

Chapter XI

THE MOST-FAVOURLED-NATION CLAUSE

A. Introduction

355. The Commission, at its sixtieth session (2008), decided to include the topic “The most-favoured-nation clause” in its programme of work and to establish a Study Group on the topic at its sixty-first session.¹³⁷⁰

356. A Study Group, co-chaired by Mr. Donald M. McRae and Mr. A. Rohan Perera, was established at the sixty-first session (2009), during which it considered, *inter alia*, a framework that would serve as a road map for future work and agreed on a work schedule involving the preparation of papers intended to shed additional light on questions concerning, in particular, the scope of most-favoured-nation clauses and their interpretation and application.¹³⁷¹

B. Consideration of the topic at the present session

357. At the present session, the Commission reconstituted the Study Group on the most-favoured-nation clause, co-chaired by Mr. Donald M. McRae and Mr. A. Rohan Perera.

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

1. DISCUSSIONS OF THE STUDY GROUP

359. The Study Group held 3 meetings on 6 May and on 23 and 29 July 2010. It considered and reviewed the various papers prepared on the basis of the framework to serve as a road map of future work, which was decided upon in 2009, and agreed upon a programme of work for next year. It had before it several papers prepared by members of the Study Group: these papers serve as the background context that seeks to illuminate further the challenges of the most-favoured-nation clause in contemporary times, by looking at the typology of existing most-favoured-nation provisions, the areas of relevance of the 1978 draft articles,¹³⁷² how most-favoured nation has developed and is developing in the context of the GATT and the WTO, other activities that have been carried out particularly in the context of OECD and UNCTAD, where

¹³⁷⁰ At its 2997th meeting, on 8 August 2008 (see *Yearbook ... 2008*, vol. II (Part Two), p. 148, para. 354). For the syllabus of the topic, see *ibid.*, Annex II. The General Assembly, in paragraph 6 of its resolution 63/123 of 11 December 2008, took note of the decision.

¹³⁷¹ At its 3029th meeting, on 31 July 2009, the Commission took note of the oral report of the Co-Chairpersons of the Study Group on the most-favoured-nation clause (see *Yearbook ... 2009*, vol. II (Part Two), pp. 146–147, paras. 211–216).

¹³⁷² *Yearbook ... 1978*, vol. II (Part Two), para. 74.

substantial work has been accomplished on the subject, as well as analyzing some of the contemporary issues concerning the scope of application of the clause, such as those arising in the *Maffezini* case.¹³⁷³

(a) *Catalogue of most-favoured-nation provisions* (Mr. Donald M. McRae and Mr. A. Rohan Perera)

360. This paper provided a preliminary categorization of most-favoured-nation clauses as they appear in various bilateral investment agreements and free trade area agreements. Rather than reproducing a catalogue of more than 3,000 bilateral investment agreements and free trade area agreements that had been concluded, an analysis of trends reflecting most-favoured-nation practice in select treaties and agreements was undertaken. It was considered that this typological approach could be more useful to the work of the Study Group. In this connection, the catalogue contained four broad categories, namely: (a) a sampling of most-favoured-nation provisions in bilateral investment agreements and free trade area agreements giving general treatment; (b) most-favoured-nation provisions in treaties that gave specific treatment, these being in turn subdivided into provisions dealing with the post-establishment phase and the pre-establishment phase; (c) provisions of exceptions within the most-favoured-nation provision; and (d) provisions of exceptions outside the specific most-favoured-nation clause. This is an ongoing exercise and the categorization may be subject to subsequent adjustments.

