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A Study on the Application of the Most Favored Nation Treatment Clause

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The issue of expanding the application of most favored nation treatment has attracted widespread attention and interest in international arbitration practice, and an increasing number of arbitration cases have been filed in this regard. However, there are still many unresolved issues, and countries have not formed a consistent international practice on this issue, and scholars from various countries have not formed a relatively consistent view on this issue. China is the largest capital importing country and a potential capital exporting country. Studying and evaluating the impact of most favored nation (MFN) clause on the rights and obligations of contracting parties in international investment agreements, analyzing the practices and experiences of various countries, and flexibly and prudently formulating investment clauses based on China's national conditions are of great significance for China's investment treaty negotiations.

Keywords: the most favored nation treatment, international investment dispute, international arbitration

What the Most Favored Nation Treatment Clause Is

The most favored nation treatment (MFN) refers to the treatment given by the granting country to the beneficiary country or a person or thing with whom it has a definite relationship, which is not lower than the treatment given by the granting country to a third country or a person or thing with whom it has a similar relationship. According to this, the MFN clause refers to a treaty provision under which a contracting party assumes obligations and grants MFN treatment to another contracting party within the agreed scope of the relationship.

The extensive inclusion of MFN clause in treaties puts each country at the hub of a dense investment treaty network. The different meanings of most favored nation treatment in various texts mean that once disputes arise, each treaty needs to undergo independent review (Yan, 2006). The arbitral tribunal has clearly applied the principle of most favored nation treatment to procedural matters in investment dispute cases in the Case Maffezini[1]. With the development of international arbitration practice, the issue of expanding the application of most favored nation treatment has attracted attention and interest from all sectors, and more and more arbitration cases have been filed in this regard.

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[1] Emilio Agustin Maffezini v. Kingdom of Spain, ICSID Case No. ARB/97/7, award on Jurisdiction, 25 January 2000.

The Issues Concerning Application of the Most Favored Nation Treatment Clause

The Issues Concerning Application of MFN Clause in the Investment Stage

From investment to determining operations, foreign investment companies in the host country need to go through two stages: the admission stage before entry and the operation stage after entry. There is no dispute over the application of the most favored nation treatment principle in the operational stage after foreign investment companies enter, but there are differences in its application during the admission stage. The inconsistency in this regulation among different countries and regions has led to the issues concerning application of MFN clause in the investment stage.

The applications of the most favored nation treatment standards at which stage are a crucial issue in the field of international investment. The controversy among countries regarding the application stage of foreign investment treatment standards is whether the most favored nation treatment only applies to the Post-admission stage or extends to the Pre-admission stage based on this. Due to the fact that the choice of this issue is related to the exercise of the host country's jurisdiction over foreign investment companies and the degree of openness to foreign investment companies, it directly and profoundly affects the process of international investment liberalization. Developing and developed countries have formed a sharp opposition on this issue. This opposition is reflected in the different stages of application of most favored nation treatment in international investment agreements.

Generally speaking, international investment treaties do not restrict the regulatory authority of either party to impose limitations the entry of foreign investment companies. That is, MFN clause does not apply to the initial stage of investment access, which is a rule adopted in most Bilateral Investment Treaties in early practice. Normally, during the operational phase of foreign investment companies entering the host country, these agreements will apply MFN clause to foreign investment regulations. This approach aligns with the traditional perspective and practice observed in European Bilateral Investment Treaties that prioritize safeguarding cross-border investments as their core objective. But for foreign investment access issues, it is classified as a matter under the domestic jurisdiction of the host country. Consequently, it uses gentle language such as "should encourage foreign investment to enter" and "should facilitate good conditions for foreign investment to enter" instead of "must allow foreign investment to enter" and "must open up investment" (Li, 2017). This change and viewpoint not only determines the admission rights accepted by various countries, but also confirms that the standard of applying most favored nation treatment protection by the state only applies to the investment and operation stage.

The approach of U.S. Bilateral Investment Treaty is to expand the scope of the MFN clause to encompass both the investment stage and investment access stage. For instance, under the 2003 US-Chile Free Trade Agreement, each contracting party must provide treatment to investors from another contracting party that is no less favorable than that provided to any non-contracting party investor in its territory during establishment, acquisition, expansion, management, operation, sale, or disposal of investments. Similarly, the US-Singapore Free Trade Agreement and Canada-Chile Free Trade Agreement also include provisions on MFN clause application in principle. These stages of application differ from European Bilateral Investment Treaty as they specifically mention "establishment", highlighting that most favored nation treatment in U.S. Bilateral

Investment Treaty applies to foreign investment access as well as operation stages. Therefore, it can be observed that these treaties and agreements exemplify typical usage of MFN clause in U.S. Bilateral Investment Treaty by extending their applicability beyond just investment operations.

