Extended and Restrictive Application of the MFN Clause to the Substantive Treatment of Investments and Implications for China

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Abstract: Most-favored-nation (MFN) treatment has become a universally incorporated rule in the standard of treatment of foreign investors in contemporary international investment agreements. The MFN clause contained in any given investment agreement acts as a chain linking the many scattered investment agreements concluded in order to ensure that the treatment provided under a particular investment agreement is not less favorable than that provided by the same contracting parties under other investment agreements in the same area. However, the excessive application of MFN treatment and expansive interpretations of arbitration agreements have seriously undermined the host country's right to regulate, and exacerbated the fragmentation of IIAs and their arbitration. In addition to this, arbitral tribunals tend to interpret the other standards of protection introduced in a way that favors the protection of the investor. This approach carries the risk of negative multilateralization, endangering the host state's legitimate right to regulate, and its public policy space. At the same time, broad judicial interpretations widen the scope of application of the MFN clause, causing the host state to take on unforeseen additional obligations as a result. Because of the problems arising from the extended or restrictive application of MFN clauses in substantive matters, and in light of China's current "dual identity" in international investment, this article attempts to provide suggestions on how to avoid the risks of negative multilateralization in China's outward investment, and for the introduction of foreign investment from the perspective of treaty-making.

Keywords: Most-favored-nation Treatment, International Investment Arbitration, International Investment Agreement, Substantive Obligations

I. INTRODUCTION

A most-favored-nation (MFN) clause in an international investment agreement (IIA) means that the host country undertakes to not treat foreign investors less favorably than it has treated, or will treat, third-country investors. The MFN clause not only requires contracting states to comply with their international

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obligations under the underlying agreement, but also uses other international agreements, i.e., third-party treaties that those contracting states have entered into with any third country, as a frame of reference for the application of the MFN clause. Statistically, 98% of all investment treaties provide for MFN treatment.[1] These MFN clauses have been widely debated in investment treaty practice, mainly to understand whether MFN clauses in investment agreements can be used to introduce provisions into third-party investment treaties. This "MFN" function could easily be used to break out of the bilateral structure of the current investment treaty system and develop it into a virtual multilateral system.[2] It is important for the creation of an open and non-discriminatory international investment market. On the other hand, however, MFN clauses can have unexpected consequences for multilateralization, and pose unpredictable risks for countries, especially developing countries.

In the practice of international investment arbitration, the expression of the basic treaty and its MFN clause, the circumstances in which investors can invoke IIA substantive treatment, and the interpretations and decisions of arbitral tribunals are diverse and divergent in relation to the application of the MFN standard to substantive treatment. For example, one of the more specific clauses on the scope of application of MFN clauses is Article 1103 of the North American Free Trade Agreement (NAFTA), which covers the establishment, acquisition, expansion, management, operation, sale or other disposition of investments. Besides this, there are other instruments that are not so specific, such as Article 4(4) of the 1998 German model investment text, which provides that investors of either contracting state shall enjoy MFN treatment in the territory of the other contracting state in respect of the matters provided for in this Article. However, whether a treaty provision contains specific qualifiers or simply includes all matters relating to investment in general terms, ultimately it is a tribunal's interpretation of the qualifiers that decides as to whether or not the investor receives the same treatment as other investors through the MFN clause. In addition to this, different tribunals in different jurisdictions have addressed the issue of introducing other standards of treatment in different ways. For example, the fair and equitable treatment (FET) standard is currently

1 SADC Model Bilateral Investment Treaty Template with Commentary, Southern African Development Community, July 1, 2012.

2 Dumberry Patrick, The Importation of the FET Standard through MFN Clauses: An Empirical Study of BITs, *ICSID Review - Foreign Investment Law Journal*, Vol. 32, No. 1, July 2016, pp. 116-137.

included in most Bilateral Investment Treats (BITs), and in arbitration practice, most tribunals accept the introduction of FET treatment through an MFN clause. The question is, in cases where the basic agreement does not contain an FET clause or even an MFN clause, can the BIT apply both as a matter of custom? In *MTD v. Chile*, the tribunal held that the MFN clause was a treaty-based obligation and, therefore, could not be considered part of custom. Therefore, an investor cannot claim favorable treatment under the MFN clause on the basis of custom, and such protection must be expressly provided for in the treaty. However, because of the special nature of the MFN clause itself, it cannot be treated as any other normal clause. By expressly providing for MFN clauses in an investment agreement, a party would be assuming international obligations in addition to those provided for in the underlying treaty. The exact content of these obligations cannot be foreseen or determined by the parties at the time of the entry into the treaty, and there is, thus, space for the FET standard to be invoked. As Patrick Dumberry has argued, if it has become a uniform standard of international arbitration practice to invoke the FET clause, could other standards of treatment be invoked as well?[3] For example, the Umbrella Clause can be invoked to protect the interests of investors through the MFN clause. However, this approach is difficult to implement in practice, and these differences in international arbitration practice need to be further discussed.

On the subject of the application of the MFN clause, there are also disagreements regarding the exclusion of treaty-based exceptions. There are no internationally agreed-upon guidelines for the interpretation of exceptions to MFN clauses, and the wording of these exceptions varies from one BIT to another, as do the content of the reservations and exclusions. Thus, arbitral tribunals' decisions have generally held that where the basic agreement expressly provides for exceptions to the application of the MFN clause, these exceptions cannot be used by the MFN clause to invoke more favorable treatment. However, this means that the parties can no longer justify the exclusion from the application of the MFN clause of matters that are not provided for in the exception clause.[4] However, the disagreement with this practice is that the results of arbitral awards often fall outside the expectations of the contracting parties at the time

3 *Ibid*.

