ARTICLES

THE GLOBAL FIFTH AMENDMENT? NAFTA'S INVESTMENT PROTECTIONS AND THE MISGUIDED QUEST FOR AN INTERNATIONAL "REGULATORY TAKINGS" DOCTRINE

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Just over two years ago, in Metalclad Corp. v. United Mexican States, *an arbitral tribunal announced a seventeen-million-dollar award under NAFTA Article 1110, which requires host governments to compensate foreign investors for acts of "direct or indirect expropriation" or "measures tantamount to expropriation." Several of these "regulatory takings" claims have recently been filed against NAFTA governments, and while it is still too early to judge how broadly tribunals will interpret the expropriation provision, the* Metalclad *case has opened the door for investors to challenge and potentially stifle environmental and land use regulation.*

In this Article, Professor Vicki Been and Joel Beauvais shed light on two issues central to the debate over global investor-protection provisions. First, the Article compares the expropriation decisions under NAFTA's Article 1110 with regulatory takings law under the Fifth Amendment of the U.S. Constitution. Despite claims that NAFTA simply "exports" the U.S. takings standard, the tribunals' interpretations of the expropriation provision have exceeded the substantive scope of U.S. compensation requirements while removing procedural limitations typically imposed on domestic takings claims. Second, the Article explores the rationales traditionally asserted for domestic compensation requirements—cost-internalization,

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We would like to thank participants in Emory Law School's Faculty Workshop; NYU School of Law's Colloquium on Law, Economics, and Politics; Professor José Alvarez's Fall 2002 Seminar on Foreign Investment at Columbia Law School; Professor Andreas Lowenfeld's Fall 2002 International Arbitration class at NYU School of Law; and the Conference on Regulatory Expropriations in International Law co-sponsored by the NYU School of Law's Center on Environmental and Land Use Law and the NYU Environmental Law Journal, as well as Robert Ahdieh, William Buzbee, Timothy Dowling, Benedict Kingsbury, Daryl Levinson, Andreas Lowenfeld, Marc Poirier, Samuel Rascoff, and Richard Revesz for their helpful comments on earlier drafts of this Article. We also are indebted to Ashley Miller for his extraordinary research assistance and many helpful suggestions, and to Erik Bluemel and Melissa Richman for invaluable help with the research. Professor Been gratefully acknowledges the support of the Filomen D'Agostino and Max E. Greenberg Research Fund at NYU School of Law. Mr. Beauvais gratefully acknowledges the support of the Center on Environmental and Land Use Law at NYU School of Law.

fairness, and insurance—finding that they do not justify an expansive regulatory takings doctrine in the international context. After rejecting claims that expropriation provisions benefit developing countries by attracting foreign investment, Been and Beauvais go on to highlight the significant costs of imposing a broad international regulatory takings doctrine: It gives foreign investors a competitive advantage over domestic firms, redistributes wealth between domestic taxpayers and foreign firms, and may deter efficient regulation.

The Article concludes that a global regulatory takings doctrine is neither necessary nor beneficial. Because of its substantial risks, the United States and other sponsors of international investment agreements should eschew the expansion of compensation requirements, instead limiting expropriation provisions to the traditional concerns of investor protections: physical invasions and seizures, direct nationalization, and governmental assumption or transfer of control of foreign property.

I
INTRODUCTION

A little more than two years ago, two distinguished international law professors and a former Attorney General of the United States arbitrating a dispute under the investment provisions of the North American Free Trade Agreement (NAFTA)[1] ordered Mexico to pay almost $17 million in compensation to a U.S. corporation, Metalclad.[2]

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1 North American Free Trade Agreement, Dec. 17, 1992, 32 I.L.M. 289 (1993) (chs. 1-9), 32 I.L.M. 605 (1993) (chs. 10-22) [hereinafter NAFTA].

2 Metalclad Corp. v. United Mexican States, Award, ICSID Case No. ARB(AF)/97/1, para. 131 (Aug. 30, 2000), 16 ICSID Rev.–Foreign Investment L.J. 168, 202 (2001), available at http://www.worldbank.org/icsid/cases/mm-award-e.pdf; the case can also be found in 40 I.L.M. 36 (2001) and 16 Int'l Arb. Rep. (Mealey), Jan. 2001, at A-1. For decisions in Canadian domestic courts relating to the enforcement of the *Metalclad* award, see generally, United Mexican States v. Metalclad Corp., 2001 BCSC 1529, [2001] 95 B.C.L.R.3d 169, available at http://www.courts.gov.bc.ca/jdb-txt/sc/01/15/2001bcsc1529.htm; United Mexican States v. Metalclad Corp., 2001 BCSC 664, [2001] 89 B.C.L.R.3d 359, available at http://www.worldbank.org/icsid/cases/metalclad_reasons_for_judgment.pdf. For discussions of *Metalclad*, see Vicki Been, NAFTA's Investment Protections and the Division of Authority for Land Use and Environmental Controls, 32 Envtl. L. Rep. 11,001, 11,008-09 (2002); Joel C. Beauvais, Note, Regulatory Expropriations Under NAFTA: Emerging