As an important means to achieve investment liberalization, the United States has been actively promoting the application of MFN clause to the investment access stage. Under the frame of U.S. Bilateral Investment Treaty, the international investment agreements require the contracting parties to give equal treatment to foreign investors and their investment in accordance with the MFN clause at the access stage, and extend the application of MFN clause to the investment access stage. On the one hand, this reflects the willingness of the host country to unconditionally open to foreign investment companies in the investment access link. On the other hand, it is more conducive to attracting more foreign investment to the host country. Generally speaking, the European Bilateral Investment Treaty often simply affirms the domestic legislation of the host country's right to manage foreign investment access while the U.S. Bilateral Investment Treaty usually require the host country to undertake the treaty obligation (Chen, 1999, p. 417) of opening to foreign investment.

From the perspective of international customary law, although the host country enjoys absolute free decision-making power on foreign investment companies accessing and has no general international legal obligations in this regard, with the rise of the concept of investment liberalization and the development of economic globalization, the application of MFN clause in the investment access stage in the international investment agreement not only reflects the development trend of economic globalization, but also reflects the development trend of the international investment field, and marks a new leap in the development process of MFN clause. Therefore, the conflict between strict control of investment companies and investment liberalization also causes obstacles in the application of MFN clause.

The Issues Concerning Application of MFN Clause in Investment Dispute Settlement

The dispute on the scope of the issues concerning application of MFN clause is not only shown in the investment stage, but also in investment dispute settlement. In the investment stage, the debate is whether MFN clause is applicable to the entry stage of investment. In terms of investment dispute settlement, the focus of dispute is whether MFN clause can be extended to the procedural matters of investment dispute settlement. Traditionally, the scope of application of MFN clause is limited to the substantive field, but after the Maffezini Case, ICSID has made a major change in the field of application of MFN clause, which focuses on whether MFN clause can be applied to the procedural matters of investment dispute settlement.

In the practice of investment arbitration, the most common arbitration strategy used by investors is to use MFN clause to avoid the dispute settlement treatment that investors consider non-preferential in the underlying treaty. This strategy is derived from the reality of "fragmentation" of international investment law, where the current bilateral paradigm of international investment law offers investors the possibility of comparative selection. This strategy follows the following pattern: Firstly, MFN clause and investment dispute settlement procedures are stipulated in the investment treaty (often referred to as the basic treaty) signed between the investor's home country and the investment host country. Secondly, since international investment law is more represented by bilateral paradigm, the litigant state may conclude multiple investment treaty (commonly known as third-party treaties) with different contents of dispute settlement procedures due to different contracting and negotiation abilities. Finally, when investors believe that other investment treaty concluded by the litigant state provides more favorable dispute settlement procedures, they can be incorporated into the more favorable procedural treatment based on the MFN clause in the underlying treaty (Schill, 2009). The MFN clause of international investment treaty has developed from a “harmless” clause that rarely became the focus of investment dispute resolution in the past to a tool for investors to “pick treaty” to avoid ICSID arbitration preconditions or expand the scope of arbitration matters (Wong, 2008).

The Countermeasures of Our Country on the Application of MFN Clause in International Investment Treaty

The Current Situation of the Application of MFN Clause in Our Country

Based on the current investment treaty concluded and in effect by China, the MFN clause can reflect the following characteristics:

(1) Some Bilateral Investment Treaties concluded by China (the largest number) stipulate that the MFN clause is applicable to ensuring fair and equitable treatment as well as adequate security and protection for investments and related activities. An exception list is often attached to specify the entities excluded from the scope of application of the MFN clause;

(2) Certain Bilateral Investment Treaties concluded by China (the second largest number) provide that the MFN clause applies to investment and investment-related activities, as well as to investment income, fund transfer, and other associated activities. Additionally, these treaties include an additional list specifying areas where the MFN clause cannot be invoked;

(3) A small number of Bilateral Investment Treaties stipulate that MFN clause apply to investment, and then specify specific sectors in which investors can obtain MFN treatment, such as investment management, use, and enjoyment, and attach a list of exceptions to MFN treatment.

The MFN clause in China’s investment treaty generally reflects the characteristics of restricting the scope of application of MFN clause, which is a positive development for China.

Strategies to the Issues Caused by MFN Clause

Drawing on international practical experience according to local conditions. Since the MFN clause appeared in the Maffezini case in 2000, the international community had immediately refocused on the MFN clause as well as the dispute settlement clause and some other core clauses in Bilateral Investment Treaties. Although the MFN clause has a long history of development, there are still many unresolved problems in the application of MFN clause in current international investment disputes. Countries have not formed a consistent international practice on this issue, and scholars from various countries have not formed a relatively consistent view on this issue.

