id.* at ¶ 216.

then advance an original analysis of the limitations that must be recognised on MFN clauses specifically within international investment law.

4. The Boundaries of MFN Clauses as Recognized by International Tribunals

Although there were relatively few decisions by international tribunals regarding the operation of MFN clauses prior to the investment arbitration decisions of the late 20th Century, three decisions from this earlier period are foundational for any understanding of the boundaries of MFN clauses. The importance of these decisions lies not just in the temporal priority they have over any later decisions, but in the approach they took to resolving the MFN-based questions with which they were faced. In each decision, the tribunal in question rejected a broad, teleological approach to the interpretation of MFN clauses, and instead recognized a specific limitation within which MFN clauses must be seen as operating in international law. As a result, the decisions of these tribunals provide three essential elements for any subsequent discussion of the boundaries of MFN clauses in international investment law.

4(a). Anglo-Iranian Oil: The Treaty-Boundedness of MFN Clauses

One of the great risks of an MFN clause, the precise purpose of which is to allow a party to an agreement to receive treatment not actually promised in that agreement, is that it will be read as operating in an almost unconstrained fashion. Since an MFN clause constitutes a promise not to treat any third party more favorably, an unrestricted MFN clause might be taken to apply to any more favorable treatment given to a third party, with few limitations deriving from the context in which that treatment occurs. As a result, an already enormously powerful

clause would potentially be transformed into a replacement for the treaty itself, gathering any more favorable treatment offered to any third party while avoiding any restrictions.

One element of this problem was addressed by the International Court of Justice ("ICJ") in its decision in the Anglo-Iranian Oil Co. case of 1952.[95] The dispute arose out of the nationalization of the Iranian oil industry, and the consequent losses suffered by the U.K.-based Anglo-Iranian Oil Co.[96] The U.K. was seeking compensation from Iran for the losses suffered by the Company during the nationalization, under treaties concluded between the U.K. and Iran in 1857 and 1903.[97]

The question faced by the ICJ, however, was not the substantive question regarding the obligation of Iran to pay compensation, but rather whether it had jurisdiction even to hear the U.K.'s claim. Under Article 36 of the Statute of the ICJ the Court's jurisdiction can be established it two ways.[98] Firstly, both parties to the dispute can consent to the case being heard at the ICJ.[99] Iran had refused its consent, and so the U.K. did not rely upon this basis for jurisdiction.[100]

Instead, the U.K. was attempting to rely upon the second basis for ICJ jurisdiction, known as its "compulsory jurisdiction".[101] Under this approach, States are permitted to lodge a declaration with the Secretary-General of the United Nations regarding the types of disputes they are willing to have brought before the ICJ.[102] Once this consent is lodged no further consent need be given for the ICJ to have jurisdiction in any specific case. As Iran had indeed given its

[95] Anglo-Iranian Oil Co. (jurisdiction), Judgment of July 22nd, 1952, I .C. J . Reports 1952, p. 93.
[96] *Id.* at 95.
[97] *Id.* at 98.
[98] Statute of the International Court of Justice, Art. 36. A useful short account of ICJ jurisdiction is available in Renata Szafarz, The Compulsory Jurisdiction of the International Court of Justce 3-14 (1993).
[99] *Id.* at Art. 36(1).
[100] Anglo-Iranian Oil Co., at 98.
[101] *Id.* at 95. *See generally* Szafarz, *supra* n. 98.
[102] Statute of the International Court of Justice, at Art. 36(4).

consent to the ICJ's compulsory jurisdiction, if the U.K. could establish that its claim fell under this consent the ICJ would have jurisdiction despite Iran's unwillingness to agree to have the Anglo-Iranian dispute itself heard at the ICJ.[103]

The complication that arose for the U.K. was that Iran's consent to the compulsory jurisdiction of the ICJ, which it had lodged in 1930, had been specifically restricted to disputes arising out of treaties concluded subsequent to that date.[104] Therefore, as the U.K. was basing its claim on treaties concluded in 1857 and 1903, the ICJ prima facie did not have compulsory jurisdiction over the case.

One of the arguments offered by the U.K. in its attempt to avoid this obstacle involved the invocation of MFN clauses included in both the 1857 and 1903 treaties.[105] According to the U.K., access to the ICJ constituted more favorable treatment than the dispute resolution mechanisms available under the Basic Treaties themselves.[106] Therefore, since Iran had consented to allow some third States to bring claims against it at the ICJ, these States were receiving more favorable treatment than was being given to the U.K., and hence the MFN clauses in the Basic Treaties required that the U.K. be allowed bring its case at the ICJ.

If one accepts the U.K.'s substantive contention that access to the ICJ constitutes more favorable treatment than the dispute resolution procedures offered under the Basic Treaties, then this argument certainly has a facial plausibility. Nonetheless, it was rejected by the ICJ. Importantly, however, this was not on the ground that ICJ jurisdiction was not more favourable than the dispute resolution provisions in the Basic Treaties.

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[103] Anglo-Iranian Oil Co., at 103-4.
[104] *Id.* at 104.
[105] *Id.* at 108.
[106] *Id.* at 110.

Instead, the Court emphasized that whatever impact an MFN clause might have on the provisions of the treaty within which it is contained, it simply cannot alter the terms of any other treaty.[107] That is, the operation of an MFN clause is restricted to the treaty in which it is contained. On one level this is an obvious conclusion, fully in line with the traditional doctrine of *res inter alios acta*.[108] However, its importance for the purposes of interpreting MFN clauses is clarified by the fact that this rule can, as it arguably did in this case, result in the beneficiary of an MFN clause not actually receiving more favorable treatment to which it is unquestionably entitled through the MFN clause.

As emphasized by the ICJ, the restriction on Iran's consent to the ICJ's compulsory jurisdiction that the UK was attempting to remove was not included within either of the Basic Treaties. Instead, it was included in a completely separate document.[109] Consequently, since the operation of the MFN clauses in the Basic Treaties was restricted to the Basic Treaties themselves, they could not remove the restriction on Iran's consent to the ICJ's compulsory jurisdiction.[110]

It simply did not matter, therefore, for the purposes of the ICJ's jurisdiction, whether access to the ICJ constituted more favorable treatment than Iran was providing to any third State, and hence whether the U.K. had a treaty-based right to bring its claim before the ICJ. The U.K.

[107] *Id.* at 108-10.
[108] Gennadii Mikhailovich Danilenko, Law-Making in the International Community 58 (1993) ("According to the prevailing opinion, the sovereign equality of states excludes any automatic effect of treaties on third states which remain for them *re inter alios acta.*"). Indeed, the doctrine was explicitly cited by the court in its decision. Anglo-Iranian Oil Co., at 103-4.
[109] *Id.* at 108-10.
[110] Id.

may indeed have possessed this right, but it simply was not a right that the ICJ had the jurisdiction to vindicate.[111]

By drawing this distinction between the existence of a right to more favorable treatment and the jurisdiction of a tribunal to determine whether that right exists, the ICJ thus recognized an important constraint on the operation of MFN clauses. Mere invocation of an MFN clause does not gain the beneficiary all more favorable treatment currently being provided to third States, as would a general "non-discrimination" clause. Unless that treatment can in some way be incorporated into the treaty in which the MFN clause is contained, it is simply unavailable to the beneficiary of the MFN clause, whether it is indeed more favorable or not.[112]

4(b). Rights of Nationals of the United States of America in Morocco: The Temporality of MFN Clauses

Only one month later, in Rights of Nationals of the United States of America in Morocco,[113] the ICJ recognized a further important limitation on the operation of MFN clauses, with respect to their essential temporality. The case concerned a disagreement between the United States and France regarding the extent of U.S. consular jurisdiction in Morocco,[114] at that

[111] It is, therefore, simply inaccurate to categorise the Anglo-Iranian Oil Co. decision as constituting a rejection of the view that MFN clauses can apply to dispute resolution procedures, as some commentators have done. *See, e.g.* Douglas, *supra* n. 19, at 5. The ICJ simply never addressed this point.