The NAFTA tribunal found that Mexico's land use and environmental laws prevented Metalclad's Mexican subsidiary from operating a hazardous waste facility in Guadalcazar, Mexico.[3] The tribunal held, as a result, that Mexico's state and local governments had "indirectly expropriated" the U.S. corporation's investment in violation of NAFTA's Article 1110, which provides, in part:

> No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
> (a) for a public purpose;
> (b) on a non-discriminatory basis;
> (c) in accordance with due process of law and Article 1105(1) [which requires "treatment in accordance with international law, including fair and equitable treatment and full protection and security"]; and
> (d) on payment of compensation in accordance with paragraphs 2 through 6 [which require compensation at fair market value to be paid without delay, with interest].[4]

The *Metalclad* award opened the door for property owners to use NAFTA to assert what we in the United States think of as "regulatory takings" challenges to land use and environmental regulations. Some eleven NAFTA claims alleging expropriation are currently pending, demanding, in total, billions of dollars to compensate for alleged takings.[5] Investors have threatened to file claims in disputes over issues

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Principles & Lingering Doubts, 10 N.Y.U. Envtl. L.J. 245, 268-69 (2002); see also Howard Mann, Private Rights, Public Problems: A Guide to NAFTA's Controversial Chapter on Investor Rights 17-18 (IISD and WWF, Working Paper, 2001), http://www.iisd.org/pdf/trade_citizensguide.pdf.

[3] *Metalclad*, ICSID Case No. ARB(AF)/97/1, paras. 106, 109.

[4] NAFTA, supra note 1, art. 1110(1), 32 I.L.M. at 641.

[5] The pending Article 1110 claims are as follows: Notice of Arbitration and Statement of Claim Under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement, Frank v. United Mexican States (Aug. 5, 2002), http://www.dfait-maeci.gc.ca/tna-nac/NoticeofArbitration1.pdf; Notice of Arbitration and Statement of Claim, Canfor Corp. v. United States (July 9, 2002), http://www.state.gov/documents/organization/13203.pdf; Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement, Doman Indus. Ltd. v. United States (May 1, 2002), http://www.international-economic-law.org/US%20Notices/Doman%20Notice%20of%20Intent.pdf; Submission to Arbitration, GAMI Investment, Inc. v. United Mexican States (Apr. 9, 2002), http://www.state.gov/documents/organization/11848.pdf; Notice of Intent to Commence Arbitration Pursuant to Chapter XI of the North American Free Trade Agreement, Calmark Commercial Dev., Inc. v. United Mexican States (Jan. 11, 2002), http://www.international-economic-law.org/Mexicans/Calmark_Redacted_NOI.pdf; Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter Eleven of the North American Free Trade Agreement, Crompton Corp. v. Canada (Nov. 6, 2001), http://www.dfait-maeci.gc.ca/tna-nac/ComptonCorp.pdf; Notice of Arbitration Under the Rules Governing the Additional Facil-

ranging from pesticide regulation to cigarette packaging requirements.[6]

The possibility that NAFTA's Article 1110 may be used to force governments in the United States and elsewhere to pay compensation for environmental and land use regulations is causing considerable consternation in the domestic and global environmental and land use communities. Provisions nearly identical to NAFTA's Article 1110 are contained in many of the 1500 bilateral investment treaties (BITs)[7] in effect around the world.[8] Similar language on expropriation has been incorporated into a number of existing and proposed multilateral investment agreements as well.[9] If expropriation claims under NAFTA are successful, these bilateral and multilateral agreements will enable the proliferation of claims challenging environmental and land use regulations throughout the world as "indirect expropriations" of foreign investments.

ity for the Administration of Proceedings by the International Centre for Settlement of Investment Disputes and the North American Free Trade Agreement, Fireman's Fund v. United Mexican States (Oct. 30, 2001), http://www.dfait-maeci.gc.ca/tna-nac/documents/Fireman_Notice.pdf; Notice of Arbitration, Adams v. United Mexican States (Feb. 16, 2001), http://www.international-economic-law.org/Mexicans/Adams%20et%20al%20and%20Mexico%20%20-%20Notice%20of%20Arbitration.PDF; Notice of Arbitration, Karpa v. United Mexican States (Apr. 30, 1999), http://www.state.gov/documents/organization/3995.pdf; Notice of Claim, Loewen Group, Inc. v. United States (Oct. 30, 1998) [hereinafter Loewen Claim], http://www.state.gov/documents/organization/3922.pdf; see also Draft Amended Claim, Methanex Corp. v. United States (Feb. 12, 2001) [hereinafter Methanex Claim], http://www.methanex.com/investorcentre/mtbe/draft_amended_claim.pdf. The tribunal rejected Methanex's first draft amended claim at the jurisdictional phase but permitted Methanex to resubmit a second amended claim adducing sufficient evidence to bring its claim within the tribunal's jurisdiction. See Methanex Corp. v. United States, First Partial Award, paras. 161-66, 172 (Aug. 7, 2002), http://www.state.gov/documents/organization/12613.pdf; Second Amended Statement of Claim, Methanex Corp. v. United States, para. 1 (Nov. 5, 2002) [hereinafter Methanex Second Amended Claim], http://www.state.gov/documents/organization/15035.pdf.