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

361. This paper reviewed, in a preliminary and non-exhaustive manner, the draft articles on most-favoured-nation clauses adopted by the Commission in 1978, focusing on their contemporary utility, without making any suggestions for any concrete amendments. The working paper identified a number of relevant and closely interrelated factors of change bearing on the 1978 draft articles, which had occurred, including: (a) a shift in importance of most-favoured-nation clauses from trade to investment; (b) the proliferation of bilateral investment treaties; (c) the strengthened multilateral framework of the WTO/GATT scheme for trade; (d) the failure of negotiations, conducted in 1995 through 1998, on a multilateral agreement on investment; (e) the development of regional integration, evidenced in European Union, NAFTA (North American Free Trade Agreement Between the Government of Canada, the Government of the United Mexican States, and the Government of the United States of America) and other regional frameworks;

¹³⁷³ *Maffezini v. Kingdom of Spain* (see footnote 16 above).

(f) the decline in enthusiasm for the New International Economic Order; (g) closer cooperation among developing countries; and (h) the development of the dispute settlement mechanisms in the areas of trade and investment. Against this background of developments, the paper proceeded to examine the 1978 draft articles by clusters. Overall, it was concluded that some elements of the 1978 draft articles need to be re-examined, taking into account contemporary developments.¹³⁷⁴ It was suggested in the paper that the Commission, in collaboration with the Sixth Committee, should aim at drafting a new set of revised draft articles on most-favoured-nation clauses in light of the review of the 1978 draft articles.

(c) *Most-favoured nation in the GATT and the WTO*
(Mr. Donald M. McRae)

362. This paper provided an analysis of the way in which most-favoured nation had been interpreted and applied in the context of GATT and WTO agreements, focusing more on the practice in relation to WTO agreements and in particular the interpretation of those agreements through WTO dispute settlement.¹³⁷⁵ The general assessment was that in all the areas of the WTO agreements to which

¹³⁷⁴ The provisions included, *inter alia*, draft articles concerning: definitional rules (draft articles 1–6), the *ejusdem generis* rule (draft articles 7–8), compensation (draft articles 11–15), bilateral and multilateral agreements (draft article 17), special consideration for developing countries (draft articles 23–24 and 30). Moreover, the customs union exception which was not treated in the draft articles would have to be reconsidered. The draft articles on national treatment (draft articles 18–19), most-favoured-nation rights (draft articles 20, paragraph 1, and 21, paragraph 1) and domestic law (draft article 22) appeared to be self-evident propositions and served as reminders, which were relevant today. However, they were not worthy of in-depth discussion at this stage. Further, the other remaining draft articles (draft articles 27–29) were essentially without prejudice clauses, and did not appear to require special consideration at this stage.

¹³⁷⁵ *European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries*, AB-2004-1, Report of the WTO Appellate Body (WT/DS246/AB/R), 24 April 2004; *Canada—Certain Measures Affecting the Automotive Industry*, AB-2000-2, Report of the WTO Appellate Body (WT/DS139/AB/R, WT/DS142/AB/R), adopted 19 June 2000; *European Economic Community—Imports of Beef from Canada*, L/5099, GATT Panel Report (BISD 28S/92), 10 March 1981; *United States—Denial of Most-Favoured-Nation Treatment as to Non-Rubber Footwear from Brazil*, GATT Panel Report (DS18/R - 39S/128), 19 June 1992; *Spain—Tariff Treatment of Unroasted Coffee*, L/5135, GATT Panel Report (BISD 28S/102), 11 June 1981; *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, AB-1997-3, Report of the WTO Appellate Body (WT/DS27/AB/R), 25 September 1997; *Turkey—Restrictions on Imports of Textile and Clothing Products*, AB-1999-5, Report of the WTO Appellate Body (WT/DS34/AB/R), 19 November 1999; *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, AB-1998-4, Report of the WTO Appellate Body (WT/DS58/AB/R), 6 November 1998; *Mexico—Tax Measures on Soft Drinks and Other Beverages*, AB-2005-10, Report of the WTO Appellate Body (WT/DS308/AB/R), 24 March 2006; *Japan—Taxes on Alcoholic Beverages*, AB-1996-2, Report of the WTO Appellate Body (WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R), 1 November 1996; *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, AB-2000-11, Report of the WTO Appellate Body (WT/DS135/AB/R), 5 April 2001; *Belgian Family Allowances*, G/32, GATT Panel Report (BISD 1S/59), 7 November 1952; *Indonesia—Certain Measures Affecting the Automobile Industry*, Report of the WTO Appellate Body (WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R), 23 July 1998; *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, Report of the WTO Appellate Body (WT/DS27/R/ECU, WT/DS27/R/MEX and WT/DS27/R/USA), 25 September 1997; and *United States—Section 211 Omnibus Appropriations Act of 1998*, AB-2001-7, Report of the WTO Appellate Body (WT/DS176/AB/R), 1 February 2002.