[112] One final important point regarding this case is worth noting, as it is far from clear that the ICJ did not actually have jurisdiction over the U.K.'s claim through the operation of the MFN clauses in the Basic Treaties. Fatally for its claim, the U.K. had attempted to rely upon Iran's consent to the compulsory jurisdiction of the ICJ. Had the U.K. attempted instead to bring its claim under the consensual jurisdiction of the ICJ, alleging that the MFN clauses in the Basic Treaties incorporated Iranian consent to the jurisdiction of the ICJ, the Court's argument rejecting jurisdiction would not have been applicable. The ICJ may, as a result, have upheld its jurisdiction over the U.K.'s claim.

[113] Case concerning rights of nationals of the United States of America in Morocco (U.S.A. v. France), Judgment of August 27th, 1952: I.C. J. Reports 1952, p. 176.

[114] *Id.* at 178-81. An informative account of U.S. law on consular jurisdiction, with a particular focus on Morocco, can be found in Kurt H. Nadelmann, "American Consular Jurisdiction in Morocco and the Tangier International Jurisdiction", 49 Am. J. Int'l L. 506 (1955).

time under the control of France.[115] While France contended that U.S. consular jurisdiction only extended to civil disputes, the United States argued that it also extended to criminal disputes.[116] As one of its arguments, the United States attempted to invoke an MFN clause included in an agreement between itself and Morocco, in an attempt to gain access to broad grants of consular jurisdiction included in treaties concluded by France with Spain and with the United Kingdom.[117]

The difficulty that arose for the United States was that even if it was accepted that the grants of broader consular jurisdiction to Spain and the United Kingdom did indeed constitute more favorable treatment than that given to the United States, the treaties delivering that treatment were no longer in effect.[118] The United States, that is, was not attempting to argue merely that an MFN clause gains the beneficiary State any more favorable treatment given to third States, but that once a State gains a certain form of treatment via an MFN clause, it retains that treatment even if the third State in question ceases to receive it. As phrased by the United States, MFN provisions should be understood as a means of drafting by reference, with incorporated treatment retained as though there were explicit language in the treaty requiring that it be given.[119]

While such an argument might have had some strength at a time when MFN clauses were understood to operate purely retrospectively, incorporating only treatment already given to third States when the MFN clause came into effect, the ICJ appropriately rejected it in the

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[115] Case concerning rights of nationals of the United States of America in Morocco (U.S.A. v. France), at 184.
[116] *Id.* at 180.
[117] *Id.*
[118] *Id.*
[119] *Id.* at 191. It is indeed quite common for MFN clauses to be described as functioning via a form of "incorporation by reference", even today. *See, e.g. Plama Consortium Limited and Republic of Bulgaria,* ICSID Case No. ARB/03/04, Decision on Jurisdiction, 8 February 2005, at ¶¶ 199-227. However, contemporary uses of this phrase do not contradict the ICJ's view that incorporation ends once the more favorable treatment is no longer provided to the third State. Moreover, as Douglas has argued, even contemporary uses of the phrase "incorporation by reference" are troubled, as they simply do not accurately describe the manner in which MFN clauses work. Douglas, *supra* n. 19, at 9-12.

contemporary context of prospective MFN clauses.[120] Instead, the Court emphasized in its decision that rather than being a form of incorporation by reference, contemporary MFN clauses are properly understood as a means of ensuring equality between the State beneficiary of the MFN clause and the third State receiving the more favorable treatment in question.[121] However, to allow the United States to retain the arguably more favorable treatment even after it was withdrawn from Spain and the United Kingdom would actually privilege the United States over its competitors, a goal inconsistent with the purpose of a contemporary MFN clause.

In this ruling, then, the ICJ further reiterated that MFN clauses are not an unrestricted means of States gaining the best form of treatment possible. Rather, they operate not only within the limits of the treaty in which they are contained, but also within the temporal limitations of the treatment being sought. MFN clauses, that is, have their effect on an ongoing basis. Treatment is not incorporated once and then forever maintained. It is instead incorporated anew at each moment the more favorable treatment is available to the third State. Consequently, once the more favorable treatment is withdrawn from the third State, it is no longer available to be incorporated via the MFN clause, and is therefore lost to the beneficiary of the clause as well.

4(c). The Ambatielos Arbitration: *Ejusdem Generis*

One final limitation that has been recognized by international tribunals addresses the risk created by the impact on the operation of MFN clauses of the broad range of issues with respect to which States enter into international agreements.

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[120] Notably. in 1928 the Committee of Experts for the Progressive Codification of International Law had noted that there was "a difference of opinion" as to whether a benefit gained via an MFN clause terminates once the more favourable treatment is no longer provided to the third State. Committee of Experts for the Progressive Codification of International Law, *supra* n. 28, at 140. However, in line with the ICJ's decision in this case, the rapporteur concluded that the benefit should indeed be understood to terminate when the treatment on which it is based terminates. *Id.*

[121] *Id.* at 191-92.

A State may, for example, be willing to subject itself to binding dispute resolution in the field of human rights, while remaining completely unwilling to do so where purely economic claims are brought. However, if the State has included an MFN clause within an economic treaty it has signed, the beneficiary of that clause may argue that States signatory to the human rights treaty are receiving more favorable treatment due to the availability of binding dispute resolution. Unrestricted interpretations of general MFN clauses, then, create the risk that States will find themselves obligated to extend benefits willingly granted in one area of law into a completely different area of law from which they may have been expressly excluded.

While the situation as just described was not itself faced by the tribunal in the Ambatielos arbitration,[122] the *ejusdem generis* principle that the tribunal enunciated has served to resolve this risk.[123] The Ambatielos arbitration concerned a claim brought by Greece against the U.K. on behalf of a Greek shipowner, Nicolas Eustache Ambatielos.[124] Ambatielos had purchased nine ships from the British government, but after a delay in delivery of the ships Ambatielos had experienced difficulties in making the agreed payments.[125] When sued by the British government in English courts for the monies owed Ambatielos brought a counterclaim arguing

[122] The Ambatielos Claim (Greece, United Kingdom of Great Britain and Northern Ireland), United Nations Reports of International Arbitral Awards 87 (1963). The Ambatielos decision was not an ICJ decision, or a decision of any other regularly constituted international tribunal, but rather the result of a State-State arbitration between the United Kingdom and Greece. Nonetheless, the reasoning of the tribunal has proven persuasive to subsequent tribunals, and its holding has been uniformly adopted by international investment tribunals as reflecting a reality of the operation of MFN clauses.

[123] By virtue of this principle, an MFN clause "can only attract matters belonging to the same category of subject as that to which the clause itself relates", *Id.* at 107. It should be emphasised that the Ambatielos tribunal did not invent the *ejusdem generis* principle, which was already recognised as applicable to the operation of MFN clauses. *See, e.g*. Schwarzenberger, *supra* n. 6, at 108 ("For practical purposes it is essential to bear in mind the exact scope of each particular m.f.n. clause; for m.f.n. treatment can only be claimed with respect to favours *ejusdem generis* granted by the promisor to third States."). However, the tribunal's use of the principle has come to be a standard reference for understanding its operation in international law.

[124] Ambatielos Claim at 97. Excellent overviews of the facts behind the Ambatielos award and the reasoning of the award itself are provided in Kurt Lipstein, "The Ambatielos Case: Last Phase", 6 Int'l & Comp. L.Q. 643 (1957), S.E.K. Hulme, "The Ambatielos Case" 1 Melb. U.L. Rev. 64 (1957), and D.H.N. Johnson, "The Ambatielos Case", 19 Mod. L. Rev. 510 (1956).