4 Zhang Hongle, *Research on Most-favored-nation Clause in International Investment Agreement*, Beijing: Economic Science Press, 2016, p. 150.

of contracting, and the awards are difficult to be accepted by the contracting parties.

In short, from the extension of MFN treatment to procedural issues in *Maffezini v. Spain*, the divergence of views on the application of MFN clauses in substantive matters has become increasingly obvious. Differences persist with respect to the invocation of other treatment clauses, the interpretation of the treaty, the relationship between the basic clause and the MFN clause, the impact of multilateralization, and the balance between the interests of the investor and the host state. At the same time, the issue to be addressed by contracting states and arbitral tribunals has changed from simply maintaining fair opportunities for investors to compete without discrimination to limiting the application and function of the MFN clause.

II. ARBITRATION PRACTICE IN THE APPLICATION OF MFN CLAUSE TO THE IIA SUBSTANTIVE TREATMENT

In today's international arbitration practice, there are few cases in which foreign investors invoke substantive treatment in third-party treaties based on the MFN clause in the underlying treaty. Most arbitral tribunals allow foreign investors to introduce the treatment of entities under third-party treaties pursuant to the MFN clause in the underlying treaty because arbitral tribunals consider this to be the essence of MFN clauses in international investment agreements.[5] The most typical case in arbitration practice that has taken this position is *Bayindir v. Pakistan*. In stark contrast is the case of *Ickale v. Turkmenistan*. While the MFN clause of the basic agreement and the FET clause in the preamble is the same in both cases, the tribunal in *Ickale v. Turkmenistan* took a very different line of interpretation with the tribunal in *Bayindir v. Pakistan*. For the first time, it refused to use the MFN clause to introduce substantive protection treatment in a third-party agreement, and the reason was that the MFN clause in the basic agreement itself did not allow it. Also, in *AAPL v. Sri Lanka*, the claimant tried to use the MFN clause in the basic agreement (Sri Lanka's BIT with the UK) to introduce liability for damages clause in a third-party investment agreement (Sri Lanka's BIT with Switzerland). While the tribunal did not deny that the MFN clause could be used to invoke the more favorable entity obligations of the third party agreement, the application was dismissed on the basis that

5 *Supra* n. 2.

the third-party treaty did not provide for the claimant's alleged strict liability standard.[6] It can, thus, be seen that investors use the MFN clause in different ways to apply third-party substantive treatment, and the results of arbitration on this basis differ. The use of MFN clauses by investors to invoke substantive treatment of third-party investment agreements can be summarized in the following three ways.

A. Invoking More Favorable Substantive Protection Clauses

Invoking other standards of protection in third-party agreements through MFN clauses is also an option for investors to obtain fair or more favorable treatment. International investment law has many standards of protection, such as FET, Adequate Protection and Security, Umbrella Clause, and National Treatment, etc. The following analysis focuses on the invocation of FET standard and the Umbrella Clause as examples.

1. The Introduction of FET Clauses

The FET is difficult to concretize because of its highly general character. In recent years, the application of the principle of FET by investors by using MFN clauses has also become more frequent, leading to more and more uncertain applications of the FET standard. Stephen Vasciannie notes that "one of the effects of the expanding network of BITs incorporating the MFN standard has been to promote the applicability of the FET standard among countries".[7] The FET standard is undoubtedly an entity right in the majority of BITs. Thus, Patrick Dumberry argues that by applying the MFN clause included in the basic agreement, investors should be allowed to benefit from the FET protection in another agreement signed by the host state.[8] In practice, invoking and granting FET protection in third-party agreements has been the approach of the majority of arbitral tribunals.

In *Bayindir v. Pakistan*, a case involving the Pakistan-Turkey BIT, the claimant, in this case, was a Turkish company whose construction contract was with the National Highways Authority of Pakistan (NHA). The NHA had unilaterally terminated the road construction contract with Bayindir. Bayindir then

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6 *Asian Agricultural Products Ltd. v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/87/3, June 27, 1990, para. 54.

7 Vasciannie Stephen, The Fair and Equitable Treatment Standard in International Investment Law and Practice, *The British Year Book of International Law*, No. 1, 2000, p. 149.

8 *Supra* n. 2.

initiated arbitration, claiming that the Pakistani authorities had acted in breach of the FET standard. The FET standard was not included in the main body of the agreement but was only mentioned in the preamble.[9] Pakistan, as the host state, argued that the introduction of an FET clause from another BIT was "only possible if the parties intended not to exclude it when they signed the treaty", and that in this case "whenever Turkey and Pakistan decided not to include a FET clause in the agreement, the intention was clear.[10] The tribunal, on the other hand, found that the general meaning of the wording of the "MFN clause" in Article 2(2) of the Pakistan-Turkey BIT, as well as its exception in Article 2(4), indicated that the parties did not intend to exclude more favorable substantive treatment for third-country investors. Pakistan did not oppose Bayindir's claim at the response and jurisdictional hearing that Pakistan's BITs with France, China, and other countries contained FET clauses. Accordingly, the Tribunal upheld Bayindir's application of the MFN clause to allege that Pakistan had violated FET by failing to provide a stable legal environment for Bayindir.

In *Rumeli v. Kazakhstan*,[11] the claimant was a company registered in Turkey. The Turkey-Kazakhstan BIT did not contain an FET clause, but only an MFN clause. The Turkish investor, as claimant, argued that they should benefit from the FET clause in other agreements signed by the host state and that the FET obligation was also reinforced by "customary international law". The claimant relied on the MFN clause of the Turkey-Kazakhstan BIT and the UK-Kazakhstan BIT and argued that Kazakhstan had an obligation of FET towards all investors. While the host state argued that such an interpretation of the agreement would impose obligations on it that went beyond international minimum standards of protection, the tribunal held that, in light of the effect of the MFN clause under the Turkey-Kazakhstan BIT, "international obligations undertaken by the host state in other bilateral agreements, in particular the UK-Kazakhstan BIT, apply to this case".[12]

Thus, even when a country's BITs with different countries contain FET clauses, they are not all formulated in the same way. A BIT that expressly contains

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9 *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, August 27, 2009, paras. 227-263.