most-favoured nation applied—goods, services and intellectual property—most-favoured-nation treatment had been treated as essential, fundamental, as the cornerstone. It had been interpreted in a way as to give it maximum effect. This broad application appeared to draw no distinction between procedural and substantive benefits.¹³⁷⁶ It was also noted that there was nothing in the jurisprudence relating to most-favoured nation under GATT to suggest that procedural rights would be excluded from the application of most-favoured nation.¹³⁷⁷ Moreover, the application of most-favoured nation under the WTO seemed to be the same regardless of the different ways in which the principle had been formulated. The interpretation of most-favoured-nation clauses under the WTO had been influenced more by a perception of the object and purpose of the provision, rather than by its precise wording.

363. At the same time, the scope of most-favoured nation was significantly curtailed by exceptions, both in general terms (such as those relating to customs unions and free trade areas) and, specifically (for example, the carve-out in respect of trade in services that WTO members were able to annex to article II of GATS (the General Agreement on Trade in Services)). The breadth of such exceptions meant that the range of application of most-favoured nation could be in fact quite limited. As a result of the burgeoning of customs unions and free trade agreements, the majority of tariffs today were not applied on a most-favoured-nation basis; they were applied under regional and other preferential GATT-exempt arrangements. The approach of the Appellate Body had been to interpret many of the exceptions narrowly.¹³⁷⁸ However, even with such a restrictive interpretation of individual applications of the exceptions, the substantive scope of the exceptions was far ranging and thus most-favoured nation under the WTO had more limited substantive application than the statement of the principle and its characterization as “fundamental” would suggest. The conclusions drawn were tentative; there was as yet insufficient jurisprudence on the interpretation of the most-favoured-nation provisions under the WTO to be too definitive.

(d) *The work of OECD on most-favoured nation*
(Mr. Mahmoud Hmoud)

364. This paper considered and reviewed the substantial work that has been carried out within the OECD, drawing attention in particular to several instruments that had been negotiated in order to achieve the goals of the OECD, including the liberalization of capital movements and the free movement of goods.¹³⁷⁹ It also considered negotiations

¹³⁷⁶ *United States—Section 337 of the Tariff Act of 1930*, L/6439, GATT Panel Report (BISD 6S/345), 7 November 1989.

¹³⁷⁷ Arguably, in the case of the Agreement on Trade-Related Aspects of Intellectual Property Rights, this might be seen to flow from the broad meaning given to the term “protection” under articles 3 and 4.

¹³⁷⁸ As the case in article XXIV of the General Agreement on Tariffs and Trade (GATT) in *Turkey—Restrictions on Imports of Textile and Clothing Products*, and to the *chapeau* to article XX, in *United States—Import Prohibition of Certain Shrimp and Shrimp Products* (see footnote 1375 above).

¹³⁷⁹ The OECD Code of Liberalisation of Capital Movements, covering direct investment and establishment; the OECD Code of Liberalisation of Invisible Operations, concerning services; and work on the draft multilateral agreement on investment (1995–1998); as well as a series of published working papers related to international investments.

on the draft multilateral agreement on investment and issues raised therein, including the most-favoured-nation clause whose scope covered the pre-establishment and post-establishment phases of investment, the work of the OECD on the terms “In like circumstances” and on issues such as the scope of most-favoured-nation treatment in relation to privatization, intellectual property, investment incentives, monopolies and state enterprises, investment protection, and exceptions (general and specific) to most-favoured-nation provisions. It was noted that the work done by the OECD could offer useful guidance for the Study Group.