[125] *Id.*

that there had been a verbal agreement regarding the dates of delivery of the ships, and that he was therefore owed compensation for losses suffered as a result of their late delivery.[126]

After losing at the level of the trial court, Ambatielos appealed to the Court of Appeals, seeking to introduce new testimony from a British government official regarding the existence of the alleged verbal agreement.[127] In accordance with British procedural rules, the Court of Appeals excluded this testimony, as it had not been presented at the original trial.[128] The Court subsequently held against Ambatielos.[129]

Ambatielos turned to the Greek government for assistance, and after failed negotiations[130] Greece attempted to bring the dispute before the ICJ.[131] The ICJ, however, held that it did not have jurisdiction over the substance of the claim due to a pre-existing arbitration clause, and that Greece and the U.K. were obligated to proceed to arbitration.[132]

The existence of an MFN clause in a treaty between Greece and the U.K. became a central issue in the arbitration when Greece attempted to invoke that clause in order to incorporate a promise made by the U.K. in treaties with third States to treat nationals "in accordance with 'justice', 'right', 'equity' and the 'principles of international law'".[133] According to Greece, the refusal by the Court of Appeals to admit the testimony of the British government official regarding the agreed dates of delivery constituted a violation of this standard.[134]

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[126] *Id.* at 100.
[127] *Id.*
[128] *Id.*
[129] *Id.* at 94.
[130] The diplomatic negotiations were commenced in 1925 and were unsuccessfully resumed in 1949 after being interrupted by World War II. *Id.*
[131] Greece finally brought the claim before the ICJ on 9th April 1951. *Id.* at 94.
[132] Ambatielos case (merits: obligation to arbitrate), Judgment of May 19th, 1953: I.C. J. Reports 1953, at 17.
[133] Ambatielos Claim, at 106.
[134] *Id.* at 105.

The U.K.'s defense included the argument that an MFN clause "can only attract matters belonging to the same category of subject as the clause itself relates to",[135] and that as the clause invoked by Greece applied only to "matters relating to commerce and navigation",[136] it could not be applied to issues regarding what the U.K. termed "the administration of justice".[137]

Adopting the *ejusdem generis* principle, the tribunal accepted the U.K.'s argument that an MFN clause only gives a right to more favorable treatment that is given in those fields to which the MFN clause itself relates.[138] Consequently, in order for Greece to use the MFN clause to incorporate the standard to which it had appealed, it was necessary that "the administration of justice" be one of the "matters relating to commerce and navigation". The tribunal held that it was indeed such a "matter", but ultimately also held that the U.K.'s actions nonetheless did not constitute a violation of the principle in question.[139]

The importance of the Ambatielos decision for the present discussion does not, however, relate to the final holding of the tribunal, but rather to its endorsement of the *ejusdem generis* principle. By recognizing the role of this principle as an essential element of the interpretation of MFN clauses, the tribunal placed a further important constraint on the operation of such clauses.[140] That is, just as MFN clauses are only able to affect the terms of the treaty in which they are contained, so they are substantively circumscribed by the nature of that treaty. The mere ability of the beneficiary of an MFN clause to identify treatment received by a third State that would also benefit its activities, in so far as they are covered by the MFN clause, does not entail

[135] *Id.* at 106.
[136] *Id.*
[137] *Id.*
[138] *Id.* at 107. Houde, *supra* n. 6, at 127 ("The ejusdem generis principle provides that an MFN clause can attract the more favourable treatment available in other treaties only in regard to the 'same subject matter', the 'same category of matter', or the 'same class of matter'.").
[139] Ambatielos Claim, at 107.
[140] Although one that can be seen as a development of the ICJ's holding in the Anglo-Iranian Oil Co. case. See *supra*, Section 4(a).

that it has a right to such treatment. MFN clauses are not, that is, a generalized means of ensuring market equality.[141] So long as the market inequality arises as an incidental consequence of treatment delivered in an area of law other than the one covered by the MFN clause, the MFN clause has no effect.[142]

Through these three cases the ICJ and the Ambatielos tribunal went a significant way towards delineating the boundaries of the functioning of MFN clauses in public international law. However, while these boundaries are also applicable to MFN clauses in international investment law, the decisions in which they were recognized do not themselves address that field. As the following Section of the Article will argue, however, the nature of international investment law itself imposes significant additional boundaries on the operation of MFN clauses.[143] Consequently, any understanding of the operation of MFN clauses in international investment agreements must attend to the specific nature of international investment law, and cannot rely solely upon discussions of the functioning of MFN clauses in public international law generally.

5. The Nature of MFN Clauses in International Investment Law

[141] *Contra* Schill, *supra* n. 9, at 502 (arguing that MFN clauses "ensure equal treatment between the State benefiting from MFN treatment and any third State").
[142] It should, however, be emphasized that the constraint placed by the *ejusdem generis* rule actually relates not to the subject matter of the treaty, but to that of the clause. Houde, *supra* n. 6, at 129 ("[I]t is only the subject-matter of the clause, not the treaty or agreement containing the clause that must belong to the same category. In other words, it is not necessary that the treaty or agreement including the clause be of the same category as that of the benefits that are claimed under the clause."). However, where the clause itself provides no clear *ejusdem generis* limitation, the nature of the treaty in which it is contained can do so, as it provides the context in which the clause must be interpreted.
[143] Robert Howse and Efraim Chalamish, "The Use and Abuse of WTO Law in Investor-State Arbitration: A Reply to Jürgen Kurtz, 20 Eur. J. Int'l L. 1087, 1088 (2009) ("[A]ny attempt to merge trade and investment jurisprudence should not ignore the unique characteristics of the investment law regime.").

This Section of the Article will argue that three important limitations must be recognised on the operation of MFN clauses in international investment law. Firstly, it will be argued that MFN clauses in international investment agreements should generally be understood as granting access solely to more favourable treatment provided after the agreement is negotiated, and not to any pre-existing more favourable treatment.[144] Secondly, it will be argued that the "favourability" of a particular type of treatment should be evaluated not with respect to the specific investor invoking an MFN clause, but with respect to the entire class of investors covered by the clause. Finally, it will be argued that MFN clauses do not merely provide to the beneficiary any more favourable treatment provided to a third party, but also simultaneously exclude the beneficiary's access to the treatment originally promised. Moreover, these latter two limitations can sometimes combine in a way that results in an investor actually being harmed by an MFN clause, rather than benefitted by it.

5(a). The Instantaneous Effect of an MFN Clause

While no-one would question that an MFN clause can have an impact on the rights and obligations included within a BIT, this section of the Article will argue that MFN clauses in international investment agreements must be understood as having an instantaneous effect, independent of any need for the beneficiary of the clause to invoke the clause's existence. That is, where State A and State B have signed a BIT containing an MFN clause, the instant State B gives more favorable treatment to State C than to State A, State A instantly becomes entitled to

[144] The word "generally" is important here. As the discussion will show, there can be cases in which an MFN clause should be seen as applying to a specific example of pre-existing treatment.

the higher level of treatment given to State C.[145] Although the instantaneous effect of an MFN clause is not itself a boundary on the operation of MFN clauses in international investment law, it plays an essential role in the existence of those boundaries, and hence must be addressed first.

That MFN clauses operate instantaneously is not in itself a controversial claim, as it is fully consistent both with the accepted approach adopted in public international law, and in decisions by international investment arbitration tribunals.[146] Simply because an MFN clause entails an obligation not to provide more favorable treatment to a third party than is provided to the beneficiary of the MFN clause, the moment more favourable treatment is provided, the State providing the more favourable treatment is in breach of its treaty obligations.