For China, as both the largest capital importer and potential capital exporter, we should further study and evaluate the impact of MFN clause on the rights and obligations of parties in international investment treaties when negotiating investment treaties. According to the national conditions of our country, the investment terms should be formulated flexibly and prudently, so as not to damage the enthusiasm of foreign investors, but also to protect the relevant industries in our country from impact, and at the same time meet the needs of protecting overseas investment in our country.

Clarifying the scope of application of MFN clause.

Gradually apply the MFN clause to the investment access stage. In the realm of international investment treaties, there are two modes of practice regarding the most-favored-nation (MFN) clause: One is the "Post-admission Mode" (MFN clause only applies to the investment and operation stage), and the other one is the "Pre-admission and Post-admission Mode" (MFN clause not only applies to the investment and operation stage, but also applies to the access stage of investment). As the United States, Canada, and other countries that apply MFN clause to the investment access stage sign bilateral or multilateral investment treaties with more countries, there will be more bilateral or multilateral investment treaties that apply MFN clause to the investment access stage. In fact, it can be predicted that with the development of economic globalization, in order to fully realize the equality of competitive opportunities through the MFN clause, more and more countries will gradually apply the MFN clause in the market access stage of investment.

Of course, if conditions permit, our country can also choose the corresponding model according to the specific national conditions of the contracting parties and stipulate exceptions and set up necessary restrictions. It is also a more flexible and beneficial choice. Specifically speaking, when signing investment treaties with developed countries, due to their relatively strong economic strength, they are often the main source countries of foreign investment in our country. In order to protect economic security and avoid the impact on key industries in our country, it is better to adopt the "Post-admission Mode", and make clear provisions on the definition of investment activities and the MFN clause is not applicable to the investment access stage; the mode of "Pre-admission and Post-admission" combined with the important exception provisions of the MFN clause can be applied to Bilateral Investment Treaties signed between China and other developing countries. This helps to strengthen China's overseas investment in the energy and raw materials fields of developing countries and accelerate the implementation of the "going global strategy".

Make it clear that MFN clause does not apply to dispute settlement procedures. The MFN clause in the field of international investment used to be a clause that rarely became the focus of controversy. In recent years, with the endless interpretation of the arbitration tribunal, it has become not only aimed at achieving fair competition conditions or eliminating discrimination, but also increasingly become a tool for investors to "select treaty", in order to achieve the purpose of bypassing the precondition of international arbitration (i.e. local relief requirements) or expanding the scope of arbitration matters (Wong, 2008).

On the one hand, our country may require the inclusion of exclusionary clause in the practice of contracting with foreign countries. Our country should propose to add an exception of investment dispute settlement procedure when concluding the treaty. The latest Bilateral Investment Treaties signed by our country and Canada have adopted such provisions. Later, of course, if there were difficulties in negotiating with other states on the addition of this exception, consideration could be given to the introduction of an alternative provision that would provide for the non-retroactivity of the MFN clause. For example, the MFN clause shall not apply to all treatment conferred by bilateral or multilateral international treaties in force or entered into prior to the entry into force date of the treaty. By such provisions, a "wall" can be built to prevent foreign investors from granting "more favourable" treatment to third parties through MFN clause in Bilateral Investment Treaties previously signed by our country.

On the other hand, China can adopt differentiated practices based on its own negotiation ability in contracting and specific contracting parties, and clearly stipulate in some investment treaties that the MFN treatment cannot be applied to dispute settlement procedures. When the relevant country does not indicate that the MFN clause can be applied to the dispute settlement procedure, the international judicial institutions such as the investment arbitration tribunal do not have jurisdiction, so the "consent" of the relevant country to resolve the relevant dispute through the international judicial organs is crucial (Chen, 2006). At present, relevant practices have emerged, such as Article 4 Paragraph 3 of the Trilateral Investment Protection Agreement between China, Japan, and the Korea in 2012, which stipulates that MFN clause cannot be suitable for dispute settlement procedures. Although the actual effect of these provisions remains to be tested over time, it is foreseeable that these provisions will certainly limit the space for interpretation of the arbitral tribunal.

Conclusion

The Most-Favored Nation (MFN) clause aims to promote fair competition and eliminate discrimination, yet it encounters various challenges in practical implementation. In the era of globalization, China should thoroughly examine the issues associated with the application of MFN treatment, adapt international best practices to local circumstances, and develop investment provisions that are both flexible and cautious. This approach will ensure that foreign investors' enthusiasm remains intact while safeguarding China's relevant industries from adverse effects. Simultaneously, it will address China's imperative to protect overseas investment enterprises and achieve mutually beneficial outcomes.

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