10 *Ibid*. paras. 227-265.

11 *Rumeli Telekom AS and Telsim Mobil Telekomikasyon Hizmetleri AS v. Republic of Kazakhstan,* ICSID Case No. ARB/05/16, July 29, 2008, paras. *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, November 14, 200592-597.

12 *Ibid*.

an FET standard may be invoked by a third-party to claim performance of the FET obligation. In addition to this, tribunals will generally hold that a claimant can invoke a new BIT even if it does not contain a mention of FET either in its preamble or in its specific terms. So long as the third-party BIT invoked was concluded prior to the disputed BIT, the claimant's claim will almost always be upheld. Given this situation, an investor's selection of an FET clause to apply in its favor through the MFN clause also poses a significant challenge to the tribunal in interpreting its meaning.

2. The Introduction of the Umbrella Clauses

In the context of a bilateral investment treaty (BIT), the Umbrella Clause requires a state party to meet commitments made to an investor of another state party in relation to an investment. Its core function is to elevate the host country's investment obligations to foreign investors from the level of national law to the level of international law. In the event of a breach of an investment contract, a party can bring an arbitration case before ICSID. The essence of the Umbrella Clause is to provide treaty protection to foreign investors.[13] The question at this point is, when the BIT between state A and state B has Umbrella Clauses, and the BIT between state A and state C does not have Umbrella Clauses, can the investor in state C invoke the Umbrella Clause of the BIT between state A and state B on the basis of MFN treatment?

In *EDF International S.A. et al. v. Argentina*,[14] the French investor, EDF, by invoking the MFN clause contained in Article 4 of the Argentine-French BIT[15] in order to benefit from the protection of Article 10(2) of the Argentine-BLEU (Belgium-Luxembourg Economic Union) BIT and Article 7(2) of the Argentine-German BIT, referred its claim for breach of contract with the Argentine government to the ICSID for resolution. The tribunal accepted this approach, finding that the MFN clause gave the investor all the rights within the scope of protection provided by the BIT and that the Umbrella Clause, in accordance with the meaning of the term "special commitments" in this clause, was designed to protect investors from infringements of their legal rights, including not only substantive rights but also procedural rights to use the BIT's

13 Song Yujin, *International Investment Law (Third Edition)*, Law Publishing House, 2018, p. 63.

14 *EDF International S.A. v. Saur International S.A. and Leon Participaciones Argentinas S.A. v. Argentina Republic (EDF v. Argentina)*, ICSID Case No. ARB/03/23, June 11, 2012, paras. 920-938.

15 *See* Article 10 of Argentina-France BIT (1991).

dispute resolution mechanism.[16]

In the case of *Mr. Franck Charles Arif v. Moldova*, the claimant, through Article 4 MFN of the France-Moldova BIT, invoked the protection provided by Article 2(2) of the Moldova-UK BIT and Article 2(3)(c) of the Moldova-US BIT to protect the foreign investor. Arguing that Moldova had violated the special provisions of Article 9 of the French-Moldovan BIT on "special commitments".[17] The tribunal held that the MFN treatment under the BIT applied to any provision of the BIT that contained substantive obligations, which included the Umbrella Clause requiring the host state to comply with all special undertakings to the investor.[18]

There are, of course, awards in international arbitration practice that have rejected the invocation of the Umbrella Clause on the basis of MFN treatment. In *CMS v. Argentina*, the arbitral tribunal rejected the claimant CMS's claim for compensation on the basis of an MFN clause. The tribunal noted that the BIT it invoked did not contain the Umbrella Clause. Even if the BIT invoked did contain an Umbrella Clause, under the rule of *ejusdem generis*, the claimant's claim could not be obtained by invoking the MFN clause in its BIT with the host country in order to apply the Umbrella Clause in the host country's BIT with other countries.[19] In *Impregilo v. Pakistan*, the arbitral tribunal held that the investor could not invoke the MFN clause to resolve the issue, given that the contract was entered into by the investor Impregilo with WAPDA, the Pakistani oil development company, and not with Pakistan. Even assuming that the MFN clause in the Italy-Pakistan BIT and the Umbrella Clause in the Switzerland-Pakistan BIT could provide a guarantee that the Pakistani government would comply with its contractual commitments to the Italian investor, such a guarantee would not cover the contract in this case because the contract was not entered into by the host government. Instead, the investment contract was entered into by a separate entity from the government and the investor, and because the subject of the Umbrella Clause was not the same as the subject of the contract in the specific request, the investor could not invoke the Umbrella Clause based on the MFN clause.

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16 *Ibid*.

17 *See* Article 9 of France-Moldova, Republic of BIT (1997)

18 *Mr. Franck Charles Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23, April 8, 2013, para. 388.

19 *Impregilo S.P.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, April 22, 2005, para. 556.

B. Changing the Scope of Application of the MFN Clause

If the scope of application of the MFN clause is clearly set out in the treaty, then the arbitral tribunal is no doubt expected to apply it strictly in accordance with the treaty. The reality is that in almost all international investment arbitration cases, the tribunal is confronted with very abstract and general MFN clauses, and the tribunal's method of interpretation directly affects the specific application of the clause. IIA generally provides for the scope of application clauses in terms of definition, scope, and final clauses regarding investors, investments, investment activities or government measures, territory, time, etc. A provision on the scope of application of a third-party treaty may be more favorable to investment protection than a provision on the scope of application of the basic treaty. In such a case, the investor may claim to invoke the third-party treaty to alter the scope of the application clause of the basic treaty. Apart from exclusions of specific matters, the application of MFN clauses in substantive matters in international investment practice is primarily limited by the scope of the underlying clause and rules of *ejusdem generis*.