There are, however, two ways in which an MFN clause could be understood as having an immediate effect, that will be referred to here as the "right to claim" understanding and the "instantaneous obligation" understanding of MFN clauses. The following Sections of the Article will explicate these two approaches, and will then argue that only the "instantaneous obligation" approach to MFN clauses is consistent with the nature of contemporary international investment law.

5(a)(i). The "Right to Claim" Understanding of MFN Obligations

The first potential way of understanding the immediate effect of an MFN clause is that as soon as more favourable treatment is provided to a third party, the beneficiary of the MFN clause gains the "right to claim" equivalent treatment for itself. That is, no immediate obligation arises

[145] It should be emphasised that the effect of an MFN clause is only unidirectional. That is, since only State B has provided more favourable treatment to a third State, only the obligations of State B are altered. The obligations of State A remain unchanged.
[146] *See, e.g.* Schwarzenberger, *supra* n. 6, at 104 ("The object of any attempt to give legal expression to the m.f.n. standard is to enable the beneficiary automatically to acquire the rights, present and future, granted by the promisor to any third State."); Houde, *supra* n. 6, at 142 (referring to MFN clauses as "ingenious legal shorthand to treaty

for the State providing the treatment to the third State to also provide it to the beneficiary of the MFN clause, but once the beneficiary requests equivalent treatment, it must be provided.[147]

The "right to claim" understanding makes a significant degree of sense in the context of international agreements, as it maximises the predictability and transparency of MFN obligations, thereby minimising the impact of such clauses on the policy-making freedom of States. After all, while there will be cases in which it is clear that treatment given to a third State is more favourable than that given to the beneficiary of the MFN clause, in many cases it will be disputable. States attempting to act in such a situation will face pressure to be conservative in the obligations they undertake with third parties, out of concern that they may unwittingly also obligate themselves to provide the same treatment to any States with which they have an applicable MFN clause. By contrast, if the beneficiary is required to make a claim for the more favourable treatment before it is owed, the granting State is assured of knowing at all times precisely what its obligations are.

In addition, because no obligation to provide the more favorable treatment existed until the claim was made, there is no risk of large backdated damages claims, extending through years in which the State in good faith did not believe any obligation to provide the treatment in question existed.

However, the "right to claim" understanding is significantly less desirable for the beneficiary of the MFN clause than it is for the State providing the more favourable treatment.

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process") (quotation marks omitted); Douglas, *supra* n. 19, at 12 (stating that "investment treaty tribunals have attempted to convert the fiction of automatic incorporation into a reality").

[147] The "right to claim" understanding of MFN obligations in international investment law has received recent support in academic commentary. *See, e.g.* Douglas, *supra* n. 19, at 9 (arguing that an MFN clause has no effect until a claim is made under it, and "does not, in truth, operate automatically to 'incorporate' provisions of a third treaty so that all that remains for a tribunal to do is to interpret the amended text of the basic treaty."). Unfortunately Douglas consistently confuses the "instantaneous obligation" understanding of MFN clauses with the view that MFN clauses serve as a form of "incorporation by reference". Consequently his argument does not really address the justifications behind adopting the "instantaneous obligation" interpretation.

After all, since the beneficiary is required to claim any treatment before it has a right to receive it, the beneficiary will need constantly to monitor the treatment provided by the granting State to third States, in order to ensure that it is not missing any benefit it should be receiving under the MFN clause.

The "right to claim" understanding of MFN obligations, then, ultimately maximises State policy-making freedom, but does so by minimising the benefits MFN clauses provide, as it creates a significant risk that the beneficiary of an MFN clause will often not in fact be receiving the most favourable treatment given by the State with which it has an MFN agreement.

6(a)(ii). The "Instantaneous Obligation" Understanding of MFN Obligations

By contrast, the "instantaneous obligation" understanding of MFN clauses eliminates any necessity for the beneficiary of the MFN clause to monitor the actions of the State with which it has an MFN agreement. However, it also significantly increases the impact of an MFN clause on State policy-making freedom.

Under this approach, if State A and State B have entered into an MFN agreement, as soon as State B provides more favourable treatment to State C, it is obligated also to provide it to State A. State A need do nothing to gain this more favourable treatment, and in turn any claim it makes against State B for benefits it should have received under the MFN clause will be backdated to the moment the more favorable treatment was given to State C.

The "instantaneous obligation" understanding, then, emphasises that States entering into an MFN agreement have done so voluntarily, and that the existence of such an agreement is

simply inconsistent with allowing one party to the agreement to violate it, so long as its counterparty remains unaware.[148]

6(a)(iii). The Justification for the "Instantaneous Obligation" Understanding in International Investment Arbitration

Within the context of international investment arbitration there are clear justifications for adopting the "instantaneous obligation" understanding, rather than the "right to claim" understanding. There is, for example, clear international investment arbitration case-law on this issue, and each tribunal that has addressed the question has adopted the "instantaneous obligation" understanding.

In addition to mere adherence to prior caselaw, however, additional substantive reasons exist to support the adoption of the "instantaneous obligation" understanding within investment arbitration, arising specifically from the incorporation of investors into the investment arbitration process.

By incorporating direct investor-State dispute resolution into a BIT, the parties to the BIT have thereby created a separation between the parties to the BIT and the parties to any dispute resolution procedure that may result from a violation of the BIT. Indeed, the existence of this distinction has traditionally served as a primary rationale for the adoption of investor-State arbitration, as it is argued that allowing an investor to bring its claim directly against the Host State serves to depoliticise the dispute, by removing the Home State from the proceedings.

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[148] Interpretation of the operation of MFN clauses in accordance with the "instantaneous obligation" understanding can be seen, for example, in Coutain, *supra* n. 10, at 147 ("The clause is…self-executing, that is to say, that any…favor granted by one State to another is immediately secured to the nations enjoying the privileges of the clause, as though the favor had been expressly granted to them simultaneous with the original grant or favour.") (quoting Joseph R. Herod, Favored Nation Treatment 28 (1901)) (citing also Richard Carlton Snyder, The Most-Favored-Nation Clause 15 (1948) and Honore Marcel Catudal, "The Most-Favored-Nation Clause and the Courts", 35 Am. J. Int'l L. 41, 53–54 (1941)).

However, if the "right to claim" understanding were to be adopted in international investment arbitration, the Home State would be required to claim MFN treatment in order for its investors to receive it. The Home State would, therefore, be reintegrated back into the dispute resolution process, in a way that would raise precisely the politicisation concerns that initially served to motivate the adoption of investor-State arbitration. The "right to claim" understanding, then, is simply inconsistent with one of the primary rationales underlying the adoption of international investment arbitration.

It might be argued that due to the delegation of dispute resolution authority to investors, commencement of arbitral proceedings by an investor should be treated as a "claim" by the investor's Home State to any more favourable treatment. However, there may clearly be situations in which a Home State does not wish allegedly more favourable treatment to be claimed. Of most immediate relevance to the current Article, the Home State may not wish the MFN clause in a BIT to be applied to dispute resolution clauses, as it has itself agreed to more favourable dispute resolution procedures with third States than exist under the BIT including the MFN clause. It does not therefore want investors from the State counterparty to the MFN agreement to be able to access those procedures.

It is, to be blunt, simply implausible to think that merely through the incorporation of direct investor-State arbitration into a BIT, the States party to that BIT intended to give investors the power effectively to rewrite the terms of the treaty they had carefully negotiated. The commencement of an arbitration by an investor, then, simply cannot be regarded as a "claim" by its Home State of any more favourable treatment currently offered by the Host State to third States.

Under the “right to claim” approach, then, no tribunal could decide in favour of an investor with respect to an MFN clause unless the Home State had explicitly supported the investor’s MFN argument. Yet such a requirement is not only clearly inconsistent with the desire to depoliticise investment disputes, it is also inconsistent with the delegation of dispute resolution to the investor, as it subjects a significant portion of the investor’s argument to an effective veto by the Home State.

