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# THE MULTILATERAL AGREEMENT ON INVESTMENT

## STATE OF PLAY AS OF FEBRUARY 1997

**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT**

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***Annex***

## OPENING ADDRESS

*by*
Joanna R. Shelton*

Minister Malan, distinguished officials, ladies and gentlemen,

As we begin this important event, I would like to express the OECD's appreciation to the Government of Brazil for its hospitality and its generosity as host of this workshop. I would also like to thank the Government of Canada and the Organisation of American States for co-sponsoring this conference.

I warmly welcome the many senior representatives from the investment community in Latin America and OECD Member countries, and from international organisations. Your presence here underscores the value we all attach to an international framework providing high standards for the protection and liberalisation of foreign investment.

This meeting is a follow-up to the workshop on *Investment Policies in Latin America and Multilateral Rules on Investment* held in Rio de Janeiro in July 1996. Participants at that workshop, requested a substantive dialogue on the key issues of the Multilateral Agreement on Investment (MAI). They also identified areas for future co-operation between OECD and Latin American countries in the area of investment and private sector development

This second workshop takes place at a time when the main components of the MAI have been assembled. The negotiations are entering their final phase towards their scheduled conclusion in May 1997 and it is a good time to engage in an in-depth consideration of the key issues of the MAI.

In the remarks that follow, I would like to highlight the major features of the MAI and offer some personal views on the value the MAI may entail for Latin American countries.

### I. The structure of the MAI

The MAI will be the first attempt to combine in one multilateral agreement the disciplines in three key areas of foreign direct investment rule-making -- specifically, investment protection, investment liberalisation and dispute settlement. The negotiations are making good progress in all three areas and the prospects for achieving a high standards agreement appear to be quite good.

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*. Ms Shelton is Deputy Secretary General of the Organisation for Economic Co-operation and Development.

Based on the progress to date, one can say the following:

-- coverage of investment will be broad, going well beyond traditional notions of foreign direct investment to include portfolio investments and intangible investments,

-- investment protection provisions will be very similar to those found in the best bilateral agreements (BITs), including such provisions as fair and equitable treatment, free transfer abroad of profits and dividends and compensation for expropriation;

-- national treatment will be assured for the establishment of new investments by non-resident investors and for the operation and expansion of established investments under foreign control;

-- dispute settlement procedures will include both state-to-state and investor-to-state arbitration.

We are also moving to new disciplines providing effective market access for foreign investors in the areas of privatisation and the operation of public monopolies. A provision on the movement of key personnel will promote the transborder movement of human resources essential to the operation of an investment. The issue of introducing greater disciplines in the use of investment incentives is also under consideration and a draft provision on performance requirements will provide absolute prohibition of certain practices which distort international trade and investment.

A mutually beneficial investment climate and a balanced approach to investment depends not only on international disciplines applied by governments, but also on responsible behaviour of investors in the countries in which they operate. It has therefore been proposed to associate the OECD Guidelines for Multinational Enterprises to the MAI without changing the voluntary nature of the Guidelines.

A number of important issues remain to be resolved -- for example, how and to what extent to bind subnational entities; how to treat culture; and what, if any, special provisions are necessary for regional international economic organisations, such as the European Union. Despite these unresolved issues, much progress has already been achieved in preparing texts, or options for text, on a wide range of subjects and, more broadly, in preparing the ground for the successful outcome of the negotiations.

Another important area of work remaining for negotiators relates to the specific reservations that each country will be permitted to lodge under the Agreement. This will require negotiations to assess how far countries are willing to go towards eliminating existing discriminatory measures, or at least setting timetables for rolling back such measures in the future. The inventory of investment restrictions so far notified under the OECD instruments has been updated and negotiations on country-specific reservations are scheduled to start at the end of February.

We believe there is strong momentum and political will behind the negotiations. Negotiators will meet each month between now and May in order to meet the deadline of concluding the negotiations by the time of the OECD Ministerial meeting on 26-27 May 1997. Although many challenges remain before us, I feel we are on track.

## II. What interest may Latin American countries have in joining the MAI

When OECD Ministers launched the negotiations in 1995, they emphasised the open character of the MAI -- specifically, that it should be a free-standing agreement, open to accession by non-OECD countries willing and able to meet its requirements.

Non-Member OECD countries will be expected to accept the same core obligations of the MAI as OECD countries. Therefore, the process of accession for non-OECD countries would require each candidate to negotiate with other Contracting Parties both the restrictions it may be allowed to maintain through specific reservations and those it will need to adjust in order to conform to the MAI obligations. Such negotiations could start as soon as the Agreement is concluded -- and before it is ratified and enters into force. The present dialogue between OECD and Latin American countries could provide the basis for such negotiations.

The resurgence of Latin America as a major recipient region (and even source) of foreign investment, and the increasing convergence between Latin American and OECD foreign investment policies suggest that Latin American countries could derive considerable benefits from joining the MAI, including:

-- greater attractiveness for potential foreign investors due to countries' acceptance of high standards of protection, treatment and legal security for those investors. The returns are likely to be higher than those resulting from bilateral treaties because the MAI will cover all phases of investment, including the entry and post-establishment phase, as well as new disciplines for the treatment of investors.

-- the MAI would also offer similar protection, treatment and legal security to those Latin American countries which are capital exporters. Although some benefits may flow automatically from the MFN provisions of the GATS and bilateral investment treaties, the scope of the MAI is much broader than these agreements since it includes all economic activities, including manufacturing and natural resources as well as services;

-- signing on to the MAI would give access to the "Parties Group", which will be the entity responsible for the implementation and operation of the Agreement. This Group will also be important for addressing those issues that are likely to be on the built-in agenda for future work.

It is, of course, for each country to decide where its national interest lies. This workshop provides a unique occasion to offer views on the MAI and to discuss what it could eventually mean for Latin American countries. You can be assured that the views you express here will receive the attention of the Negotiating Group. Your views will also be important in helping us decide with you how this dialogue should evolve in the future.

# STATE OF PLAY OF THE MAI NEGOTIATIONS

*by*
William S. Dymond*

## I. Introduction

Investment has a positive impact on economic growth, productivity and competitiveness and widespread liberalisation, increasing competition for investment capital and globalisation of production have created dramatic growth in foreign direct investment (FDI). The annual FDI flows into Latin America and the Caribbean have nearly tripled since 1990 (US$26.5 billion in 1995) surpassing trade as a means of serving foreign markets.

There is a need today for multilateral rules that set high standards for investment liberalisation and protection, as well as to create a balanced and equitable framework for addressing investment issues. The guiding principle of the Multilateral Agreement on Investment is to eliminate such barriers and practices that distort investment flows, and result in unfair and inefficient allocation of resources.

## 2. State of play

Negotiations began in September 1995 and are due to be completed by the OECD Ministerial in May of this year. The negotiations are on track (all the major issues have been discussed by the Negotiating Group and bracketed text on basic commitments has been prepared by Expert and Drafting Groups), but serious issues remain to be resolved. As a result, the negotiations are moving into a new phase, with parallel efforts to complete text (through formal and informal proceedings) and to negotiate exceptions.

### *Contents of the Agreement*

The definition of "investment" must be broad enough to ensure that all relevant forms of investment enjoy MAI benefits, and yet it must not incorporate only trade and financial operations.

To date the majority of delegations support a definition which includes a non-exhaustive list of assets considered to be investments and broad agreement has been reached on the core principles of investment protection, including:

-- disciplines on expropriation
-- obligations regarding compensation
-- protection from strife
-- free transfer of payments related to an investment

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It has also been generally agreed to apply the better of national or most-favoured nation treatment standard to all stages of investment. General exceptions will be allowed for only the most compelling conflicting concerns (e.g. national security) and, in addition, countries will be permitted to draw up narrowly defined country-specific reservations for non-conforming measures.

The MAI will include disciplines in "new" matters in order to facilitate entry and stay of investors and their key personnel, to prohibit the imposition of certain distorting performance requirements, as well as to extend the basic MAI commitments (national treatment, transparency) to investment incentives, privatisations, and monopolies and state enterprises. So as to protect both the investor and the investment, the MAI will also include both investor-state and state-state dispute settlement procedures.