The scope of the basic clause limits the application of MFN treatment to substantive matters in certain circumstances, such as in *Metal-Tech v. Uzbekistan*, where Metal-Tech's attempt to invoke the MFN clause to expand the definition of "investment" failed.[20] Metal-Tech invoked Article 3 of the basic clause, which contained an MFN clause, in an attempt to invoke a more favorable definition of "investment" from the 1997 Greece-Uzbekistan BIT. However, the tribunal rejected the claimant's request, holding that the MFN clause could not be used to introduce a more favorable definition of "investment" under another BIT. The reason was that the MFN clause itself provided a definition of "investment" and "investor". The treatment guaranteed to investments and investors in Article 3 therefore necessarily refers to investments and investors as defined in Article 1 of the BIT. In *MCI v. Ecuador*, MCI sought to invoke the "application of other rules" of a third-party treaty to assert the retroactive application of the basic treaty, and the tribunal held that MFN treatment did not apply to the "application of other rules" clause in the third party treaty.[21] In *HICEE v. Slovakia*, the arbitral tribunal held that the MFN clause could only extend the scope

20 *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, October 4, 2013, paras. 131-163.

21 *M.C.I. Power Group L.C. and New Turbine, Inc. v. Republic of Ecuador*, ICSID Case No. ARB/03/6, July 31, 2007, paras. 118-128.

of substantive protection on the basis of the investor and its investment as defined in the basic treaty, and could not be used to extend the definition of "investor" or "investment" in the basic treaty.[22] In arbitral practice, the invocation of third-party treaties by investors to alter the scope of application of the underlying treaty on the basis of MFN treatment has not been upheld by arbitral tribunals. In other words, the scope of application of the MFN clause must first fall within the scope of the treaty, and in particular be limited by the definition of investment and investor, in order for a claimant to be entitled to invoke the protection of other treaties. Thus, unless the contracting states have expressly provided otherwise in the MFN clause of the underlying treaty to the contrary, MFN standard cannot be used to invoke the more favorable scope of the application clause of a third-party treaty, nor can MFN standard be used to invoke the scope of application clause of a third-party treaty to alter or override the scope of application clause of the underlying treaty. However, there remains a certain inconsistency in the interpretation of the tribunal on this issue.

The rule of *ejusdem generis* is also a rule that we must consider when invoking the MFN clause. Specifically, when determining whether the MFN clause can be invoked in the application of a particular provision of a third country's BIT, it is necessary to determine whether the matters specified in that particular provision are "the same" or "similar" as those under the scope of application of the basic provision. To determine whether the claimant is in a situation similar to that of the third-party investor, the tribunal will need to evaluate the overall situation between them. Therefore, this requirement must be mentioned in the application of the MFN treatment, whether or not it is explicitly mentioned in the treaty provisions. However, even if the rule of *ejusdem generis* becomes a prerequisite for the application of MFN clauses in international arbitration practice, different arbitral tribunals have differed in their views as to how the rule of *ejusdem generis* should be interpreted. For example, some tribunals have tended to hold that, unless expressly excluded, any substantive interest will be deemed to be covered by the MFN treatment.[23] In *Bayindir v. Pakistan*, the arbitral tribunal allowed the FET clause to be invoked from another treaty through the MFN clause in the underlying clause, as the FET standard was not expressly excluded from the MFN treatment. Although, the arbitral

22 *HICEE B.V. v. The Slovak Republic*, UNCITRAL, PCA Case No. 2009-11, May 23, 2011, paras. 148-149.

23 Sharmin Tanjina, *Application of Most-favored-nation Clauses by Investor-State Arbitral Tribunals: Implications for the Developing Countries*, Singapore: Springer Singapore Press, 2020, pp. 129-130.

tribunal in that case also acknowledged that it was necessary to compare the similarities between the two investors for the purposes of the application of the MFN treatment. In *Içkale v. Turkmenistan*, however, the tribunal applied the MFN clause with a different logic than in *Bayindir v. Pakistan*. The tribunal held that since the MFN clause expressly referred to "the granting of (most-favored-nation) treatment in similar situations", for the phrase "similar situations" not to be invalid, it required that the investor should be in a similar factual situation to that of the third-country investor. On this basis, the tribunal held that the applicant was not entitled to introduce a standard of substantive protection not provided for in the underlying treaty and rejected the applicant's introduction of the FET standard under the third-party treaty, despite the fact that the preamble to the underlying treaty referred to the FET standard.[24] This decision contradicts the *Bayindir* decision.