The very structure of international investment arbitration, then, with its incorporation of direct investor-State arbitration, requires that MFN clauses in international investment agreements be interpreted in accordance with the “instantaneous obligation” understanding, as a result of which any more favourable treatment delivered by State B to State C is instantly owed to State A, without requiring any form of claim to the treatment to be made by State A. The following Section of the Article will demonstrate how this aspect of MFN clauses in international investment law creates an important boundary for their functioning in this field, that does not apply to MFN clauses in public international law generally.

6(b). The Predominantly Forward-Looking Nature of MFN Clauses in International Investment Arbitration

The preceding section of the Article addressed one element of what can be called the “temporality” of MFN clauses, or the way in which they are fundamentally enmeshed in considerations regarding time. As seen in that discussion, MFN clauses in international investment arbitration must be understood as having their effect the instant more favourable treatment is provided to a third State. This Section of the Article will be demonstrating the impact of this instantaneous effect on the applicability of MFN clauses to more favourable

treatment already existing when the MFN clause came into effect. Specifically, it will be argued that an MFN clause in an investment treaty should not usually be understood as giving the beneficiary of the clause access to more favourable treatment in a pre-existing third-party treaty, although it can give access to pre-existing non-treaty treatment. This is a particularly important limitation on the operation of MFN clauses in international investment law, as there has traditionally been no controversy regarding the applicability of MFN clauses to pre-existing treatment.[149]

6(b)(i). The Role of Intent in Interpreting MFN Clauses in Investment Treaties

The approach to MFN clauses advanced in this Article relies heavily upon arguments regarding what can plausibly be said to have been intended by the States party to a BIT when they decide to incorporate an MFN clause into their treaty. There is, however, a significant difference of opinion amongst legal commentators regarding the relevance to treaty interpretation of the subjective intentions of the Contracting States. This Section of the Article will, therefore, lay out the justification for appealing to party intent in interpreting MFN clauses.

Although it is uncontested that Articles 31 and 32 of the Vienna Convention on the Law of Treaties ("VCLT") are the touchstone for interpretation of any BIT, there is still significant disagreement among commentators regarding their precise meaning. While few, if any, commentators would deny that the VCLT gives primacy to the text of a treaty over any textually unexpressed intentions of the Contracting States, disagreement exists regarding how strong this

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[149] Indeed, in the early 20th Century the controversy concerned whether MFN clauses applied to future treatment, not pre-existing treatment. Committee of Experts for the Progressive Codification of International Law, *supra* n. 28, at 140 ("Whether or not the clause applies to future as well as to past favours is much discussed by writers, although no actual case has been found in which the question was raised."); Thomas Barclay, "Effect of 'Most-Favoured-Nation' Clause in Commercial Treaties", 17 Yale L.J. 26, 31 (1907) (noting the view of a prominent French commentator that an MFN clause "must be considered as implying everything that existed at the moment when signed, but that it could not be considered to extend to anything later in date.").

preference for "text" over "intention" actually is. Most controversially, commentators are split regarding whether clear evidence that the text as adopted does not accurately reflect the intentions of the Contracting States should suffice to overrule otherwise clear treaty language, or if States must instead simply live with the agreements they sign.[150]

The source of this disagreement lies in the language adopted in Articles 31 and 32 of the VCLT. It is unquestionably true that Article 31 of the VCLT gives primacy to the text of the treaty, rather than to the subjective intentions of the parties, adopting as its fundamental rule that treaties be interpreted "in accordance to the terms of the treaty in their context and in light of its object and purpose."[151] While this rule is admittedly framed in a way that gives recognition to the intentions of the parties, requiring interpretation in accordance with the "object and purpose" of the treaty, this recognition applies solely with respect to interpretation of the written language. Consequently, it cannot justify giving any reading to a clause not directly based upon the actual language of the treaty.

The complication arises, however, when proper consideration is given to Article 32 of the VCLT, regarding the use of "supplementary means of interpretation", such as "the preparatory work of the treaty".[152] Article 32 lays out a two-step process, in which an interpretation is initially developed under Article 31, but is then tested against supplementary means of interpretation, to either "confirm" the interpretation arrived at under Article 31, or to derive a different interpretation where the interpretation arrived at under Article 31 left the treaty language either "ambiguous or obscure" or "manifestly absurd or unreasonable".[153]

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[150] In support of a broad interpretation, see, e.g. Emmanuel Gaillard, "International Arbitration Law: Establishing Jurisdiction Through a Most-Favored-Nation Clause", N.Y.L.J. (June 2, 2005), at 3. In support of a narrow interpretation, *see, e.g.* Vesel, *supra* n. 21, at 175.
[151] Vienna Convention on the Law of Treaties, 23 May 1969, U.N.T.S., vol.1155, p. 331, at Art. 31.
[152] *Id.* at Art. 32.
[153] *Id.*

It is the recognition in Article 32 that supplementary means of interpretation can be used to "confirm" an interpretation reached under Article 31 that creates the difficulty for a purely "textualist" interpretation of the VCLT, as this option is listed separately to situations in which the treaty language remains "ambiguous" or "absurd".[154] That is, it is not first necessary for the interpretation reached via Article 31 to be clearly flawed in some way for supplementary means of interpretation be used to "confirm" its correctness.

There is, however, little point in confirming the correctness of an interpretation if that interpretation cannot be rejected when shown to be wrong. It must, therefore, be the case, as recognised by commentators such as Stephen Schwebel, former President of the ICJ, that clear evidence of the intentions of Contracting States can override even apparently clear treaty language.[155]

Even on this understanding of the VCLT, of course, the text retains its centrality in interpretation. Otherwise Article 31's emphasis on the text would be nonsensical. However, this emphasis on the text can be understood as simply requiring a high level of certainty regarding the subjective intentions of the parties to the treaty if apparently clear language is to be overridden. That is, clear treaty language overrides vague indications of contrary party intent, but where party intent is sufficiently clear, even apparently clear treaty language must give way to it.

The subjective intentions of the States party to a BIT are, therefore, always important in the interpretation of the provisions of the BIT, including an MFN clause, even though they remain subsidiary to the language of the BIT itself.

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[154] *Id.*

[155] Stephen Schwebel, *May Preparatory Work Be Used to Correct Rather than Confirm the 'Clear' Meaning of a Treaty Provision?*, in Theory of International Law at the Threshold of the 21st Century 541 (1996). *See also* Anthony Aust, Modern Treaty Law and Practice 197 (2000). For the opposing view see Ulf Linderfalk, "Is the Hierarchical Structure of Articles 31 and 32 of the Vienna Convention Real or Not: Interpreting the Rules of Interpretation" 54 Netherlands Int'l L. Rev. 133 (2007); Mahnoush H. Arsanjani & W. Michael Reisman,

6(b)(ii). Party Intent as to the Extension of MFN Clauses to Already-Existing More Favorable Treatment

Once it has been accepted, however, that party intent can correct even otherwise clear treaty language, an important consequence can be drawn regarding the operation of MFN clauses. Specifically, it will be argued in this Section of the Article that parties usually cannot plausibly be understood to have intended an MFN clause in an investment treaty to grant the beneficiary of the clause access to more favourable provisions present in other investment treaties already in effect when the Basic Treaty came into force.[156] Consequently, even where the text of the MFN clause would itself seem to allow such an application, the clear intent of the parties should be taken to override the language of the clause.

The justification for this preclusion of already-existing treaty provisions from coverage by an MFN clause in a BIT derives directly from the instantaneous obligations that arise as a result of such clauses, as discussed above. To illustrate with an example, presume that in 1995 States A and B sign an investment treaty including an MFN clause, as well as including a fair and equitable treatment clause,[157] restricted in certain ways. However, States B and C had already signed, in 1992, an investment treaty containing an unrestricted fair and equitable treatment clause. If the MFN clause in the A-B treaty is understood as applying to treaty provisions already in existence when the A-B treaty comes into force, then investors from A are

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"Interpreting Treaties for the Benefit of Third Parties: The "*Salvors'* Doctrine" and the Use of Legislative History in Investment Treaties", 104 Am. J. Int'l L. 597 (2010).

