



Negotiating Group on the Multilateral Agreement on Investment (MAI)

APPLICATION OF THE MAI TO DIFFERENT LEVELS OF GOVERNMENT

(Note by the Chairman)

APPLICATION OF THE MAI TO DIFFERENT LEVELS OF GOVERNMENT

(Note by the Chairman)

1. One of the aims of the MAI negotiations is to achieve an agreement, with a satisfactory scope and balance of commitments that would, inter-alia, apply these commitments to all parties to the MAI at all levels of government. MAI parties will include countries with central systems of government as well as countries with federal parliamentary systems. The division of constitutional responsibilities differs from country to country and the MAI will need to find ways to achieve the stated aim.

2. Most measures of interest to the MAI are likely to be found at the central government level. However, local governments too may sometimes have authority for measures affecting foreign direct investment. In federal parliamentary states, subnational authorities (states, provinces, cantons, etc.) can have autonomous powers in investment matters, for instance in land, banking, insurance and other financial sectors.

3. Generally, the central government has authority for entering into international treaties which create obligations for all territorial subdivisions as well. Thus, treaties provide that all parties to the agreement are fully responsible for the observance of treaty provisions. Each party is required to take all "reasonable" or all "necessary" measures to ensure such observance by state, regional, local, provincial governments. (See general observance provisions, Annex 1.)

Existing disciplines

4. The OECD Liberalisation Codes contain special provisions for certain countries with federal systems of government which largely eliminate the commitments at the provincial or state level (Annexes C (US) and D (Canada) in the Current Invisibles Code, and Annex C (US) and General Remarks (Australia and Canada) in the Capital Movements Code. These special provisions are attenuated in the field of inward direct investment and establishment and for cross-border banking and financial services by an understanding that measures taken in these fields will be subject to the usual notification and examination procedures of the Codes.

5. The OECD National Treatment instrument provides that Member countries will endeavour to ensure that their territorial subdivisions apply National Treatment. The 1991 review extended notification and examination obligations to all Member countries at all levels of government. All non-conforming measures at the subnational level are listed in the Annex to the 1991 Decision on National Treatment.

6. More recent agreements (GATS, NAFTA, ECT) provide examples of techniques to deal with the treatment of subnational measures. In case of non-compliance by a subnational level of government, these agreements foresee the possibility of recourse to dispute settlement.

7. In the GATS, which has only state to state dispute settlement, the Understanding on Rules and Procedures Governing the Settlement of Disputes (paragraph 22.9) provides that: "The dispute settlement procedures of the covered agreements may be invoked in respect of measures affecting their observance taken by regional or local governments or authorities within the territory of a Member. When the Dispute Settlement Board has ruled that a provision of a covered agreement has not been observed, the responsible Member shall take such reasonable measures as may be available to it to ensure its observance. The

provisions of the covered agreements and this Understanding relating to compensation and suspension of concession or other obligations apply in cases where it has not been possible to secure such observance."

8. NAFTA parties, three federal states, have undertaken that the national government is the defending party in either investor-state dispute settlement or state-state dispute settlement. In investor-state, monetary compensation will be available to remedy breaches of the obligations governing investment, and related provisions applicable to monopolies and state enterprises, by any level of government where an investor has incurred loss or damage caused by that breach. In state-state, compensation or the suspension of equivalent benefits may be available where the dispute is not resolved through the non-implementation or removal of a non-conforming measure. (See Annex 2 of this note).

9. After recognising the responsibility of each Contracting Party for the observance of of the provisions of the Treaty, the ECT (Article 23(2)) provides that the Treaty's dispute settlement provisions can be invoked in respect of regional or local measures affecting the Contracting Party's observance of the Treaty.

10. Under the ECT, in an investor-state dispute, an award of arbitration concerning a measure of a subnational government or authority of the disputing party shall provide that the contracting party may pay monetary damages in lieu of any other remedy granted (Article 26(8)). Where in state-state arbitration, a measure of a regional or local government is found not to be in conformity with the Treaty, those Contracting Parties listed in the ECT's Annex P (see Annex 3 to this note) may invoke the procedures of that annex providing for Charter conference authorisation to the injured party to suspend such of its treaty obligations to the offending party as the Contracting Party considers equivalent to those denied. Australia and Canada are listed in Annex P.

The MAI

11. Preparatory discussions in the MAI identified several options for dealing with the subnational issue:

a) General legislative power

12. Depending on the constitution of the federal country in question, there might be scope for using constitutional authority to legislate in areas not exclusively the responsibility of the federal government. However, this legislative power might be limited by constitutional provisions and recourse to this technique might be difficult for some federal countries.

b) Prior voluntary compliance

13. Where there is no scope for the central authority to legislate to ensure observance, the other technique which could be used would consist of consultative mechanisms to ensure that subnational governments share the same goals as the federal authorities and undertake voluntary compliance with the obligations entered into by the federal government. The consultations ensure that subnational governments are informed and can co-operate fully with federal authorities in the development of negotiating positions. Some federal countries used this process in the GATS and also rely on it in bilateral investment protection agreements.

c) Recourse to dispute settlement/remedies

14. In the case of non-compliance by a subnational government, mechanisms similar to the NAFTA or the ECT could be considered for both state-state and investor-states disputes in the MAI.