In recognition of the difference in the concept of "non-discrimination" as used in tax treaties from that in investment treaties, and in order that MAI dispute settlement not be used to undermine the existing network of bilateral tax treaties, tax matters have been carved out of the MAI except to the extent they have been specifically carved in (e.g. expropriation).

## II. Difficult/Key Issues

***How to achieve liberalisation?***

There are two possible approaches to achieve liberalisation. There can be either up front negotiations over reservations aimed at achieving a satisfactory overall balance of commitments or the application of peer pressure over time.

There are other factors to be taken into consideration as well, and which include:

a) aspects of binding sub-federal entities;

b) in addition to the national security exception, should there be general exceptions:
   *i)* for public order
   *ii)* for cultural industries
   *iii)* for regional economic integration organisations (national treatment exception for members, MFN exception for liberalising measures taken by REIO, measures taken by countries with association agreements);

c) should there be prohibitions on measures that impose conflicting requirements and secondary investment boycotts?

d) the scope of application of dispute settlement?

e) how should the MAI reflect the need to balance investor rights with the desire to protect the environment, respect the interests of workers?

## III. Accession by non-Members

The MAI will be a free standing treaty, not an OECD instrument, and the original OECD signatories will create a Parties Group to administer the Agreement. Non-OECD Members wishing to

accede will negotiate with the Parties Group a list of exceptions to the basic commitments. (Transition periods may be possible for meeting some obligations.)

Accession to the MAI would send a signal to investors that the acceding country subscribes to high standards of investment liberalisation and protection, thus giving it a competitive edge. The MAI could make it easier for Latin American countries to attract a broader range of investments beyond privatisations and the few large sectors which have historically attracted FDI.

Most MAI commitments will be similar to those undertaken by many Latin American countries in their BITs. This Agreement will help assure market access and protections for an acceding nation's outward investors. Its comprehensiveness and dispute settlement provisions will augment MFN protections in GATS, BITs. Finally, the acceding countries would become full members of the MAI Parties Group.

## III. Conclusion

Tremendous progress has been made towards the goal of creating a high standards multilateral investment framework, but a great deal of work remains to be done. It is, however, too soon to say whether the original May deadline for completing negotiations as established by the OECD Ministers will be met.

## SCOPE OF THE MAI: DEFINITION OF INVESTOR AND INVESTMENTS

*by*
Manfred Schekulin*

### I. Introduction

The terms investor and investment stand at the very heart of every investment agreement, including the MAI.

It is to investors of another Contracting Party and their investments that the MAI will give rights such as those to be accorded under National Treatment and Most Favoured Nation treatment; that is, fair and equitable treatment and full and constant protection and security. For any losses or damages inflicted on such investors or their investments, the MAI will give investors standing in Dispute Settlement procedures against the host state.

Given the far reaching consequences of any decision on who is to be considered an investor and what is to be considered an investment under the MAI, both for the scope of the actual MAI disciplines and the applicability of the dispute settlement arrangements, it is natural that deliberations on the drafting of the provisions on definitions has taken considerable time. There is not yet final agreement, but there is a good possibility that these definitions will be based on an early consensus expressed in the mandate given to the Negotiating Group that the scope of the agreement be as broad as possible.

On 31 January 1997 a breakthrough was achieved and a single draft text for both definitions met with strong support from most of the participants, even though some questions still remain open.

### II. Definition of investor

Consensus that the definition of investor should be as broad as possible was quickly achieved. It covers all natural persons who are nationals or permanent residents of a Contracting Party in accordance with its applicable laws, and legal persons or other entities constituted under the applicable law of a Contracting Party, whether or not for profit, or whether private or government-owned or -controlled.

The issue covering permanent residents was quickly solved with outstanding problems being left for the dispute settlement provisions.

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In the last stages of the negotiations, the discussion has focused on three questions:

*a. Whether the list in the second part of the definition should involve branches or not?*

- As most, if not all, countries participating in the negotiations do not confer upon branches the legal capacity to act as investors in their own name and on their own account, the reference to branches was deleted.
- Given the open, non exclusive character of this list, some suggested going one step further and including an explicit reference to the "legal capacity to invest" in the definition.
- Most delegations considered this neither necessary nor useful because such a reference could create legal uncertainties.

*b. Whether "Contracting Parties" should be mentioned explicitly?*

- Some argued that this was necessary because a Contracting Party was neither a *natural person* nor *a legal person constituted under the applicable law of a Contracting Party*. The majority, however, saw no need for this because in most cases a Contracting Party would invest through state-owned entities covered by the present definition and, in the few cases where this was not the case, it could be protected by diplomatic process under international law.

c. *Finally, whether the definition should include a link between the investor and the activity of investing*?

- Though the present description does not say so explicitly, it is clearly not the intention of MAI negotiators to give rights, and especially standing in dispute settlement procedures, to any natural or legal person but only to investors in relation to their present or future investment. The prevailing view was that in order to achieve this result no special reference, as for example in the Canadian Model-BIT, was necessary because it could be defined from the context of the definition, especially the provision on the treatment of investors. The MAI follows the example recently set by the ECT.

## III. Definition of Investment

A basic consensus was quickly found: the MAI should have a single, broad and asset based definition of investment.

Single means that one definition should apply to all obligations of the agreement without distinction between the pre- and the post-establishment phase.

Broad means that the definition should go beyond the traditional concept of FDI and also cover portfolio investments. This is reflected by the fact that the definition is based on the notion of assets instead of on the notion of enterprise and that it includes tangibles as well as intangibles.

This approach is not new. On the contrary, it can be found in all but a very few BITs as well as in several recent multilateral treaties concerning investment, notably the ECT and the NAFTA.

It implies the necessity to strike a balance between two conflicting aims:

-- it must be broad enough to ensure that all relevant forms of investment undertaken by foreign investors enjoy the benefits of the MAI, such as protection against expropriation; yet

-- it must not be so broad as to cover trade operations and purely financial transactions that by themselves lack the characteristics of an investment and fall under existing international regimes for cross border trade operations and financial market regulations.

To transform this ambiguity into a coherent legal text was a challenge given the few precedents that exist. Most BITs do not have to cope with this problem because they typically concentrate on investment protection and contain no binding obligations in the pre-establishment phase. Nor does the ECT contain a full National Treatment-obligation in the pre-establishment phase as this question was left for separate negotiations which are currently underway.

In all, six different approaches and innumerable combinations of them were identified. It seemed at one point as if any MAI definition would have to include a positive list of assets that constitute an investment and a negative list of assets that do not, thereby following the example of Article 1139 of NAFTA. However, the text that emerged attempts to avoid establishing such a negative list by a very short and general statement declaring that investment means "every kind of asset owned or controlled, directly or indirectly, by an investor". This would be followed by an illustrative, but very broad, list of such assets and supplemented by an interpretative note saying that in order to qualify as an investment under the MAI, certain characteristics of an investment must be present such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.

This approach is based on the assumption that all concerns regarding financial transactions should and can be accommodated outside the definition by specific safeguard provisions currently under consideration. These include

-- A measure with respect to financial services on which agreement has already been achieved.

-- A derogation clause for situations in which BOP difficulties or threats to the stability of monetary and exchange rate policies occur. Now that a broad definition of investment has materialised, a BOP clause seems very likely and even inevitable.

-- Another safety net against unmanageable short term capital flows could be established by an exception to the NT obligation for the acquisition or sale of assets of an initial maturity of, for example, less than one year. Such an approach would leave investors better off than the entry of such assets into a negative list because once admitted it would integrated into the core of the MAI and therefore protected, for example, against expropriation. Many delegations feel that it nevertheless goes too far by giving a Contracting Party unconditional freedom to restrict the movement of certain assets.

In addition to these peculiarities of financial transactions, some further questions still remain unresolved. The Chairman of the Negotiating Group identified five of them at the January 1997 meeting:

*a)* *Indirect control*: opinions still diverge on whether investments by an investor established in a non-MAI-party, but owned or controlled by a MAI party investor, should be covered.