[156] By contrast, see the 1978 ILC Draft Articles on Most-Favoured-Nation Clauses, describing as "obviously" true that MFN clauses apply to "benefits extended to a third State both before and after the entry into force of the treaty containing the clause." Draft Articles, *supra* n. 15, at 53. As noted previously, however, the 1978 Draft Articles were prepared without significant consideration of the context of international investment law.

[157] On the meaning of "fair and equitable treatment" in international investment law, see Christoph Schreuer, "Fair and Equitable Treatment in Arbitral Practice", 6 J. World Invest. Trade 357 (2005).

actually covered by an unrestricted fair and equitable treatment clause, despite the restrictions explicitly incorporated into the A-B treaty.

The implausibility of this situation actually being intended by the parties to the treaty derives not from the fact that the parties to the A-B BIT are receiving treatment other than that promised them in the BIT, as that is an inherent consequence of the operation of an MFN clause. The implausibility, rather, consists in that due to the instantaneous effect of MFN clauses, the removal of the restrictions on the fair and equitable treatment obligation included in the A-B treaty occurred the instant the A-B treaty came into force. That is, there was no point at which the fair and equitable treatment clause expressly negotiated between A and B was actually in effect between them. Such a situation, however, simply makes incomprehensible the inclusion of the restrictions in question within the treaty.

However, as established above, sufficiently strong evidence of party intent can suffice to override otherwise clear treaty language. Consequently, the sheer implausibility that A and B negotiated treaty language that would have absolutely no effect might justify precluding the application of the MFN clause in the A-B treaty to the fair and equitable treatment clause in the B-C treaty. That is, although the language of the MFN clause itself is unrestricted, an exception is read into the clause that prevents it being applied to any more favourable treaty provisions already in effect at the time the A-B treaty came into force.

The difficulty with such an argument is that, as noted in the historical survey earlier in the article, MFN clauses have traditionally been recognised as applying to already-existing treatment.[158] Indeed, one of the primary purposes of an MFN clause has been argued to be that it serves to reassure treaty negotiators that they have secured the best available treatment for their

[158] See *supra*, Sections 2-3.

State, rather than leaving them with the burden of discovering every form of treatment the counterparty to the treaty is providing to third States.[159]

It is at this point that the distinctively public nature of investment treaties becomes important. Unlike most treaties, investment treaties are expressly designed to be broadly publicised. After all, States enter into investment treaties as a means of attracting private investment from abroad. The entire purpose of such a treaty, then, would be undermined were it to be kept secret, or even just not made broadly available. As a result, information on the investment treaties signed by States is easily available, even to the extent of being collected on publicly accessible websites.[160]

The consequence of this public nature of investment treaties for the interpretation of MFN clauses is that it is simply implausible that States incorporated an MFN clause into their treaty as a protection against unknown already-existing BIT-based treatment. The information on such treatment is simply too easily accessible. To return to the example above, if unrestricted fair and equitable treatment had been discussed in the negotiations between A and B, B could have insisted that A grant some countervailing benefit. However, if it is subsequently incorporated via an MFN clause, no compensation is given, and B has effectively granted unrestricted fair and equitable treatment for free. Absent evidence to the contrary, then, it is simply implausible to read an MFN clause in a BIT as referring to already-existing provisions in a third-State BIT.

The precise nature of the position being maintained here should be emphasised. It is not being argued that the MFN clause in the A-B BIT should be understood as including an

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[159] Schwarzenberger, *supra* n. 6, at 99 ("It is clear the m.f.n. clauses serve as an insurance against incompetent draftsmanship and lack of imagination on the part of those who are responsible for the conclusion of international treaties.").
[160] See, e.g. Investment Instruments Online, www.unctadxi.org/templates/DocSearch____779.aspx.

exception specifically precluding its applicability to the already-existing B-C BIT. Rather, the exception in question is a generalised one, referring to any pre-existing BIT-based treatment. It does not, therefore, require that the parties have identified the BITs in question in any way.

Importantly, however, since this argument is premised upon the publicity attached to BITs, it will be far less applicable to non-treaty-based treatment or to treaties that have not received significant publicity. Where the treatment granted to a third State constitutes, for example, an administrative practice, any tribunal addressing the applicability of an MFN clause must undertake an analysis of the accessibility to the Contracting States of information on the practice. Only if the availability of information on the practice reaches a level corresponding to the publicity attached to BITs will the current argument be applicable.[161]

Nonetheless, as argued above, using the intentions of the parties to override otherwise clear treaty language is only appropriate when those intentions can be clearly ascertained, and it might be argued that the mere implausibility that States would knowingly agree to an MFN clause that automatically deleted negotiated treaty language does not rise to the level of certainty required by the VCLT. After all, it is certainly possible that the individuals negotiating the treaty simply adopted the general MFN clause without a full awareness of its effects. In such a situation, however, there would be no intent to exclude pre-existing BIT provisions.

The following Section of the Article will, therefore, offer an alternative argument that requires consideration of available evidence, rather than merely invoking a presumption. As will be discussed below, these two arguments have importantly different impacts on the interpretation of MFN clauses, but both would suffice to preclude the application of MFN clauses to already-existing more favourable BIT provisions in at least some situations.

[161] Importantly, the knowledge need only be attributed to the beneficiary, not to those who negotiated the treaty on its behalf.

6(b)(iii). Interpretation of MFN Clauses and the Interconnectedness of Treaty Rights

While the argument advanced in the preceding section would justify a blanket exclusion of pre-existing BIT provisions from the application of MFN clauses, it is also possible to make an argument for a more limited exclusion, but one that is based on a stronger evidential foundation. As a result, even if the blanket exclusion argued for above is rejected, a more limited exclusion might still be applicable.

The argument for this more limited exclusion centers on interpretation of the term "treatment" as used in an MFN clause. MFN clauses, after all, are a promise that no more favourable "treatment" will be given to investors from any third State than is given to investors from the beneficiary State. What constitutes "treatment" under an MFN clause, however, is never specified, and hence must be determined by each tribunal that is faced with an MFN-based argument.

The conventional approach to evaluating an MFN-based argument involves comparing the specific treaty provisions invoked by the investor. That is, if the investor is attempting to use the MFN clause in the Basic Treaty to alter that treaty's dispute resolution provisions, a conventional analysis would involve comparing those provisions with the dispute resolution provisions in the third-State treaty. If the latter are judged to be more favourable, then the MFN clause is held to be applicable.

Such an approach, however, relies upon a contention that each treaty provision in a treaty constitutes an identifiable form of treatment, independent of the other clauses in the treaty. Without such a premise, a one-to-one comparison of treaty provisions could not suffice to show that investors under the third-State Treaty are receiving more favourable "treatment" than

investors under the Basic Treaty. Of course, the alternative of viewing the "treatment" received by an investor as constituting every provision of the applicable treaty, acting together, is itself unworkable, as it would make any meaningful comparison impossible. Consequently, inclusion of an MFN clause would be nonsensical, as it could never be successfully invoked.

A third approach is, however, available, and it is this approach that serves as the foundation for the argument to be presented in this section. This approach emphasises that treaty negotiation is not a clause-by-clause matter, with each provision being agreed before another is addressed. Rather, treaty negotiation is fundamentally a more inter-related enterprise, with substantively unconnected elements of the treaty often being used as trade-offs: one party getting its preferred language in the first clause in exchange for the other party getting its preferred language in the second clause.