C. Exclusion of Exceptional Limitation Clauses from the Basic Agreements

In *CMS v. Argentina*, the applicant sought to avoid the enforcement of the emergency exception clause provided for in the basic treaty between the United States and Argentina. The applicant sought to remove Article 11 of the BIT between the parties to the dispute through the MFN clause in the 1991 Argentina-US BIT, arguing that this was an unfavorable entity standard of the BIT and that Article 11, which preserved the power of the host country to take the necessary measures to preserve its public order, essential interests, and international peace, could potentially justify its adjustment of duties (this is because the issue in the case was the suspension of Argentina's duty adjustment methodology for natural gas shipments to CMS-invested enterprises). However, some other BITs concluded by the host country did not contain any provision similar to Article 11 of the 1991 Argentina-US BIT. Investors believe that it is because other third parties' BITs do not contain provisions similar to Article 11 of the Argentina-US BIT that investors from these countries receive more favorable treatment as a result. The MFN clause in the underlying treaty itself was intended to entitle the investor to better treatment, and so it was argued that Article 11 could be removed from the application of the BIT. The arbitral tribunal in this case rejected the application of the MFN treatment, holding that although the claimant

24 *Içkale İnşaat Limited Şirketi v. Turkmenistan*, ICSID Case No. ARB/10/24, March 8, 2016, paras. 329-332.

had invoked the MFN treatment included in the treaty, the MFN treatment might apply only if a third-party treaty clause similar to Article 11 gave more favorable treatment to the investor.[25]

III. RISKS OF THE APPLICATION OF THE MFN CLAUSE TO SUBSTANTIVE TREATMENTS

A. Weakening the Regulatory Power and Public Policy Space of the Host State

As a product of globalization, the effects of multilateralization are also two-sided, and the negative effects of multilateralization on the application of the MFN clause to entity matters is one of the issues that need to be addressed in practice. Stephen W. Schill argues that the more than 3,000 existing IIAs constitute a virtual "multilateral system".[26] Schill illustrates through the "multilateralization" function of MFN treatment that it should not only help to introduce more favorable substantive protection and procedural provisions, but also expand the jurisdiction of the BIT to include more general consent to third-party treaty arbitration. However, in practical and national contexts, the introduction of MFN protections and the expansion of the jurisdiction of the BIT may lead to a weakening of the regulatory powers of the host country, and such an expansion of the criteria for the application of MFN clauses to facilitate multilateralization may be unacceptable for host countries with immature market regulation when it is not possible to take into account the circumstances and policies of all host countries. Unlike trade multilateralization, where barriers such as tariffs exist, investment is different in that once an investment is made, MFN treatment is extended throughout the investment, including the obligation not to change the investment framework, i.e., by not enacting any new measures that discriminate against foreign investors.[27] Thus, to date, most IIAs (especially BITs) have followed the approach of granting MFN treatment after investment admission, where the admission of foreign investors is dealt with by a

25 *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, May 12, 2005, paras. 336-378.

26 Andrew D. Mitchell and James Munro, Someone Else's Deal: Interpreting International Investment Agreements in the Light of Third-party Agreements, *European Journal of International Law*, No. 3, 2017, pp. 669-695.

27 UNCTAD, Most-favoured-nation Treatment, *UNCTAD Series on Issues in International Investment Agreements II*, United Nations, 2010, p. 39.

specific admission clause, which requires that the investment be made in accordance with the laws and regulations of the host country. In practice, there have been many cases where more favorable standards of protection, such as FET and Umbrella Clauses, have been successfully introduced through MFN clauses, and arbitral tribunals have broadly adopted preambles, or even preambles without a reference to FET, in favor of applicants' claims, which may indeed be unforeseen and not contemplated at the time of contracting for the host state. Most host countries protect foreign investment through post-establishment MFN treatment and regulate it through domestic legal policies, and the inability of countries to harmonize standards of protection in relation to substantive matters is unfair to developing countries. If investment treaties were to be multilateral, their impact would extend far beyond the particular bilateral relationship, and the invocation of more favorable compensation standards through the MFN clause would become a burden for many developing and under-developed countries. Schill also argues that "multilateral" does not mean "universal", and that even for a BIT, a contracting party can be considered to be part of the multilateral system because the effects of a typical BIT are not limited to a specific bilateral relationship.[28] For example, in the case of multinational corporate investments, most BITs allow investments to be made in the form of a "corporate structure" due to the flexibility of the "nationality" requirement, allowing a natural person or a company to obtain the BIT that they consider most beneficial for their purposes. Thus, "any investor from almost any country has the ability to choose to enter any BIT regime".[29] This means that, through the MFN clause, situations that are restricted by the host country may be evaded by investors through treaty shopping, and policies that are made to achieve specific targets and do not constitute discrimination may be exploited by other investors. In other words, one of the risks of multilateralization is that it gives access to those who are not entitled to BIT protection. Thus, one of the negative effects is that the application of MFN treatment to entity interests can easily lead to treaty shopping by investors.[30] While some arbitral tribunals have taken a lenient position on how to deal with treaty shopping, others have taken the opposite position. By treaty shopping, investors have evaded conditions that

28 Stephan W. Schill, *The Multilateralization of International Investment Law*, Cambridge University Press, 2009, pp. 121-193.

29 *Ibid*., pp. 197-236.

30 *Supra* n. 23, p. 135.

they would not otherwise meet, or have led to an increase in the number of applicable investment treaties, thus challenging the host country's right to regulate investment.

B. Broadening the Scope of Application of the MFN Clause

In investment treaties, the interpretation of MFN clauses can have a significant impact on the scope and extent of a state's obligations in relation to foreign investors. As discussed above, arbitral tribunals have generally upheld claimants' requests. However, there are problems with not strictly following treaty interpretation techniques, or not limiting the contracting purpose to the parties. By way of presumption, the interests in third-party treaties are interpreted in general terms as customary general practice and common understanding. This approach essentially expands the scope of application of the MFN clause, ignoring its own specific provisions and limitations. For example, in *Al-Warraq v. Indonesia*, the tribunal upheld the application of MFN treatment and held that the application of MFN treatment was consistent with the rule of *ejusdem generis*. More specifically, the host state's reference to the "same economic activity" did not constitute a limitation on the scope of application of the relevant MFN clause in this case. The investor's investment was in the banking sector, which is an area of "economic activity". There is no provision in the UK-Indonesia BIT that excludes or restricts the banking sector from the protection afforded to investments in another country. However, the tribunal itself did not clarify whether the investor could invoke the MFN clause in the foundation clause, which did not include the FET clause, to claim the benefit of the FET clause contained in the host country's BIT with third countries. This is a typical example of interpreting a treaty with a general understanding while ignoring special provisions. The problem that the tribunals, thus, pose is that in disregarding the contractual purpose and express provisions stipulated by the host state, other more favorable standards of protection arising from the MFN clause will become a legitimate burden. There are, of course, a few courts that have held that such an approach as described above is questionable, such as in *Pope & Talbot v. Canada*. In this case, the focus of the NAFTA arbitration was whether Article 1103 the MFN clause could be used to introduce a standard of treatment of entities from a third party agreement. In the 2001 award on liability, the tribunal used the MFN clause to demonstrate that the Article 1105 minimum standard of treatment provided a "stand-alone" standard, rather than a standard of