*b)* *Intellectual property*: some participants in the negotiations question whether all intellectual property rights should be covered given the complexity of issues involved and the ongoing work in the World Intellectual Property Organisation. A full fledged discussion of this item is on the agenda for the next meeting of the Negotiating Group.

*c)* *Concessions*: no final consensus has been achieved on whether the granting of concessions should fall under the discipline of the MAI and therefore be covered by the definition.

*d)* *Public debt*: Some characteristics of public debt seem to imply the necessity of a departure from MAI disciplines otherwise the rescheduling of public funds could be considered an expropriation. It remains to be seen if a solution to this problem can be achieved through the safeguard provisions presently under consideration as to whether a specific provision on public debt or source changes to the definition article will be needed.

*e)* *Real estate*: Many BITs and the NAFTA exclude real estate if acquired for personal use or, in NAFTA language, not "acquired in the expectation or used for the purpose of economic benefit or other business purposes." Opinions among MAI negotiators are divided. Some would like this concept to be incorporated in the MAI. Others think this wording be suggested for an interpretative note which would effectively deal with these concerns and, finally, a third group would like to extend the coverage of the MAI and leave it up to individual Contracting Parties to lodge specific reservations if they were not willing to follow this route.

## IV. Concluding Remarks

After extensive discussions, MAI negotiators seem to have agreed upon definitions for both investors and investment; This will consist of a broad definition of *investor* covering nationals, permanent residents and legal entities constituted under the law of a Contracting Party and a single, broad and asset based definition of *investment* including a non exclusive positive list of assets covered by a negative list.

In order to achieve this result, they agreed to rely on specific safeguard provisions in order to address concerns related to certain characteristics of financial and monetary markets. It should be noted that a denial of benefit clause is also under consideration. Such a clause could help overcome worries concerning free-riding *via* letter box companies.

# INVESTMENT PROTECTION

*by*
Joachim Karl*

## I. Introduction

Nearly one and a half years after the launching of the negotiations, the MAI draft provisions on investment protection are almost complete. The latest draft contains the following elements:

-- general treatment of the investor and the investment;
-- expropriation and compensation;
-- protection from strife;
-- transfer of funds;
-- subrogation;
-- protection of existing investment;
-- relationship to other sources of protection.

Discussions are also continuing on whether to include a provision protecting investor rights arising from other agreements between the investor and the host country.

In general, the draft has many similarities with well-known investment protection provisions found in hundreds of bilateral investment protection agreements. This is no surprise because it was never the intention of the negotiating partners to "re-invent the wheel", but rather to add some more spokes in order to strengthen the whole vehicle.

Following are the main results of the various draft provisions with particular emphasis being placed on those issues where it has not yet been possible to achieve final agreement.

## II. The MAI provisions on investment protection

### *1. General treatment*

In this introductory article, it is stated that the investment shall receive fair and equitable treatment as well as full and constant protection and security. Treatment must in no case be less favourable than what is required by international law.

We then tried to be more specific about what this obligation means. We agreed that both the operation and the management, maintenance, use, enjoyment or disposal of an investment shall be protected. However, with regard to these activities it is not yet clear whether only unreasonable and

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discriminatory state measures shall be prohibited or whether it is sufficient that these measures are either unreasonable or discriminatory. Those who support the cumulative approach argue that it would go too far to prohibit measures that are only "unreasonable" -- given the vagueness of this term. In the view of others, it would be too narrow to cover only "discriminatory" measures because there may be severe interference with the investor's activities without a discrimination necessarily having taken place.

### *2. Expropriation and compensation*

It was not very difficult to come to an agreement with regard to the core provisions of this article. An expropriation, or any other measure having an equivalent effect, whether directly or indirectly, is only permitted if it is in the public interest, non-discriminatory, against payment of prompt, adequate and effective compensation, and in accordance with due process of law. The article then continues by specifying in more detail what the terms "prompt, adequate and effective" and "due process" mean.

a) There is already agreement on the following elements:

-- "prompt" means without delay;
-- "adequate" means that compensation must be equivalent to the fair market value immediately before the expropriation took place, without any deduction due to the fact that the pending expropriation became publicly known in advance;
-- "effective" means that compensation shall be fully realisable and freely transferable; and
-- "due process of law" includes the right of an investor to have its case reviewed by a judicial authority or any other independent body in the host country.

b) With regard to the following issue, the discussions were more difficult:

-- The question came up what compensation the investor can claim for in the case where payment has been delayed. There was already at an early point agreement that the host country has to pay interest at a commercial rate established on a market basis for the currency of payment from the date of expropriation until the date of actual payment. However, it was unclear whether we would need an additional provision according to which the host country would also bear the exchange-rate risk in case of a delay. This means that in case of a devaluation of the host country's currency between the time of expropriation and the time of actual payment, the host country would have to compensate the investor for this devaluation as well. Several draft provisions have been developed to take care of this problem. They were all based on the idea that compensation would already be calculated in a certain currency (e.g., a freely usuable currency or any other currency acceptable to the investor). At the December 1996 meeting of the Negotiating Group -- where the issue was discussed in detail -- none of these options proved to be satisfactory. The huge majority now supports the idea that MAI would not contain an explicit provision on the subject. However, an interpretative statement would be added to the text according to which "adequate" compensation includes compensation for devaluation losses.

### *3. Protection from Strife*

This provision deals with the situation where an investor suffers losses in the host country due to war, any other armed conflict, state of emergency or similar events. In principle, the host country shall not be obliged to pay compensation in such cases. Rather, the draft MAI provision stipulates that if the host government decides to pay compensation, then the principles of national treatment and most-favoured

national treatment shall apply. However, there are two situations where there exists an obligation to pay: *a)* in the case where the armed forces of the host country requisition the property of the investor; and *b)* in the case where the property is destroyed by the armed forces of the host country where this demolition was not required by the necessity of the situation. Compensation in such cases must be prompt, adequate and effective.

### *4. Transfer of Funds*

This article states that all payments into and out of the host country related to an investment may be freely transferred without delay at the market rate of exchange prevailing on the date of transfer. The provision contains an open-ended list of what kind of payments are included (e.g. the initial capital, returns, compensation, proceeds from the sale or liquidation of the investment, earnings and other remuneration of personnel).

The following, however, has not yet been resolved:

-- The most important is the question of whether a "balance-of-payments" clause should be included. While some delegations think that the free transfer should be an absolute obligation and that even in a balance-of-payments crisis there is not really a need to restrict foreign direct investment, others hold the view that a government must maintain the possibility of controlling all kinds of payments in an actual crisis. Most delegations underline the close link between the possible need for a BOP clause and the scope of the definition of an investment; the broader the definition, the more likely it becomes that the MAI contains a BOP clause. At its December meeting, the Negotiating Group decided that -- without prejudice to future deliberations -- the working group on "Financial Services" should develop a draft text for such a clause. In doing so, the Group must pay close attention to the role of the IMF.

-- Second, a final decision has not yet been taken with regard to the currency in which transfers may be made. The majority supports a provision according to which transfers may be made in a freely convertible currency and where this term will then be defined. Two options for such a definition are currently being discussed. While the first alternative defines a "freely convertible currency" as one which is widely traded in international foreign exchange markets and widely used in international transactions, the second option refers to such a currency which is, in fact, widely used to make payments for international transactions and is widely traded in the principle exchange markets.

-- Third, it still has to be decided whether a clause is needed to deal with the situation where there is no market rate of exchange. It has been suggested that in such a situation the rate to be used shall be the most recent exchange rate for conversion of currencies into Special Drawing Rights.

### *5. Subrogation*

All delegations accept the principle that if the home government compensates an investor with regard to a loss that has occurred in the host country, the first country enters into all the rights and claims that the investor had *vis-à-vis* the host country.

Two issues are still under consideration. First, a few delegations believe that the provision should make it clear that it deals only with compensation for non-commercial risks. Second, one

delegation would have serious difficulties to allow the home country of the compensated investor to proceed -- as the latter's successor in rem -- under the rules of investor-state arbitration.