Because of this interconnectedness of treaty negotiation, an agreement between State A and State B to include, for example, restrictions on access to investor-State arbitration in the A-B BIT, need not reflect an unwillingness of one of the States to grant unrestricted access to investor-State arbitration. Rather, it may simply be that what State B, for example, requested from State A in exchange for unrestricted access to investor-State arbitration was something State A was unwilling to give. That is, the existence of the restriction might represent a failure of negotiation, rather than an agreed level of treatment.

However, this does not mean that there is no identifiable "treatment" of investors that was agreed between A and B. Rather, it means that the "treatment" consists in a combination of the restricted dispute resolution procedure included in the treaty, and the provision(s) with which it was connected during negotiations. The dispute resolution procedure, that is, was agreed as

part of a broader package, and it is this broader package that constitutes the "treatment" of the investor from the perspective of an MFN clause.

Of course there will rarely be information available to a tribunal as to which aspects of the treaty were connected in this way during negotiations. Consequently, it might seem that this broader conception of "treatment" is of no use to a tribunal faced with an MFN-based argument. However, it is unnecessary for a tribunal actually to identify which treaty provisions were used as trade-offs against one another. Rather, all the tribunal must do is find adequate evidence that such a trade-off took place.

For example, the tribunal may note that in the B-C BIT, entered into prior to the A-B BIT, State B was willing to agree to unrestricted investor-State dispute resolution. Consequently, absent evidence of a change in policy by B between negotiation of the two BITs, it is reasonable to conclude that B was willing to agree to unrestricted investor-State arbitration in the A-B BIT. Similarly, the tribunal may find that there is no evidence that State A was unwilling to agree to unrestricted investor-State arbitration. As a result, a rebuttable presumption must arise that unrestricted investor-State arbitration was an option during negotiations for the A-B BIT, but that restrictions were imposed anyway.

That is, the tribunal need simply conclude that since both parties were willing to agree to unrestricted investor-State arbitration, but nonetheless ultimately imposed restrictions, the most plausible explanation is that the dispute resolution provisions were not negotiated independently, but were instead linked to another provision(s) during negotiations. The limitations on dispute resolution, that is, were part of a broader package of treatment, in which those limitations were imposed as a result of a failure to agree alternative terms on one or more other provisions.

Nonetheless, whatever other provisions were included in this broader "treatment", the available evidence indicates that unrestricted dispute resolution was expressly rejected by the parties. As argued in the previous section of the Article, though, if the MFN clause in the A-B BIT is interpreted as applying to provisions in the pre-existing B-C BIT, the restrictions on dispute resolution in the A-B BIT will never come into force. Consequently, given that information on the B-C BIT was easily accessible to both States, it would have made no sense for A and B to agree on limited investor-State arbitration as part of a broader package of "treatment", only to have those limitations removed as soon as the A-B BIT came into effect. This would involve giving away for free something for which a price was clearly being asked during negotiations.

This second argument, therefore, also justifies interpreting the MFN clause in the A-B BIT as not applying to the dispute resolution provisions of the B-C BIT. However, it does so in a more limited fashion than the first argument. That is, while a conclusion derived from this second argument has the benefit of being based on evidence, rather than on a mere presumption, it is also limited in that if the evidence is not sufficient, the argument fails. There might be, for example, evidence that at the time the A-B BIT was negotiated, State A had a policy opposing unrestricted investor-State arbitration. In such a situation, an alternative explanation for the incorporation of restricted investor-State arbitration into the BIT exists, and it is unnecessary to appeal to negotiation trade-offs. As a result there would be inadequate justification for interpreting the MFN clause in the A-B BIT as not applying to the dispute resolution provisions of the B-C BIT.

It is also important, however, to emphasise precisely what is precluded by this argument, as it differs from what is precluded by the first argument. The first argument, that is, resulted in

a blanket exception of the application of the MFN clause to all pre-existing BIT provisions. The exception created by this second argument, on the other hand, relates not to pre-existing BIT provisions, but to a particular type of provision. That is, it is based on a conclusion by the tribunal that the parties most probably considered and rejected unrestricted investor-State arbitration. As a result, it is the substantive agreement to unrestricted investor-State arbitration that is excluded from the application of the MFN clause, not mere appeal to the B-C BIT. The following section of the Article will address the importance of this distinction between the two arguments.

6(b)(iv). MFN Clauses and Subsequent Adoptions of Already-Existing More Favorable Treatment

The preceding two Sections of the Article have offered two approaches to the issue of the application of MFN clauses to treatment of a third State already in existence at the time the treaty containing the MFN clause comes into effect. As will be demonstrated, however, these two arguments have significantly different effects on the impact of the subsequent adoption by a State of already pre-existing more favourable treatment.

That is, even if, it is determined, for example, that investors from State A should not receive the unrestricted access to investor-State arbitration already available to investors from State C when the A-B BIT came into effect, State B may nonetheless subsequently negotiate a further BIT with State D, which also includes unrestricted access to investor-State arbitration. The question this raises is whether investors from State A could then gain unrestricted access to investor-State arbitration through the B-D treaty, even though they were precluded from doing so through the B-C treaty.

The difference in this context between the two arguments offered above arises from the rationales on which each argument is based. The first argument is based upon a determination that the MFN clause in the A-B BIT must be understood not to refer to already-existing third-State BIT provisions, due to the implausibility that the parties would have adopted a treaty provision with the knowledge that it would have absolutely no effect.

However, a subsequent adoption by State B of precisely the same treatment with respect to State D would not have the effect of making the original negotiation of the language in the A-B BIT pointless. After all, had the B-C treaty never existed, there would be no question that the MFN clause in the A-B BIT would be applicable to the terms of the B-D BIT.

Consequently, a tribunal that adopted the first argument in refusing to apply the MFN clause in the A-B BIT to give investors from State A the unrestricted access to investor-State arbitration included in the B-C treaty, would nonetheless remain perfectly free to grant that access via the B-D treaty.

By contrast, the second argument, focusing upon the interconnectedness of treaty negotiation, ultimately relies upon a conclusion that the States party to the BIT containing the MFN clause had considered and rejected a particular type of provision. As a result, a tribunal adopting this second argument as a ground for rejecting the applicability of the MFN clause in the A-B BIT to the dispute resolution procedures in the B-C BIT does so on the ground that the MFN clause in the A-B BIT simply cannot be a means of incorporating unrestricted investor-State arbitration into the A-B BIT. The subsequent adoption of precisely the same substantive treatment in the B-D treaty, therefore, would fall to precisely the same argument.

Ultimately, then, while both of the arguments advanced here provide a justification for holding MFN clauses to be inapplicable to at least some types of pre-existing treatment, they are

nonetheless importantly different, and significantly different impacts will result from a tribunal's adoption of one of the arguments rather than the other.

6(c). Non-State Beneficiaries of MFN Clauses in BITs as Classes, Not Individual Claimants

While the preceding Sections of the Article have addressed potential exclusions of the applicability of MFN clauses to substantive treaty promises, no analysis has as yet been made regarding the nature of the beneficiaries of an MFN clause. While for most non-investment treaties this question may have an obvious answer, it is a more complex issue in the international investment law context, as MFN clauses in BITs do not generally refer to the Contracting States to the BIT, but to their "investors".[162]

In response to this situation, arbitration tribunals have uniformly approached MFN-based claims as though they required that any evaluation of the "favourability" of treatment be done with reference to the particular individual bringing the claim. The claimant, after all, is the "investor", and hence presumably the subject of the reference in the MFN clause. The goal of this Section of the Article is to demonstrate that this approach is mistaken, and that evaluations of the favourability of treatment must be made with respect to the class of investors from which the claimant in an arbitration has come, rather than with respect to the claimant itself.