treatment under customary international law.[31]

Furthermore, in addition to introducing a more favorable standard of protection, the interpretation of the text and wording of the MFN clause may also lead to an expansion of its scope of application. The general presumption that the purpose of investment agreements is to protect foreign investment has influenced the practice of investment tribunals and the outcome of their decisions. For example, Dolzer and Stevens argue that "since most of the substantive provisions of the BIT relate to the promotion and protection of foreign investment, it can be argued that any ambiguity should be interpreted in favor of granting rights to foreign investors".[32] The tribunal in *HICEE v. Slovakia*, for example, interpreted the MFN treatment clause as extending the scope of substantive protection only to investors and investments within the scope of the basic clause, and not as extending the definition of "investor" or "investment" in the basic clause. The tribunal explained that the MFN treatment clause could only extend the scope of substantive protection on the basis of investors and investments within the scope of the basic clause, and could not be used to extend the definition of "investor" or "investment" in the basic clause.

IV. HOW CHINA RESPONDS TO THE APPLICATION OF MFN STANDARD TO SUBSTAINTIVE TREATMENTS

China has gradually shifted from its previous role as a pure importer of capital in international investment to one of both "capital importer and exporter". In order to attract foreign investment and promote outward investment, China has concluded a large number of investment treaties and actively participated in regional economic integration processes. Almost all of these investment treaties provide for MFN clauses, but most of them are general and extensive, with only a few treaties specifying the scope of application of MFN clauses, and the practice of limiting the scope of application of MFN clauses only appears in some of the more recently concluded investment treaties, mainly by excluding dispute settlement procedures, including in "similar circumstances", and by excluding particular industries, sectors, etc. Most MFN clauses in older generation IIAs were general in nature. Even where there are explicit exceptions in

31 *Pope & Talbot Inc. v. The Government of Canada*, UNCITRAL, Award on the Merits of Phase 2, Eighth Submission of the United States, December 3, 2001.

32 Rudolf Dolzer and Margrete Stevens, Bilateral Investment Treaties, *Kluwer Law International*, 1995, p. 17.

MFN clauses, there are still expressions like "based on equally favorable treatment", which are likely to lead to an expansion of the substantive application of MFN clauses. Overall, the way in which we have limited the scope of application of MFN treatment is inadequate, and the limitations on the obligations are not specific enough to address the risks arising from an expansive interpretation of the MFN clause. Therefore, we need to start from the perspective of the formulation of the treaty itself, by avoiding vague words and clarifying specific concrete meanings, and by having the scope of the presumptive interpretation by the courts be reasonably narrowed, in order to minimize the problems of interpreting the expanded scope of application of the treaty and the divergence of interpretation of the exceptions when the MFN clause is applied in substantive matters.

A. Specifying the Basic Concepts in the Treaty

The basic constituent concepts that are unclear and ambiguous in the provisions of the treaty should be specified in order to reduce the negative impact of the provisions of the treaty itself on foreign investors or states. Therefore, the scope of the specific concepts should be specified during the negotiations, or in additional/subsequent declarations, in order to ensure that the intention is expressed as clearly as possible in the treaty. For example, the MFN clauses in most IIAs at this stage relate to the post-establishment treatment, which also means that the laws and regulations relating to foreign investment entry may change over time. And there is no commitment to loosen entry conditions or remove any discriminatory legislation for foreign investment. However, some countries' BITs pursue the goal of liberalization by providing for the pre-establishment MFN treatment, such as those of Canada and the US. This means that host countries may not take any discriminatory measures against foreigners in relation to the conditions of entry of investors, and those host countries may neither apply any existing measures that are inconsistent with MFN treatment, nor create any new measures.[33] The difference between pre-establishment treatment and post-establishment treatment is mainly in terms of liberalization commitments, so it is even more important for countries with a lower degree of acceptance of liberalization to have detailed and clear provisions in the treaty on the scope of application of the post-establishment MFN clause, similar to Article

33 *Supra* n. 27, pp. 38-105.

3 of the Sino-Japanese BIT. Its provisions can be interpreted as meaning that the parties do not intend to include treatment other than that listed in the relationship of rights and obligations between the parties so that the parties intend that more favorable treatment can be introduced only to the extent that it is available. Such a clear listing of "post-establishment MFN clauses" would, thus, effectively ensure that "pre-establishment" treatment in third-party treaties cannot be invoked.[34] There is a need to strictly define specific concepts and to define the scope of application of the substantive matters of the MFN clause. For the tribunal, it not only provides clear treaty basis for the arbitration, but also prevents the tribunal from over-protecting the investor. At the same time, it is possible to judge whether, and to what extent, the interests of the host state have been taken into account in balancing the interests of the investor and the host state. Thus, the specificity of the treaty itself not only largely avoids unpredictable outcomes, but also helps less liberalized countries to avoid being overburdened by the introduction of more favorable standards of protection through the MFN clause.