### *6. Protection of existing investments*

Delegations agree in principle that the MAI should cover investments, irrespective of whether they have been made before of after entry into force of the Agreement. However, some delegations would like to add a provision to the effect that the MAI does not apply to claims arising out of events which have occurred, or to claims that have been settled, prior to its entry into force.

Furthermore, some delegations suggested yet another addition according to which a change in the form in which assets are invested does not affect their character as investments.

### *7. Relationship to other sources of protection*

Several delegations support the idea of including an article stating that if the domestic law of a Contracting Party or any other obligation under international law provides for a more favourable treatment of the investor than does the MAI, the former shall, to the extent that it is more favourable, prevail over the present Agreement.

### *8. Protection of investor rights arising from other Agreements between the host country and the investor*

Discussions are continuing as to whether the MAI should contain a provision according to which each Contracting Party shall respect any other obligation it has undertaken in an investment agreement with a specific investor. As a consequence, a breach of such an investment agreement would amount to a violation of the MAI.

At the moment, there are three options on the table. First, the MAI would not contain such a provision at all; second, only the MAI dispute settlement mechanism would be available in the case of an alleged violation of the investment agreement; third, the MAI would contain a so-called "respect clause", including the possibility to have recourse to the MAI dispute settlement mechanism. The main difference between the first and second options on the one hand, and the third option on the other hand, would be that in the latter case the breach of the investment agreement by the host country would, in principle, always amount to a violation of the MAI. Consequently, the investor and its home country would be entitled to the remedies that the MAI provides in such a case.

Conversely, with a "dispute settlement clause", the investor (and its home country) could only seek such remedies that are available under the domestic law governing the agreement, unless the investor rights deriving therefrom can be qualified as an "investment" under the MAI.

# NATIONAL TREATMENT, MOST FAVOURED NATION TREATMENT AND TRANSPARENCY

*by*
Valérie Charolles*

## I. Basic principles

Three basic principles will govern the application of the Multilateral Agreement on Investment:

***National Treatment***

Foreign investors must not be treated less favourably than national investors. This is unquestionably the essence of a multilateral agreement on investment; an investor who invests abroad must have the certainty that the rules applicable to him are at least as favourable as those applicable to national operators.

***Most Favoured Nation clause***

This is, to a certain extent, a remedial clause. If a country cannot guarantee national treatment for foreign investors, the most favoured nation clause can at least guarantee that one foreign investor is not treated worse than another foreign investor from another country.

***Transparency***

Foreign investors can only invest on foreign markets if they know the rules. This is the purpose of the rules on transparency under which countries are obliged to disclose all general measures which affect investment.

These principles are widely recognised in multilateral agreements and are applicable in the draft articles of the MAI. A more in-depth explanation should, however, be given on two points: the scope assigned to these principles and the clarifications that are still necessary.

## II. Scope of the Agreement

The text of the Agreement contains five indicators which help explain the purpose of the principles of national treatment, the most favoured nation clause and transparency:

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a) *"Each Contracting Party":* under the mandate granted by the Ministers of the OECD, the MAI is intended to apply to all government levels. In other words, national as well as regional and local measures must provide for national treatment.

b) *"Each Contracting Party shall accord to investors of another Contracting Party and to their investments, treatment no less favourable than the treatment it accords to its own investors and their investments."* What is meant here by the term "treatment? From the beginning, negotiators agreed that the term "treatment" should normally cover all policies which affect investment (economic policy, financial policy, tax policy, policy on public sector subsidies, company law, etc.). Only when expressly stipulated may a given type of policy which affects investment be excluded from the Agreement.

   The negotiators also agree that the term "treatment" should cover all types of discrimination, whether *de facto* or *de jure*. This is a fundamental principle. For example, if there is no measure which formally forbids access to a given economic sector but for which seemingly non-discriminatory technical rules actually make it impossible for foreign investors to compete in such a sector, these rules would be contrary to the MAI.

c) *"Each Contracting Party shall accord (...) treatment (...) with respect to the establishment, acquisition, expansion, operation, management, use, enjoyment and sale or other disposition of investments."* This means that all investment phases will be covered by the MAI, from admission of the investor and his investment to the national economy (pre-establishment phase) to the activities of the investor and his investment once the investment has been made (post-establishment phase).

d) In addition, the text stipulates that the best of two treatments will be granted if there is a difference between national treatment and the most favoured nation clause. If a country, for example, treats foreign investors from a MAI signatory better than its own investors, it will have to treat all foreign investors this way.

e) *the article on transparency* not only provides for disclosure of discriminatory measures but also of all policies which affect investment. This transparency obligation applies to all forms of public policy, including what is known as "established policies" which have not yet been entirely formalised.

These five indicators demonstrate that even if the MAI does not formally cover access to the market, the meaning given to national treatment, most favoured nation clause and transparency are very similar to the concepts as defined in, for example, the GATS.

## III. Necessary clarifications

The purpose of the MAI is to forbid any discrimination against foreign investors. However, its purpose is not to forbid countries from pursuing their own foreign investment policies if they are not discriminatory.

If the MAI principles were to be summarised, one could say that the MAI is not designed to forbid any form of regulation against foreign investors, but only discriminatory policies. This is essential; the MAI does not aim to challenge the legitimacy of a public action connected with investment.

Three observations can be made in this respect:

a) National Treatment and the Most Favoured nation clause are relative, not absolute. Their purpose is to make sure that foreign investors receive similar treatment to national investors, not to establish an absolute standard on investment policy. Moreover, it is still being debated whether or not to place added emphasis on the comparative nature of national treatment and the most favoured nation clause. Some consider it advisable to add the words "*under similar circumstances*" to the current draft articles in order to highlight the fact that comparison between foreign investors and national investors needs to be placed in their respective environment. Others are of the opinion that the comparative nature of national treatment and most favoured nation clause is obvious.

b) The MAI does not challenge the right of countries to develop their own investment policy. In this area, the Contracting Parties are debating on which conditions common investment policies can be developed in regional economic integration organisations. Such organisations group a number of countries that have embarked on far-reaching integration of their economies, notably the European Union.

c) In this phase, the MAI does not ban more favourable treatment for foreign investors than for national investors. This is the meaning of the term "no less favourable". In the future, it will probably be necessary to reflect on competition between countries to attract foreign investors, generally reflected in preferential treatment for foreign investors. The MAI is part of a plan to establish fair competition between the signatory countries -- competition which is as little distorted as possible. This will in time make it necessary to clarify the issue of positive discrimination (better treatment for foreign investors).

In short, the essence of the treatment provided for under the MAI is the following: to forbid discrimination in general between foreign investors and national investors. Obviously, the inclusion of such an obligation in an international agreement is a large step forward and it cannot be expected that this treatment will be granted at once under all circumstances and in all economic sectors.

The following intervention will discuss the mechanisms which make it possible to deviate from these principles.

## EXCEPTIONS, DEROGATIONS AND NATIONAL RESERVATIONS

*by*
Marinus W. Sikkel*

### I. Exceptions, derogations and national reservations

To what extent and on which conditions is it possible to derogate from the MAI principles?

Ideally, there would be no derogation from the principles of the Agreement. Two comments may be made about this, even if the discussions are far from over:

*a)* At the request of OECD Ministers, the MAI will be very ambitious in this area. Its ambition is reflected in two types of provisions:

-- the agreement will be based on a standstill agreement and a rollback principle: the parties will not be entitled to add non-conforming measures once the agreement has been signed. They will only be entitled to liberalise in the future.
-- above all, the agreement will follow a top-down, rather than a bottom-up, approach. Using a bottom-up approach, such as the one applied by the WTO, only declared sectors are covered by an agreement. The MAI follows the opposite approach: for example, only those sectors which are explicitly excluded by a party are not entitled to national treatment. This is obviously much more restrictive.

*b)* Five types of provisions will enable the signatories to derogate from the principles of the agreement:

-- *General exceptions:* under these exceptions, States would have the possibility to take the measures necessary to ensure compliance with certain general objectives.

-- *Taxation* is generally not covered by the MAI. A so-called carve-out/carve-in approach will be followed.

-- *Temporary derogation*: the definition of investment should be very broad and therefore cover most of the balance of payments. Accordingly, a temporary derogation clause in case of serious problems with balance of payments could be inserted.