(e) *The work of UNCTAD on most-favoured nation*
(Mr. Stephen Vasciannie)

365. This paper examined two substantial publications of UNCTAD,¹³⁸⁰ and considered other aspects of its work in collecting and analyzing State practice on the most-favoured-nation standard in investment agreements. In particular, the paper discussed issues concerning the scope and definition of the most-favoured-nation standard, the role of this standard in protecting investors, different ways in which the standard has been formulated in various agreements and exceptions to the standard, including the provisions on regional economic integration organizations, reciprocity requirements and intellectual property considerations. It also identified certain issues concerning the most-favoured-nation standard that had not been fully explored by UNCTAD, noting that some of these issues, including the status of the standard in customary international law, the legal interpretation of different formulations of the standard and the relationship between treaty provisions and municipal law practice, could be further considered. In reviewing the UNCTAD papers, reference was also made to various policy questions such as the “free rider” and identity issues, pre-entry and post-entry clauses and the relationship between the most-favoured-nation treatment standard and other standards of investment protection.

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

366. This paper reviewed the development relating to the broad interpretation given by arbitral tribunals to the most-favoured-nation clause in investment agreements, in a series of decisions relating to investment disputes starting with the *Maffezini* case. The principal problem arising out of the case was the question whether it could be determined with any certainty the obligations a contracting party had undertaken when including the most-favoured-nation clause within an investment treaty and in particular the relationship of such a clause to provisions relating to dispute settlement. A related question was whether substantive rights and protection standards contained in a treaty with a third State, which were more beneficial to an investor, could be relied upon by such an investor to his advantage, by virtue of the most-favoured-nation clause.¹³⁸¹

¹³⁸⁰ The UNCTAD Series on Issues in International Investment Agreements and the UNCTAD Series on International Investment Policies for Development.

¹³⁸¹ Cases following a cautious approach include, for example, *Tecnicas Medioambientales Tecmed S.A. v. the United Mexican States*,

367. The analysis of arbitral awards dealt with two types of claims where the most-favoured-nation clause in the basic treaty was sought to be invoked to expand the scope of the dispute settlement provisions of such treaty, namely: (a) to override the applicability of a provision requiring the submission of a dispute to a domestic court for a “waiting period” of 18 months, prior to submission to international arbitration; and (b) to broaden the jurisdictional scope in the basic treaty that restricted the ambit of the dispute settlement clause to a specific category of disputes, such as disputes relating to compensation for expropriation.¹³⁸²

368. Following a review of recent arbitral practice, including *Maffezini* and subsequent developments, the paper stated that one of the important conclusions was that the particular form in which a most-favoured-nation clause was drafted in a particular agreement mattered and depending on the wording of the applicable clause, a dispute could lead to different outcomes, giving rise to the need for legal certainty. Accordingly, some guidelines could assist States in determining with some degree of certainty whether they were granting broad rights or whether the rights they were granting were more circumscribed when they include a most-favoured-nation clause in an

ICSID Case No. ARB/(AF)/00/2, Award of 29 May 2003. See also Salini Costruttori S.p.A. and Italstrade S.p.A. v. Hashemite Kingdom of Jordan, ICSID Case No. ARB/02/13, Award of 31 January 2006; Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Award of 27 August 2008; and CMS Gas Transmission Company v. Argentine Republic, ICSID Case No. ARB/01/8, Award of 12 May 2005. Cases reflecting a liberal approach importing substantive protection standards include Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, Award of 6 February 2007; MTD Equity Sdn. Bhd., MTD Chile S.A. v. Republic of Chile, ICSID Case ARB/01/7, Award of 25 May 2004; and Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29, Decision on jurisdiction of 14 November 2005. For treaty practice reacting to the liberal interpretation, see the formulations in the Chile–Colombia Free Trade Agreement of 27 November 2006 and the Maffezini note in the draft free trade agreement of the Americas, FTAA.TNC/w/133/Rev.3, 21 November 2003.