B. Making an Effort to Remove Uncertainty in the Treaty-making Process through Effective Ways

In the process of treaty-making and development, the level of development of the parties, the domestic legal provisions, and the negotiations in the process of concluding the treaty, all influence the final content of the treaty. The host country's role in relation to the provisions of the treaty should, therefore, also be exercised. An effective way for the contracting parties to remove any legal uncertainty in disputes over MFN treatment in substantive matters is through Joint Declarations, Protocols, Exchange of Notes, or any other appropriate form of joint interpretation.

By joint interpretation, the contracting parties may indicate whether they accept any obligations in relation to the special provisions concluded by the investor of the other party in relation to the MFN clause, or whether they assume the content of those obligations as appropriate. In 2004, during the negotiations of the US-Central America-Dominican Republic Free Trade Agreement, the MFN clause was agreed upon and documented in the draft treaty as follows: "The application of the MFN clause in this agreement is expressly limited to

34 *Supra* n. 4, p. 195.

the establishment, acquisition, expansion, management, control, operation, and sale or other disposition of investments". The parties agreed that this clause would not apply to dispute settlement mechanisms. Although this consensus did not ultimately become part of the agreement, it certainly became an objective fact of life in the treaty negotiations. In future investment disputes, this consensus could undoubtedly corroborate the true intentions of the contracting parties, thus avoiding an expansive interpretation of the scope of application of the MFN clause by arbitral tribunals.[35] Another example is India's omission of MFN treatment from its Model Text for the Indian BIT issued in 2015.[36] India also sent a draft joint interpretative statement to the 25 BIT partners, which suggested that the purpose of clarifying the MFN obligations was not to change the substantive content of the agreement. However, it is doubtful that India adopted the approach of directly omitting the MFN clause merely to address the disadvantages of the application of the MFN clause in IIA substantive matters. Without an MFN clause in the treaty, the question arises as to how to avoid discrimination against, and how to maintain a fair chance of competition between, investors from different countries, and it is difficult to avoid an increase in the risk of unfair competitive opportunities as well as discrimination unless other reasonable solutions can be found to replace the MFN clause. However, it is undeniable that identifying specific concepts through joint interpretative declarations, such as an explicit provision on "similar situations", is an effective way to address the mis-application of the MFN clause.

When states are unable to adopt the joint interpretation of a declaration, they may consider issuing a one-sided interpretative declaration. Although there is no agreement between the contracting states, a one-sided declaration made may still have a practical effect. This is because the tribunal needs to take into account the content and position of the joint declaration to evaluate the reasonable expectations of the foreign investor. Further interpretation and clarification by the contracting states of overly broad MFN clauses are justified; specifically, the contracting states may impose some time or substantive limitations on the application of MFN clauses in the treaty.[37] Contracting states should

35 Tarcisio Gazzini and Attila Tanzi, Handle with Care: Umbrella Clauses and MFN Treatment in Investment Arbitration, *Journal of World Investment and Trade*, Vol. 6, No. 14, 2013, pp. 978-994.

36 *See* Model Text for the Indian Bilateral Investment Treaty, Chapter II, 2015.

37 *See* Article 4(5) of Agreement for the Promotion and Reciprocal Protection of Investments, Slovk-Iran, January 19, 2016.

either expressly provide that the MFN obligation does not apply to the obligations of third-party treaty entities, or provide that the MFN obligation does not affect the provisions of the underlying treaty, along the lines of UNCTAD 2010.[38]

C. Refining and Enriching the Content of the Restrictive Provisions in the IIA

Contracting states need to refine and increase the content of the restrictive provisions and define the content of the exceptions in a more specific and explicit manner. At the same time, contracting states must increase the specificity of the contracting parties' provisions on reservations or exceptions to public interest and goals. They must also increase the consideration of public policy and interests by arbitral tribunals when interpreting treaties. Although China has used "public objectives" to limit the scope of application of the MFN clause in existing investment treaties, this differs from the way the "public objectives" restriction is expressed in the 2016 Brazil-Peru Economic and Trade Expansion Agreement and the 2016 Slovakia-Iran BIT. Moreover, the explicit provision on "public objectives" places more emphasis on preserving the public policy space of contracting states, which to a certain extent limits the invocation of MFN clauses by investors. However, in the event of a conflict between the treaty and domestic law, the MFN treatment protects investors, while at the same time challenging the host country's regulation of investment. The negative effects of MFN clauses are bound to affect the host country itself, especially if the host country is not mature in its regulation of the market. Thus, one of the negative effects of the vague MFN clause exception is that arbitral tribunals take less account of the domestic public policy and interests of the host state in their practice. This interpretation bias essentially results in a situation where treaties alter domestic laws, especially when the domestic policy is related to public interests such as national security and environmental protection, and is not justified. In *MTD v. Chile*, for example, the tribunal stated that MFN treatment in IIAs should not alter the domestic legal framework of the host country. Even if the MFN clause does not explicitly refer to the domestic legal framework of the host country, the influence of the application of MFN clause to the domestic laws and policies of the host country should be noted. Accordingly,

38 *Supra* n. 27, pp. 38-105.

the public objectives provision provides clear directions to arbitral tribunals when interpreting and applying MFN clauses, enabling them to proactively consider the "public objectives" stated by the contracting state.