Questions:

- a) Where a Member country is prevented, for constitutional reasons, from binding its subnational governments under the MAI, should the agreement provide for a mechanism which would ensure that federal governments undertake equivalent obligations to those undertaken by other countries?
- b) In this regard, could the MAI have provisions similar to those in the NAFTA, ECT, GATS?
- c) Could federal countries indicate whether other mechanisms would be available, in their particular circumstances, to bind their subnational governments or to undertake equivalent obligations with respect to subnational measures affecting foreign investment?

Annex 1

General Observance Provisions

NAFTA

Article 105: Extent of Obligations

The Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments.

GATS

Article I: Scope and Definition

3. For the purposes of this Agreement

(a) "measures by Members" means measures taken by:

(I) central, regional or local governments and authorities; and

(ii) non-governmental bodies in the exercise of powers delegated by central, regional or local governments or authorities;

In fulfilling its obligations and commitments under the Agreement, each Member shall take such reasonable measures as may be available to it to ensure their observance by regional and local governments and authorities and non-governmental bodies within its territory;

Energy Charter Treaty

ARTICLE 23

OBSERVANCE BY SUB-NATIONAL AUTHORITIES

(1) Each Contracting Party is fully responsible under this Treaty for the observance of all provisions of the Treaty, and shall take such reasonable measures as may be available to it to ensure such observance by regional and local governments and authorities within its Area.

(2) The dispute settlement provisions in Parts II, IV and V of this Treaty may be invoked in respect of measures affecting the observance of the Treaty by a Contracting Party which have been taken by regional or local governments or authorities within the Area of the Contracting Party.

Annex 2

[Extract from DAF/IME/IPG(94)1]

The NAFTA investor-state arbitration regime has the following features:

- before an investor-state tribunal, the national government is the defending party regardless of whether the national government or a subnational government is alleged to have violated the NAFTA.

- a tribunal can order the national government to pay compensation regardless of whether the national government or a subnational government is found to have violated the NAFTA.

- a tribunal can order the national government to return property to an investor (provided that the tribunal gives the government the alternative of paying compensation).

Similarly, the NAFTA's state-state arbitration operates as follows:

- state-to-state dispute settlement can be invoked in regard to measures of any level of government concerning disputes involving the implementation or application of the agreement, or wherever a party considers that an actual or proposed measure of another party is, or would be, inconsistent with the agreement.

- before a state-to-state panel, the national government is the defending party regardless of whether the measure challenged is that of the national or a subnational government.

- where a panel finds a violation, the parties to the dispute are to resolve their dispute through an agreed resolution involving non-implementation, or removal, of a measure not conforming with the agreement or the making of compensation by the party complained against. Where the dispute is not so resolved, the complainant state may suspend equivalent benefits.

Annex 3

Energy Charter Treaty

ANNEX P

SPECIAL SUB-NATIONAL DISPUTE PROCEDURE

(In accordance with Article 27(3)(i))

PART I

1. Canada
2. Australia

PART II

(1) Where, in making an award, the tribunal finds that a measure of a regional or local government or authority of a Contracting Party (hereinafter referred to as the "Responsible Party") is not in conformity with a provision of this Treaty, the Responsible Party shall take such reasonable measures as may be available to it to ensure observance of the Treaty in respect of the measure.

(2) The Responsible Party shall, within 30 days from the date the award is made, provide to the Secretariat written notice of its intentions as to ensuring observance of the Treaty in respect of the measure. The Secretariat shall present the notification to the Charter Conference at the earliest practicable opportunity, and no later than the meeting of the Charter Conference following receipt of the notice. If it is impracticable to ensure observance immediately, the Responsible Party shall have a reasonable period of time in which to do so. The reasonable period of time shall be agreed by both parties to the dispute. In the event that such agreement is not reached, the Responsible Party shall propose a reasonable period for approval by the Charter Conference.

(3) Where the Responsible Party fails, within the reasonable period of time, to ensure observance in respect of the measure, it shall at the request of the other Contracting Party party to the dispute (hereinafter referred to as the "Injured Party") endeavour to agree with the Injured Party on appropriate compensation as a mutually satisfactory resolution of the dispute.

(4) If no satisfactory compensation has been agreed within 20 days of the request of the Injured Party, the Injured Party may with the authorization of the Charter Conference suspend such of its obligations to the Responsible Party under the Treaty as it considers equivalent to those denied by the measure in question, until such time as the Contracting Parties have reached agreement on a resolution of their dispute or the non-conforming measure has been brought into conformity with the Treaty.

(5) In considering what obligations to suspend, the Injured Party shall apply the following principles and procedures:

(a) The Injured Party should first seek to suspend obligations with respect to the same Part of the Treaty as that in which the tribunal has found a violation.

(b) If the Injured Party considers that it is not practicable or effective to suspend obligations with respect to the same Part of the Treaty, it may seek to suspend obligations in other Parts of the Treaty. If the Injured Party decides to request authorization to suspend obligations under this subparagraph, it shall state the reasons therefor in its request to the Charter Conference for authorization.

(6) On written request of the Responsible Party, delivered to the Injured Party and to the President of the tribunal that rendered the award, the tribunal shall determine whether the level of obligations suspended by the Injured Party is excessive, and if so, to what extent. If the tribunal cannot be reconstituted, such determination shall be made by one or more arbitrators appointed by the Secretary-General. Determinations pursuant to this paragraph shall be completed within 60 days of the request to the tribunal or the appointment by the Secretary-General. Obligations shall not be suspended pending the determination, which shall be final and binding.

(7) In suspending any obligations to a Responsible Party, an Injured Party shall make every effort not to affect adversely the rights under the Treaty of any other Contracting Party.