¹³⁸² *Maffezini v. Kingdom of Spain, ICSID Case No. ARB 97/7, Decision of the Tribunal on objections to jurisdiction of 25 January 2000, ICSID Review—Foreign Investment Law Journal*, vol. 16, No. 1 (2001), p. 1; the text of the decision is also available at <http://icsid.worldbank.org>. For cases following the reasoning in *Maffezini* and its implications, see, for example, *Suez, Sociedad General de Aguas de Barcelona S.A. and InterAguas Servicios Integrales del Agua S.A. v. the Argentine Republic, ICSID Case No. ARB/03/17, Decision on jurisdiction of 16 May 2006; Siemens A.G. v. Argentine Republic, ICSID Case No. ARB/02/8, Decision on jurisdiction of 3 August 2004; Gas Natural SDG, S.A. v. Argentine Republic, ICSID Case No. ARB/03/10, Decision of the Tribunal on preliminary questions of jurisdiction of 17 June 2005; and RosInvestCo UK Ltd. v. the Russian Federation, Case No. Arbitration V 079/2005, Award on jurisdiction of October 2007, Arbitration Institute of the Stockholm Chamber of Commerce. For cases contrary to the *Maffezini* reasoning and their implications, see, for example, *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Hashemite Kingdom of Jordan, ICSID Case No. ARB/02/13, Decision on jurisdiction of 29 November 2004; Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Decision on jurisdiction of 8 February 2005; Vladimir Berschader and Moise Berschader v. the Russian Federation, Case No. Arbitration V 080/2005, Award of 21 April 2006, Arbitration Institute of the Stockholm Chamber of Commerce; and *Telenor Mobile Communications A.S. v. Republic of Hungary, ICSID Case No. ARB/04/15, Award of 13 September 2006. See also Tza Yup Shum v. Republic of Peru, ICSID Case No. ARB/07/6, Decision on jurisdiction and competence of 19 June 2009; and Renta 4 S.V.S.A. et al. v. the Russian Federation, Case No. Arbitration V 024/2007, Award of 20 March 2009, Arbitration Institute of the Stockholm Chamber of Commerce. The text of the ICSID decisions are available at <http://icsid.worldbank.org>.***

investment treaty. Another underlying issue that arose from these decisions was the difficulty surrounding any attempt to ascertain the intention of the parties. Although the criteria identified by the tribunals were helpful, crucial issues were still left open and these required discussion in determining possible guidelines on the scope of application of the most-favoured-nation clause, whether in relation to existing treaties or future treaties.

2. CONSIDERATION OF FUTURE WORK OF THE STUDY GROUP

369. The Study Group held wide-ranging discussions on the basis of the papers before it as well as on developments elsewhere, including within the context of MERCOSUR (the Southern Common Market). Its central focus was on the issue of how most-favoured-nation clauses are being interpreted, particularly in the context of investment relations and whether some common underlying guidelines could be formulated to serve as interpretative tools or in order to assure some certainty and stability in the field of investment law. The general sense of the Group was that it was premature at this stage to consider the option of preparing draft articles or a revision of the 1978 draft articles.

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

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

372. It was thought necessary to review the types of most-favoured-nation clauses that have been applied, the types of questions that have been the subject of determination in respect of this clause, as well as to examine the outcomes in the arbitral awards, in light of the rules of treaty interpretation in the 1969 Vienna Convention. It was considered that the Study Group had a role to play in contributing to the interpretation of treaties, in particular focusing on the 1969 Vienna Convention, and in respect of future developments in this field.

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