Moreover, in addition to the adoption of reservations and exclusions on specific matters in the "public objectives", the impact of the transition between the old and new IIAs should also be a major consideration in treaty-making. In particular, in the current complex global investment environment, the investment issues addressed by different generations are not the same. It is, therefore, clearly not a reasonable consideration to apply the new IIAs by referring to the provisions contained in the old IIAs. However, the recent investment agreements signed by China do not limit the application of the MFN clause to the treatment of the older generation of investment agreements. Rather than discouraging investors from treaty shopping, this has allowed investors to use the MFN clause to obtain perhaps more favorable treatment under investment agreements of different eras. These results have a negative impact on the modernization of the IIA regime. Therefore, by specifying that the MFN clause does not apply to treatment in older agreements, it is possible to exclude more favorable treatment granted to investors in all previous treaties signed by the contracting parties, without the need to analyze whether the measure in question is designed to achieve a "public objective" of the host country, such as the article 5(3) of the 2018 Singapore-Kazakhstan BIT.[39] Explicitly limiting the treatment of entities in the new generation of IIAs may be a more effective way of protecting the sovereignty, public policy, public interest and regulatory powers of host countries. At the same time, it would be more likely that tribunals will consider the far-reaching implications of MFN treatment for IIA reform in international investment practice.

In summary, with the in-depth development of China's Belt and Road economic zone in recent years, China's investment cooperation with countries along the route has been increasing; the scope of the MFN clause applicable to the treatment of investment entities is not conducive to the protection of the interests of China's overseas investors if it is overly restrictive or overly broad.[40] Therefore, in the process of improving and refining the MFN clauses in the treaty, China needs to clearly define the scope of the basic concepts involved

39 *See* Article 5(3) of Kazakhstan-Singapore BIT, 2018.

40 Zhang Jin Jin, On the Restrictive Development Trend of the Most Favored Nation Clause Applied to the Treatment of Investment Entities, *International Economic and Trade Exploration*, No. 5, 2019, pp. 105-120.

in the MFN clauses. This could be enumerated by way of a list or a negative list. This would clearly indicate to investors and arbitral tribunals the intention of the contracting parties and scope of the obligations accepted by the contracting parties, leading arbitral tribunals to fairly assess the reasonable expectations of investors, and reduce the abuse of "discretionary power" by arbitral tribunals due to vague provisions. With regard to the resolution of differences in the application of MFN clauses in substantive matters, states may clarify matters in a timely manner through Joint Declarations, Protocols, etc. Provisions on public policy and public interest can be added to the treaty exceptions to enable arbitral tribunals to reasonably consider the domestic public policy objectives of the host country in practice. Due to the rapid development of China's economy after the reform and opening up, combined with the development of economic globalization, the needs and objectives of the BITs formulated by China at different stages of development were different. Therefore, attention needs to be paid to the turnover between the old and new generations of IIAs in China when signing new treaties, so as to avoid investors invoking old investment treaties by way of the MFN standard in order to seek more favorable treatment, and to prevent disrupting the process of development of the IIA system. As China is faced with the "dual identity" of being a capital-importing country as well as a capital-exporting country, restricting the scope of application of the MFN clause, and the related reservations and exceptions, does not mean promoting investment protectionism, but rather reaching a better balance between the interests of the investor and the host country. Not only is it necessary to safeguard our public interest, but it is also necessary to create a favorable environment for our investors to invest abroad. In this way, the broad interpretation of the MFN clause by arbitral tribunals may be effectively prevented, reducing the number of unpredictable and unprecedented disputes in our investment practice. Moreover, it will safeguard the interests of our investors investing abroad, as well as our own domestic interests when engaging in economic transactions with regions and countries with highly developed and mature investment markets/regimes.

V. CONCLUSION

The international investment law system is currently undergoing profound changes, which will inevitably affect the drafting and application of specific

provisions of international investment treaties. The MFN standard, as an important principle of international investment law, is crucial to this. In international investment law, the MFN principle is considered to have two major objectives and functions. On the one hand, it ensures that different foreign investors enjoy fair competitive conditions in the host country without being subject to unjustified discrimination. The other is to enable the multilateralization of the international investment legal regime by cross-referencing a large number of IIAs.

In international arbitration practice, however, arbitral tribunals are biased in favor of investment protection in disputes for the purpose of protecting and promoting investment. This has led to general and ambiguous provisions in MFN clauses being interpreted in a way that tends to protect investments. The invocation by investors of more favorable standards of protection in third-party BITs through MFN clauses is a matter of treaty shopping and also poses a risk of negative multilateralization. This is not only reflected in investors' invocation of third-party treaty investor-state dispute settlement procedures based on MFN treatment, but also in the invocation of third-party treaty substantive obligations. The invocation of the MFN principle by investors and its application by arbitral tribunals is fraught with selectivity and uncertainty, thereby resulting in MFN treatment not being fully effective in achieving the objectives of non-discrimination and multilateralization, and exacerbating the fragmentation and imbalance of international investment law. Moreover, and more importantly, it constitutes a major obstacle to the renewal of the IIA generation. In a situation where most investing countries are now faced with the dual development task of attracting foreign investment as well as making outward investment, the need and possibility of balancing the interests of investors and host countries will become a common development objective, and there may be a trend for arbitral tribunals to move away from the old tendency of defending investors. The investment treaties that currently exist in various contracting states that specify MFN clauses are also an attempt to limit the scope for interpretation by arbitral tribunals and to balance different interests. Against this background, China should carefully choose its response and measures: firstly, it should specify the specific content of the MFN clauses, specify and express the basic concepts and definitions in the treaty, and narrow the scope for possible expansion of interpretation due to the non-specific provisions of the treaty; secondly, joint interpretations in the form of joint Declarations, Protocols, etc. can be adopted to clearly express the attitude of our country in assuming international obligations

or additional obligations; and finally, the content of the exceptions to the MFN clause that do not apply needs to be clearly identified by way of lists or other refined provisions to increase our reservation of public space, public interest and objectives. This will affect the arbitral tribunal's consideration of our public policy and interests in practice.