-- *Prudential measures* which give the Contracting Parties the possibility to ensure the integrity and stability of their financial system.

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-- *National reservations*: States will have to disclose all non-conforming measures which they maintain at the time the MAI is signed or at the time they join. Clearly, the final negotiating phase will focus on such a list and seek to establish commitments which are as open as possible. Once the agreement has been signed, signatories will no longer be entitled to add new non-conforming measures.

## II. General exceptions

Such exceptions could be granted for reasons of national security, public law and order, and maintenance of international peace. The question of a "cultural exception" intended to protect linguistic and cultural diversity is also under discussion. Talks are in progress to determine how to limit abuses which could result from such provisions.

Some of the elements under discussion with regard to this article follow.

It has been proposed that the general exceptions provisions not be applicable to all of the obligations under the agreement. The ECT (Article 24(1)) is an example of a multilateral agreement that does not allow for general exceptions to be taken with regard to specific obligations concerning compensation for losses or expropriation. Bilateral treaty practice differs on this matter. The question is whether certain obligations of the agreement are considered so central to investor protection, for example compensation in case of expropriation, that a provision should limit the right of a Contracting Party to invoke this Article for actions that would be inconsistent with its obligation to pay compensation in the case of an expropriation.

Should the provisions regarding protection of essential security interests be self-judging?

Recent agreements like the NAFTA, the ECT, the GATS and the Shipbuilding agreement do not define essential security interests but provide elements clarifying the purpose of the provision. Should the list of such elements be open or closed?

Agreements such as the NAFTA, GATS, and the Shipbuilding agreement include a general exception provision relating to obligations for the maintenance of international peace and security. These provisions refer specifically to obligations under the UN Charter. Some delegations thought it unnecessary to refer to this obligation because the supremacy of the UN Charter over international treaties is not disputed. Other countries believe that a reference to public order is necessary to allow countries to take exceptional measures based on this principle.

An anti-abuse-clause could be added to this article. However, a good faith obligation already exists in international law and there are concerns that by restating it in the agreement, a different standard may be created. Some delegations thought it might be useful to follow the ECT (Article 24) and GATS (Article XIV) provisos that public order or other general exceptions must not constitute a disguised restriction or that they are invoked without proper justification.

The requirement to notify measures is intended to facilitate transparency and to promote consistency in the manner that MAI Parties might apply the general exceptions provisions. Some delegations thought that the 1991 clarification by the CIME, that "measures taken for economic, cultural or other reasons should be identified as such and should not be shielded by an excessively broad interpretation of public order and essential security interests...", might also assist the Parties in applying these provisions.

Most delegations were in favour of providing for a mechanism for consultation/dispute settlement. It would be understood that entering into consultations would not prejudice the right of either Party to invoke the other procedures of the agreement to which it might be entitled. The question remains whether an anti-abuse-clause provides an objective standard which, if violated, can give rise to an actionable cause. Several options with regard to procedures are considered:

*a)* actions relating to any of the provisions of this article could be subject to consultations and to the dispute settlement provisions of the agreement to the extent that the provisions are not entirely self-judging;

*b)* actions relating to any of the provisions of this article could be subject to consultations to the exclusion of recourse to the dispute settlement provisions of the agreement;

*c)* actions relating to some of the provisions of this article could be subject to consultations and to the dispute settlement provisions of the agreement.

## III. Balance of payments clause

OECD Member countries are strongly attached to the freedom of investment, and capital movements more generally, as well as to the right of investors to freely make payments and transfers in connection with current and capital transactions. They have traditionally discouraged resort to exchange restrictions and capital controls as a means of solving balance-of-payments problems, stressing that they should not be a substitute for appropriate adjustment policies. Nevertheless, it may be considered that there could exist exceptional circumstances in which a country should have the flexibility to introduce such restrictions for a temporary period if this can allow the country to buy time until appropriate policy measures take hold. This may be especially important in the context of adjustment policies adopted with IMF support.

## IV. Taxation

"Nothing in this Agreement shall apply to taxation measures except as expressly provided in paragraphs 2 to ... below:"

Taxation is a vital point in foreign investment decisions. Foreign investors attach primary importance to fair fiscal treatment. Logically, therefore, the non-discrimination rule in the MAI should extend to fiscal treatment. However, fiscal experts have identified a number of problems that would arise if the MAI were in its entirety to apply to taxation. Their primary concern is that strong obligations on national treatment, non-discrimination and most-favoured nation treatment, as envisaged in the MAI, could conflict with obligations contained in the many bilateral agreements on the avoidance of double taxation. Although these agreements are also based on the non-discrimination principle, this does not necessarily mean that a foreign investor is always taxed identically to a local firm.

Also, because bilateral agreements on taxation do not contain arbitration as a dispute settlement mechanism, there might be a temptation for firms to use MAI mechanisms and thus undermine the taxation treaties.

These considerations led some fiscal experts to advocate a provision in the MAI stating very simply that this Agreement would not apply to tax measures. Others said some MAI rules could possibly apply to taxation; thus, the tax carve-out would have to be more accurately defined.

After considerable debate the conclusion is that, as a general rule, the MAI will not apply to fiscal measures, except for certain specific provisions such as expropriation and transparency. The carve-in of other matters is still under consideration. Although taxes will not normally have an expropriatory effect, it is conceivable that a country use fiscal measures to achieve a so-called creeping expropriation. Also, investors should have the right to be fully informed about applicable fiscal policy.

## V. Prudential measures

*"1. Notwithstanding any other provisions of the Agreement, a Contracting Party shall not be prevented from taking prudential measures with respect to financial services, including measures for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by an enterprise providing financial services, or to ensure the integrity and stability of its financial system.*

*2. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Contracting Party's commitments or obligations under the Agreement."*

The proposed Article applies to measures taken with respect to financial services. Given the coverage of the MAI, the Article will apply to measures affecting investors and their investments in the financial services area and not all aspects of international trade in financial services. The proposed text recognises the right of a Party to take prudential measures which do not conform with National Treatment, MFN and the other provisions of the Agreement, provided that the measures are not used as a means of avoiding Party's commitments and obligations.

Several questions are under consideration, such as the question whether the exercise of a Party's right to take prudential measures which do not conform with the provisions of the Agreement should be subject to the dispute settlement mechanism of the MAI, or whether financial services expertise should be required for any arbitration panel for disputes on issues relevant to financial services.

## VI. Standstill and the listing of country specific reservations

The MAI aims to ensure a high minimum standard of treatment for investors and their investments, including National Treatment and MFN treatment. Standstill would result from the prohibition of new or more restrictive exceptions to this minimum standard of treatment. From this perspective, a violation of standstill would be a violation of the underlying MAI obligations (e.g. National Treatment and MFN), and the dispute settlement provisions would apply to such breaches of the MAI obligations. Standstill would not apply, however, to any general exceptions (e.g. national security) or to any temporary derogations (e.g. balance of payments) that might be allowed under the MAI.

For those matters where Contracting Parties are ready to commit to standstill:

*a)* each Contracting Party should list all non-conforming measures in an Annex of the Agreement;
*b)* the reservations should describe, in the most precise terms possible, the nature and scope of the non-conforming measures. This would ensure that the scope of the reservations is not broader than these measures and, thus, that the reservations are not of a "precautionary" nature;
*c)* no additional non-conforming measures could be introduced; and

*d)* an amendment to a non-conforming measure would be permitted provided it did not decrease the conformity of the measure.

Of course, if the MAI obligations were expanded, (a) - (d) would come into play again with respect to the new or enlarged obligations.

A standard presentation of the non-conforming measures listed in Contracting Parties' specific reservations would enhance transparency and facilitate the operation of the Agreement. Specific reservations listed in the schedules of the Contracting Parties should include the following elements:

*a)* the obligation or MAI article in respect of which the reservation is taken;
*b)* the sector(s)or sub-sector(s) covered by the reservation;
*c)* the level of government which maintains the non-conforming measure;
*d)* the legal source or authority of the non-conforming measure;
*e)* the description of the non-conforming measure; and
*f)* the purpose of the non-conforming measure.