The initial indication that it is the class of investors from which the claimant in an arbitration comes that is the beneficiary of an MFN clause in a BIT comes simply from the language adopted in such a clause. The claimant, after all, is not only not a signatory to the BIT, but is also nowhere referenced in it. That is, rather than including a promise that MFN treatment

[162] An MFN clause may refer to "investments", rather than "investors", or indeed may refer to both. However, to simplify the explanation being made here, only "investors" will be referred to. Nonetheless, precisely the same argument as made in this section with respect to "investors" can be made with respect to "investments".

will be provided to this specific investor, the BIT will include merely a generalised reference to "investors", a class to which this particular investor belongs.[163]

It might nonetheless be argued that although the collective term "investors" is used, it is used as a means of referring individually to each member of the class, rather than referring collectively to the class as a whole. In the same manner, someone who says "I fed my children dinner" is not saying that he somehow gave food to an abstract class of children, of which his individual children happen to be members. Rather, the clear meaning is that he provided food individually to each of his children. If the collective reference to "investors" in a BIT is understood as also operating in this individualised manner, then the relevant reference for the evaluation of favourability would remain the claimant investor, rather than the broader class from which it came.

However, the instantaneous obligation understanding of MFN clauses in investment treaties simply makes such an individualised interpretation of the term "investor" unworkable. Presume, for example, that in 1990 State A and State B enter into a BIT that includes an MFN clause. Then, in 1995, State B enters into a BIT with State C that includes a more favourable fair and equitable treatment provision than the one included in the A-B BIT. As a result of the instantaneous effect of MFN clauses, that more favourable fair and equitable treatment provision is incorporated into the A-B BIT in 1995, as soon as the B-C BIT comes into force.

Importantly, however, some investors from State A will not even have invested in State B as of 1995. In addition, few of those who have invested prior to 1995 will have a claim against State B as of that date. As a result, no facts about investors from State A, their investments, or the bases of their claims can be relevant to determining whether the treatment provided to

[163] As previously noted, the reference may be to "investments", rather than "investors", or indeed to both. However, for purposes of clarity this complication will be ignored here, as it does not affect the analysis being made.

investors from State C is indeed more favourable than that provided to investors from State A. The information is simply not there to be considered.

Rather, only an evaluation of favourability with respect to investors from State A *as a class* can possibly support a conclusion that the broader fair and equitable treatment provision included in the B-C BIT was also applicable to investors from State A as of 1995. This is, however, precisely the conclusion mandated by the instantaneous effect of MFN clauses.

The consequence of this is that the proper evaluation to be undertaken by a tribunal addressing an MFN-based claim is not whether the treatment claimed by the investor would be more favourable to the specific investor bringing the claim. It must, rather, be whether the treatment in question would be more favourable to investors from the claimant's Home State *as a class*.

As the following Section of the Article will argue, however, moving the focus of a favourability evaluation from the claimant to the class of investors from which the claimant comes can cause an enormous change in the impact on an investor of an MFN clause. Indeed, it can have the consequence that an MFN clause will actually harm a claimant, rather than benefit it.

6(c). The "Exclusionary Effect" of an MFN Clause

That MFN clauses only serve to provide "more favourable" treatment to investors might be taken to imply there is no circumstance in which a respondent State in an arbitration would be able to invoke an MFN clause as a defence against an investor's claims. After all, if the application of an MFN clause to a particular type of third-State treatment would harm an investor, that treatment would hardly be "more favourable" for it. However, as the preceding

Section of the Article has argued, this view is fundamentally flawed, as it bases the evaluation of the favourability of third-State treatment on the individual claimant in an arbitration, rather than on the class from which the claimant comes. This Section of the Article will demonstrate, however, that MFN clauses can in fact harm an investor, and hence can indeed be used by respondent States as a defence against an investor's claims.

Presume, for example, that in 1990 State A and State B sign a BIT that includes an MFN clause, as well as a consent to investor-State arbitration restricted to claims for expropriation. Subsequently, in 1995, State B signs a BIT with State C that includes a consent to investor-State arbitration for a wide variety of claims, but not including expropriation. Presuming that this latter consent is indeed more favourable than the narrower consent in the A-B BIT, the instantaneous effect of MFN clauses means that as of 1995 the broader consent to arbitration in the B-C BIT is incorporated into the A-B BIT.

Importantly, however, the MFN clause in the A-B BIT only constitutes a promise that investors from third States will not be treated better than investors from State A. That is, as discussed in the historical survey at the beginning of the Article, MFN clauses are a means of providing equality with competitors, not superiority. As a result, the MFN clause in the A-B BIT only provides investors from State A with treatment equal to that received by investors from State C. It cannot provide them with better treatment.

Investors from State C, however, cannot bring expropriation claims to investor-State arbitration, as such claims are not covered by the consent to arbitration in the B-C BIT. Consequently, were investors from A able to retain their right to bring expropriation claims, while also gaining the right to bring claims under the terms of the B-C BIT, they would actually be receiving better treatment than investors from State C.

It must, therefore, be that as soon as investors from State A gain the ability to bring claims under the consent to arbitration in the B-C treaty, they simultaneously lose the right to bring claims under the consent to arbitration in the A-B treaty. That is, MFN clauses incorporate more favourable treatment given to third parties, but in so doing exclude the treatment originally promised in the treaty in which they are contained. This element of the operation of MFN clauses is what is here called the "exclusionary effect" of an MFN clause.

This may initially appear to be a minor point, given that the MFN clause will only incorporate treatment given to third parties where that treatment is more favourable to the beneficiary of the clause. However, as was made clear in the previous Section of the Article, the proper standard for determining whether an MFN clause incorporates treatment into the BIT in which it is contained is not whether the treatment in question would be more favourable to the investor bringing the arbitration, but whether it would be more favourable to the class referred to in the MFN clause, such as "investors from State A".

To return to the example, then, it would presumably be more favourable to investors from State A as a class to have access to a broad dispute resolution provision, even one that does not include expropriation. There is, after all, no way of knowing in advance the specific grounds on which investors may need to bring a claim. Consequently, the broader consent to investor-State arbitration in the B-C BIT will replace the narrower consent originally included in the A-B BIT through the operation of the MFN clause.

This will, however, have the effect of preventing any investor from State A from bringing to arbitration a claim of expropriation. The effect of the MFN clause in the A-B BIT will, therefore, by no means be "more favourable" to investors whose only claim is one of expropriation, as they will lose their ability to bring any claim at all.

The exclusionary effect of an MFN clause, then, once understood in the context of the class-based nature of MFN beneficiaries under BITS, can actually serve to make MFN clauses harmful to specific investors. In turn, it can give respondent States a reason to invoke MFN clauses as a defence to an investor's claim, in opposition to the traditional view that they are merely a mechanism to be used by investors.

8. Conclusion

MFN clauses have gained a prominence within international investment law that they have not achieved elsewhere primarily because of the interaction between such clauses and investor-State arbitration. Nonetheless, international investment arbitration tribunals have done little to explicate the operation of MFN clauses in the international investment context, focusing instead on the perceived teleological nature of such clauses. The goal of this Article has been to demonstrate that this teleological, non-discrimination approach to the interpretation of MFN clauses is both inconsistent with the historical development of MFN clauses, and fails to recognize certain limitations on MFN clauses that follow necessarily from their incorporation into international investment agreements.

As the foregoing discussion has attempted to emphasize, however, an analysis of the boundaries of MFN clauses in international investment law is not worth pursuing solely for academic curiosity. A full understanding of MFN clauses makes clear that they are an enormously powerful instrument, and can impede significantly a State's otherwise legitimate regulatory activities. Nonetheless, despite the power of MFN clauses, they are almost routinely incorporated into contemporary BITs, as though they constitute little more than a political statement of friendship, with no legal consequences. The hope underlying this Article is that

once the operation of MFN clauses in international investment agreements is more clearly understood, they will be used more circumspectly.