## VII. Rollback

Rollback is the liberalisation process by which the reduction and eventual elimination of non-conforming measures to the MAI would take place. It is a dynamic element linked with standstill, which provides its starting point. Combined with standstill, it would produce a "ratchet effect", where any new liberalisation measures would be "locked in" so they could not be rescinded or nullified over time. There are a number of ways for achieving rollback. The most commonly known in the trade field is that of successive rounds of negotiations where rollback results from the trade-offs or exchange of trade concessions. Peer pressure through periodic examinations of Member countries' restrictions has been the approach of the OECD liberalisation instruments. Rollback commitments may also be inscribed in schedules of commitments or list of reservations. While this has not been a generalised practice, it has been done in some cases under the OECD instruments.

Rollback might be achieved through:

*a)* liberalisation commitments by the Contracting Parties effective on the date of entry into force of the MAI. This would imply that that not all restrictions currently maintained would be included in the list of reservations of the Contracting Parties;

*b)* rollback commitments inscribed in a country reservation or description of a non-conforming measure by means of a "phase-out" or a "sunset clause" specifying a future date when the non-conforming measure would be removed or made more limited in the future. Phase-out or sunset provisions could not be envisaged for all non-conforming measures. They might be useful, however, where the phase-out of a non-conforming measure is inscribed in domestic legislation or where a Contracting Party is able to commit itself to future liberalisation by a specified date.

Rollback after the entry into force of the MAI could result from:

*a)* an obligation for a Contracting Party to adjust its reservations to reflect any new liberalisation measure (the "ratchet" effect).

*b)* periodic examinations of non-conforming measures. These examinations could lead to recommendations in favour of the removal or limitations of specific measures. These reviews could be conducted on a country-by-country basis, or on an horizontal or sectoral basis, taking into account the degree of liberalisation already achieved; and

*c)* future rounds of negotiations designed to remove non-conforming measures. The decision to launch future negotiations could be taken at the conclusion of the MAI negotiations or the MAI could provide a specific date for the first round of such negotiations.

# SPECIAL TOPICS

*by*
Anders Ahnlid*

In the early stages of the negotiating process, the Negotiating Group came to the conclusion that observance of national treatment and most favoured nation treatment would not -- in itself -- be enough to guarantee the open investment regime that is the aim of the Multilateral Agreement on Investment.

Consequently, an expert group was created to assess the need for, and develop MAI disciplines concerning, a number of special topics. Considerable progress has been made in the past year and the experts have developed advanced proposals for MAI provisions covering "key personnel", "performance requirements", "investment incentives", "privatisation" and "monopolies/state enterprises".

The expert group submitted its final report on these topics to the Negotiating Group in January 1997. Further work is needed to finalise the provisions and this will be pursued on an informal basis. Following is a summary of where these topics now stand in the negotiations.

## I. Key Personnel

Difficulties encountered by investors with respect to the need to transfer personnel to perform important key functions for an investment made abroad could jeopardise such an investment. It is why the business community has expressed a strong desire to have rules that would give some basic guarantees for key personnel under the MAI.

Provisions are thus being developed on the temporary entry, stay and work of key personnel. The term "key personnel" would comprise executives, managers and specialists. The meaning of "specialists" in particular needs to be defined. In addition, the agreement will most likely contain rules of the same kind for investors.

Much of the technical work has focused on the relationship between MAI rules and national immigration and labour laws. A number of delegations have indicated that they are neither willing nor able to waive their national regulations in these fields for key personnel. Thus, national immigration laws will be untouched by the MAI. The same is true for the majority of labour laws. One exception, however, will certainly be made. Contracting Parties will not be allowed to restrict the entry, stay and work of key personnel and investors through the application of any quantitative restriction or economic needs test. This will be a legally binding provision under the Agreement.

In addition, the experts discussed whether an anti-abuse clause along similar lines as the one found in the GATS Annex on movement of natural persons should be included in the article on key

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personnel. Such a clause would state that signatories would not be allowed to use their respective immigration and labour laws in such a way as to circumvent obligations under the Agreement.

The question of whether covered key personnel should have a prior relationship with the investor in the form of employment is also under consideration.

Spouses and dependent children are likely to be given the same right of entry and stay as key personnel. In addition, a best efforts commitment may be included concerning the granting of work permits to spouses.

## II. Performance requirements

There is general agreement that national and most favoured nation treatment are not sufficient to tackle investment distortions and inefficiencies created by performance requirements; that is, requirements governments impose on investors in order to secure perceived benefits for society as a whole. Such requirements may take many forms. Among the most common ones are probably the various forms of trade balancing requirements and domestic content requirements.

The MAI will try to go beyond the provisions on performance requirements found in the WTO TRIMS Agreement, which centres on trade related requirements, and NAFTA, which does not cover requirements in the field of services. The MAI prohibitions will focus on investment related measures and cover both goods and services.

A fairly specific proposal for a draft article has been developed. A central feature of the draft is a distinction between performance requirements that depend on the granting of an advantage and those that do not. As in NAFTA, the list of prohibited requirements will be longer for the latter category than for the former.

The "main features" document specifies what performance requirements are being considered for prohibition under the different circumstances mentioned above. The document also lists the suggested prohibitions, but for which agreement has not yet been achieved.

The question of whether the prohibitions should apply equally to goods and services has been subject to debate. It will most likely be decided that it should apply in both cases and that countries may request national reservations if needed. Finally, it should be noted that some explanatory and/or exception-like provisions are being discussed in the context of performance requirements.

## III. Investment incentives

Among the special topics, "investment incentives" has been the most difficult. It involves issues that are both technically complex and politically sensitive. A number of countries want to make sure that the MAI helps put an end to the often costly competition between countries for a particular investment by means of investment incentives. Others do not share this view and prefer to maintain the *status quo*.

There is broad agreement that national and most favoured nation treatment should apply to investment incentives. This would probably introduce some discipline since it would make investment incentive programmes more costly to apply, provided, of course, that countries do not request reservations under which they could continue the discriminatory application of investment incentives.

Which disciplines, if any, should the MAI contain concerning investment incentives over and above national and most favoured nation treatment? There is no answer as positions differ considerably.

Some delegations are in favour of additional disciplines. A ban on "positive discrimination", in the form of better treatment of foreign investors than domestic ones, is one option that has been put forward. The possibility of placing caps on the magnitude of certain investment incentives has also been mentioned.

However, these proposals have not been subject to any serious discussions since other delegations reject the idea of additional disciplines in this area. These delegations have argued that the MAI should not duplicate existing and possible future rules on subsidies in the WTO and that there has been insufficient analysis of the nature and impact of investment incentives and possible MAI disciplines.

In this context it is also worth noting that the treatment of investment incentives in the form of tax measures -- perhaps the most common form of incentive -- has been subject to considerable debate. Once again, positions differ ranging from full coverage to a complete carve out.

What will be the final result? It seems likely -- and particularly in view of the rapidly approaching deadline for the MAI negotiations -- that the issue of investment incentives will be deferred to a built-in agenda, under which negotiations on the matter would start after the entry into force of the agreement. In addition, some transparency and notification provisions concerning investment incentives, over and above the general provision on transparency, might be introduced as part of the agreement.

## IV. Privatisation

Privatisation has no doubt become an increasingly common and important phenomenon and therefore an important subject for the MAI. The MAI could in fact break new ground in this sector as OECD rules and rules found in many other international agreements do not fully cover the subject.

The point of departure for the draft MAI provision on privatisation is that any decision to privatise remains in the hands of the government.

The current proposal confirms the applicability of the principle of non-discrimination in the area of privatisation. Accordingly, national and most favoured national treatment would apply to both initial and subsequent sales associated with the privatisation operation.

A potential problem in this context might be a variety of so-called special share arrangements, for example in the form of "golden shares" management buy-outs of special schemes for the public. Under such arrangements, certain categories of shareholders might be given rights that exceed those of other shareholders. According to some delegations such arrangements have an inherent discriminatory bias and should therefore require a reservation if maintained. Others hold the view that special share arrangements ought to be permitted under the MAI, regardless of whether they lead to *de facto* discrimination or not, in particular since they actually often facilitate privatisation.

While it is agreed that explicitly discriminatory special share arrangements would require a reservation, more work will be needed in order to determine how arrangements that do not explicitly discriminate against foreigners should be handled. In this context it is worth noting that the MAI will most probably include some specific transparency rules for the field of privatisation. The purpose of these rules would be to make sure that foreign investors are not put in a disadvantaged position due to a lack of information.

## V. Monopolies and state enterprises

A final "special topic" has been subject to considerable debate: "monopolies and state enterprises".

In a sector where a monopoly exists there is obviously limited room for other investors, be they foreign or domestic, to conduct business. The MAI will not change that. There is, however, broad agreement that government-designated monopolies should be covered by the MAI with the objective of ensuring that these entities do not treat foreign investors less favourably than national enterprises.

While several issues concerning this matter remain to be resolved, draft provisions on monopolies are taking shape. A basic point of departure is that the right of governments to create, allow or maintain monopolies not be challenged. Furthermore, there is general agreement that a government designated monopoly should act in a manner that is not inconsistent with MAI obligations wherever they exercise delegated regulatory power. This premise is translated into a number of more specific rules in the draft proposal on monopolies. First, a general "anti-circumvention clause" is suggested. Second, a rule stating that monopolies will have to sell their monopoly good or service in a non-discriminatory manner has been proposed. Third, monopolies, or rather monopsonists, would be required to act in a non-discriminatory manner in their purchase of the monopsony good or service.

There is general agreement on these principles. However, views still differ concerning whether there is a need to explicitly state them in the agreement or whether the existing obligations would suffice.

Proposals have also been made concerning provisions that would prohibit government designated monopolies to exploit monopoly gains by engaging in anti-competitive practices through cross-subsidisation in non-monopolised markets. A number of delegations favour such a provision while others find that it enters too far into the area of competition policy. A possible solution might be to resort to language similar to the one found in GATS article VIII on monopolies.

Furthermore, some delegations are of the view that Contracting Parties should be given the right to enter new national reservations under MAI upon demonopolisation. Others disagree. It has also been proposed that investor-state dispute settlement should not apply under the monopoly provisions. Again many object to such a fragmentation of the dispute settlement system.

Finally, it also remains to be decided what, if any, specific rules should apply to the monopoly rules just mentioned.

## VI. Other topics

When the Expert Group started its work it was also charged with the task of looking at any possible obligations on "corporate practices", *i.e*. measures that corporations take independently of government actions.

Government mandated "corporate practices" would, of course, be covered by the normal non-discriminatory rules of MAI. Some delegations have suggested additional disciplines on independent corporate practices. However, at its December 1996 meeting the Negotiating Group decided that the support for such disciplines was too weak to motivate any further expert work in this area.

Finally, the Expert Group has also looked into the need for specific MAI provisions with respect to research and development/technology, non-discriminatory barriers/market needs tests and concessions.

To date, no agreement exists on the need to cover any of these issues by specific provisions in the agreement. Proposals to that effect, however, enjoy more or less broad support among participants.

# DISPUTE SETTLEMENT

*by*
Ambassador Marino Baldi*

The MAI, as it has already been stated, shall be an agreement with high standards for the treatment and protection of investments. In order that such high standards are properly implemented by Contracting Parties, an effective dispute settlement system is necessary which, in principle, covers all obligations under the MAI. Such a dispute settlement system is needed not only because it helps to solve possible disputes under the MAI through formal proceedings, but also -- and perhaps even more importantly -- because it encourages dispute avoidance and helps to resolve divergencies of views informally. It is indeed believed that most disputes that might arise under the MAI could be settled through informal consultations leading to amicable solutions. It is, nevertheless, highly important for the credibility and the viability of the MAI that Contracting Parties to a dispute have recourse to binding arbitration in the event of an alleged breach of the Agreement and this in two ways: for States wishing to take action against another state (state-to-state arbitration) and for investors wishing to directly submit a case to arbitration against their host country (investor-to-state arbitration).

The MAI Negotiating Group entrusted to Expert Group N°1 on Dispute Settlement and Geographical Scope with the task of developing a dispute settlement system. After thorough discussions on the scope and the possible features of such a system, broad agreement was reached on important issues.

## I. Main characteristics of a dispute settlement mechanism

### *i) State-to-state arbitration*

With regard to state-to-state arbitration, five points can be highlighted:

a) Following the precedent set by the WTO, the Contracting Parties to the dispute should, as a first step, attempt to resolve their dispute through consultations. If the Contracting Parties fail to come to an amicable solution, the dispute may, at the request of any Contracting Party to the dispute, be submitted to an *arbitral panel*.

b) There is broad support for arbitration by *ad hoc* panels. The panellists may be chosen from a roster, which would be established and maintained by the Parties Group. Persons serving as a member of a particular panel would be required to be impartial, independent and free of conflict of interest. A “regular” panel would be composed of three arbitrators, chosen by agreement of the parties to the dispute. Other options could include a different selection mode or a different number of panellists (e.g. five arbitrators).

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c) The MAI would set out basic rules and procedures for state-to-state arbitration. However, for particular disputes, the Parties to the dispute could always agree to apply modified rules. If gaps in the MAI rules appear during a dispute and the parties are not able to agree on supplementary rules, the UNCITRAL rules could serve as default rules.

d) The substantive law to be applied would be the provisions of the MAI, but other international laws would be relevant as concerns the interpretation and application of a treaty. Domestic law could be taken into account where it is relevant under the MAI and consistent with it.

e) Finally, awards issued by a Panel would be final and binding upon the parties to the dispute. It is still under consideration whether an award should be provided first to the parties as a draft so as to give them the opportunity to comment. This procedural safety valve could help to avoid aberrant decisions, particularly with respect to questions of fact. Possible remedies that a panel may include in an award could be: a declaration that a measure is incompatible with the MAI; the granting of a pecuniary award; a recommendation that a party bring its measures into conformity with the MAI; or any relief to which the party against whom the award is made consents (this may include restitution in kind).

***ii) Investor to state arbitration***

There is general agreement that in addition to state-to-state arbitration there should exist an investor-to-state procedure. Investors generally wish to have at their disposal a dispute settlement mechanism that they can activate. Governments also see advantages in dispute settlement procedures to which they do not need to become a party. Yet, if there is general agreement that the MAI should provide for investor to state arbitration, it has not yet been decided whether such arbitration should cover all disciplines of the MAI.

What would be the main characteristics of such a mechanism? Three basic elements may be mentioned:

a) It will be the investor's choice as to whether he would like the dispute to be submitted for resolution to one of the following:
   -- to a national court or administrative authority of the Contracting Party;
   -- to any dispute settlement procedure the parties to the dispute may have previously agreed on; or
   -- to the procedures provided for by the MAI.

b) MAI Parties would give unconditional consent to submission of a covered dispute to arbitration, under either
   -- the ICSID rules of arbitration or under the rules of the ICSID Additional Facility;
   -- the UNCITRAL rules; or
   -- the ICC Court of Arbitration.

   Contracting Parties would most probably be allowed not to consent in cases where the investor has previously submitted the dispute either to a national court or to international arbitration in accordance with any other dispute settlement procedure. In other words, Contracting Parties would be allowed to impose what is called a "fork in the road".

c) The forms of relief that awards of any of these tribunals may provide will be specified in the MAI. They include: a declaration concerning the requirements of the MAI; compensatory

monetary damages; restitution in kind in appropriate cases; and, with the consent of all parties to the dispute, any other form of relief.

## II. Open questions

Following are some the issues on which consensus has not yet been reached.

### *a) State-to-state arbitration*

*Role of the Parties Group*

Should the Parties Group have a role in dispute settlement? Perhaps as a forum for multilateral consultations that precede state-to-state arbitration in addition to bilateral consultations?

Should the Parties Group have the function of a safety valve for decisions that are considered to aberrant?

*Ripeness of a dispute for arbitration*

Another open issue relates to the question as to when a dispute is ripe for arbitration. In other words: should a party that wants to challenge a measure of another Contracting Party have to demonstrate concrete harmful effects of the measure or would it suffice if there was an abstract non-compliance with the MAI, *i.e.* potential harmful effects?

*Enforcement of awards*

Another important question still to be resolved concerns the enforcement of awards. What measures or countermeasures shall be permitted with a view to bring about compliance with an arbitral award. Possible measures are the suspension of the non-complying party's right to participate in the Parties Group and its right to invoke the dispute settlement provisions of the MAI.

### *b) Investor to state arbitration*

*Scope of arbitration procedure*

As mentioned above, the scope of investor-to-state arbitration is still under consideration and it is certainly the most important open question. Should investor-to-state procedures apply only to post-establishment questions, as a number of delegations have proposed, or should such procedures also apply to pre-establishment disputes? In other words, should an investor who wishes to make an investment, but is precluded from doing so by a (potential) host government in violation of the MAI be able to start proceedings against that government? Most delegations by now accept this proposition, while a few continue to have difficulties with the idea of applying investor-to-state proceedings to pre-establishment questions.

*Prior consent*

Although unconditional prior consent was previously mentioned as one of the main characteristics of the investor-to-state procedure, which it is without any doubt, it should be noted that a

few delegations are still not in a position to accept the idea of prior consent at all. In addition, some minor issues remain to be solved in relation to the so-called "fork in the road".

*Standing*

Finally, there is an open question as to whether a company established in a MAI country that is controlled by an investor of another MAI country would have standing to act as the foreign investor in bringing a claim to arbitration against the host government. In other words, would, for instance, Volkswagen United States have standing before an arbitral tribunal or only Volkswagen Germany? There are good arguments in favour of the more generous of these solutions (where the two companies would have standing), but also understandable concerns about it.

# MAI: INSTITUTIONAL ARRANGEMENTS AND ACCESSION

*by*
Charles Bridge*

## I. Legal Framework

OECD Members are expected to sign both a "Final Act" and the Multilateral Agreement on Investment (MAI). The main purpose of the Final Act is to provide a formal basis for the prepatory work before the MAI enters into force. This would include negotiations/decisions on non-Member countries applications to join. This would allow these countries to join before the MAI entered into force.

The Final Act will likely name a target date for entry into force, for example, a year or so later. The final decision, however, is likely to be left for signatories' collective decision closer to the date of signature.

## II. Accession

The process of accession (*i.e.* joining the MAI after entry into force) will be the same for all including those OECD Members who for any reason were not original signatories. The basic requirement for signing the Agreement will be the country's willingness and ability to accept the obligations of the MAI. Each country -- whether an OECD Member or not -- will be able to negotiate its terms of accession, *i.e.* its own reservations.

No other requirements are needed although in practice a "minimum standard" may emerge. The MAI is unlikely to accept standards of liberalisation that are significantly worse than the lowest OECD country standard. Finally, there will be no exceptions to investor protection obligations.

## III. Institutions: the Prepatory Group and the Parties' Group

The Final Act will establish the Prepatory Group with all signatories as members. It is likely that any non-OECD signatory will also become a member of the Group. As well as negotiating with potential MAI parties, the Group will also be responsible for the setting up of administrative arrangements, secretariat, budget, etc.

The Parties' Group will come into operation when the MAI comes into force. There is still some uncertainty about its character. "Minimalists" see the MAI as simply a framework of rights and obligations together with a procedure for settlement of disputes. The Parties' Group would have little to

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do other than the important task of handling new accessions. "Maximalists" see the Parties' Group as a new institution to act as a forum for debate and for carrying forward a wider policy agenda.

The possible functions of the Parties' Group would include:

-- "interpretation" or "clarification" of the MAI (but no role in dispute settlement cases);
-- "review" of the MAI;
-- negotiation of amendments;
-- work on "Guidelines" (see below).

It has been agreed that the MAI is to be a "free-standing" international agreement. There has been no decision, however, on its relationship with the OECD nor on the Parties' Group's relationship with the CIME. Some delegations, particularly the "minimalists", expect the Parties' Group secretariat to work closely alongside, and perhaps to co-operate within, the OECD secretariat.

The decision-making rules will likely be based on consensus as much as possible, although most delegations recognise the need for some flexibility. One possible approach would be to give the Parties' Group the ability to decide, by consensus, that certain types of decisions should be subject to, for example, two-thirds majority voting. The alternative could be that the MAI specify the decisions requiring consensus (perhaps accessions, interpretations, amendments), leaving others for majority decisions.

## IV. OECD Guidelines for Multinational Enterprises

"Guidelines" are non-binding recommendations to MNEs by OECD Governments (and other members of CIME) calling for good practice in labour and environment matters in particular, but also in the fields of competition, finance, tax and technology. It has been agreed by a large majority that the Guidelines should be "associated" with the MAI.

The maximalists and the minimalists differ on this point as well. The first would like all MAI Contracting Parties to participate in work associated with the Guidelines co-ordinated by the Parties' Group. (The OECD work on the Guidelines could continue in parallel or wither away.) Minimalists would like no more than a passing reference to the Guidelines in the MAI preamble.

This is a politically sensitive issue and possible specific provisions on labour standards are even more so. Many delegations have stated that agreements to liberalise trade and investment should not attempt to tackle subjects such as labour standards, nor possibly environmental standards. It has been suggested that delegations compare their own positions with that of the WTO's on trade and labour issues. Other delegations, however, believe that provisions on trade and on environment are essential for a balanced agreement.

## V. Conclusion

There is at the present time no clear decision on whether the MAI Parties' Group is to be a major new institution, actively developing work on international investment issues or whether it should be a minimal body looking after housekeeping matters and little more.

It would certainly be wise to provide for both possibilities in the basic legal texts. The MAI would then be free to evolve during its first few years. How it evolves will most likely be affected by what happens on investment in the WTO.

Either way, the MAI will remain a free-standing agreement, independent of the OECD, and non-OECD countries will be able to join and participate on equal terms with OECD countries.

*Annex*

**Press Release**
**Issued at the end of the Second Workshop on**
**Multilateral Rules on Investment**
**Held in Brasilia, 4-5 February 1997**

For a second time in Brazil, senior officials from OECD Member countries and representatives of a number of non-member countries* met on 4-5 February 1997 in Brasilia to discuss the future Multilateral Agreement on Investment (MAI) under negotiation in the OECD.

The event was hosted by the Ministry of External Relations of Brazil and co-sponsored by the Department of Foreign Affairs and International Trade of Canada, the Organisation of American States and the OECD. It was a follow-up to a first workshop held in Rio de Janeiro in July 1996, the proceedings of which have just been published by the OECD.

The conference produced a structured and a substantive dialogue between OECD countries and non-member countries on key issues of the future MAI at a time when the negotiations are entering their final phase towards their conclusion in May 1997.

The main issues discussed were the definition of investor and investment, investment protection, the national treatment and most-favoured-nation provisions of the MAI, and their application in the areas of key personnel, privatisation, investment incentives, monopolies, the prohibition of performance requirements, and the subject of dispute settlement. These discussions benefited from the presence of key MAI negotiators and Chairmen of Drafting and Expert Groups and also from extensive documentation on all the components of the MAI.

Non-member participants raised some important issues in relation of the broad coverage of the MAI, its possible impact on capital movements, the nature and scope of the exceptions and reservations that would be allowed by the contracting parties in order to take into account specific regulatory concerns, and the scope of dispute settlement, notably in respect to investor to State disputes.

The other most important topic discussed was the process of accession to MAI by non-OECD countries. The MAI will be a free-standing agreement, open to accession by other than OECD member countries, willing and able to meet its requirements. Procedures are under consideration which would permit non-OECD countries to become founding members of the MAI. Participants underlined the growing convergence between Latin American and OECD countries in foreign investment policies, as a result of the major policy reforms undertaken in recent years.

It was concluded that the workshop was a success in deepening the understanding of the MAI. There was also agreement on the importance of maintaining the dialogue developed in the workshop. This would assist interested non-OECD countries to consider eventual participation in the MAI.

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* Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Paraguay, Peru and Uruguay.