6 See infra notes 461-69 and accompanying text.

7 Daniel M. Price, NAFTA Chapter 11—Investor-State Dispute Settlement: Frankenstein or Safety Valve?, 26 Can.-U.S. L.J. 1, 2 (Supp. 2001) ("[F]rom the vantage point of the year 2000, more than 1500 bilateral investment treaties have been signed. Most of them have provisions nearly identical to those found in NAFTA Chapter 11, including the feature of investor-state dispute settlement.").

8 For discussions of how NAFTA's investor protection provisions compare with those of other bilateral and multilateral agreements, see, for example, United Nat'l [sic] Conference on Trade and Dev., Trends in International Investment Agreements: An Overview at 44-46, U.N. Doc. UNCTAD/ITE/IIT/13, U.N. Sales No. E.99.II.D.23 (1999); Price, supra note 7, at 2; Thomas W. Wälde & Stephen Dow, Treaties and Regulatory Risk in Infrastructure Investment—The Effectiveness of International Law Disciplines *Versus* Sanctions by Global Markets in Reducing the Political and Regulatory Risk for Private Infrastructure Investment, J. World Trade, Apr. 2000, at 15-22.

9 See infra notes 98-102 and accompanying text.

Increasingly, environmentalists and others are decrying "the unexpectedly broad and aggressive use" of Article 1110, along with other investor provisions in NAFTA's Chapter 11, "to challenge public policy and public welfare measures" by turning shields—"provisions designed to ensure security and predictability for the investors"—into strategic swords that have "created uncertainty and unpredictability for environmental (and other) regulators."[10] While it is still too early to judge just how broadly arbitral panels are going to interpret Article 1110 and similar expropriation provisions, *Metalclad* and other NAFTA regulatory takings claims[11] were sufficiently worrisome that controversy over such claims helped scuttle the Organisation for Economic Cooperation and Development's (OECD's) proposed Multilateral Agreement on Investment (MAI) in 1998.[12] Concern about the investor protection provisions also figured prominently in debates over the Trade Promotion Authority Act[13] that President Bush re-

[10] Howard Mann & Konrad von Moltke, NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment 6 (IISD, Working Paper, 1999), http://www.iisd.org/pdf/nafta.pdf; Mann, supra note 2, at 16.

[11] See supra note 5.

[12] The negotiating text of the Organisation for Economic Cooperation and Development's (OECD's) proposed Multilateral Agreement on Investment (MAI) originally incorporated a compensation requirement identical to that of NAFTA to be enforced through a similar mandatory direct investor-state dispute mechanism (ISDM). MAI Negotiating Text, Apr. 24, 1998, art. IV(2), at http://www.oecd.org/pdf/M00003000/M00003291.pdf. If adopted, the MAI would have globalized the NAFTA approach to compensation requirements, covering foreign direct investment between the OECD's twenty-nine member states. However, early experience with claims under NAFTA's investment chapter brought strong opposition from environmentalists and others, which significantly contributed to the scrapping of the MAI after contentious negotiations in 1998. As Wälde and Dow observed:

> All criticism raised against the NAFTA or GATT/WTO treaties, and their subsequent application, easily re-focused on the MAI negotiations.... NGO criticism led in the latter drafts of the MAI negotiating text to formulations to exempt national regulation from the MAI expropriation and national treatment disciplines except in very egregious and usually unspecified cases.

Wälde & Dow, supra note 8, at 19-21; see also Frances Seymour, Lisa Dreier & Lily Donge, Aligning North-South Financial Flows with Sustainable Development: An Unfinished Agenda, 32 Envtl. L. Rep. 10,571, 10,584 (2002).

For a sampling of the extensive commentary on the MAI, see generally Peter T. Muchlinski, The Rise and Fall of the Multilateral Agreement on Investment: Where Now?, 34 Int'l Law. 1033 (2000); Robert Stumberg, Sovereignty by Subtraction: The Multilateral Agreement on Investment, 31 Cornell Int'l L.J. 491 (1998); Mark Vallianatos, De-Fanging the MAI, 31 Cornell Int'l L.J. 713 (1998).

[13] Bipartisan Trade Promotion Authority Act of 2002, Pub. L. No. 107-210, 116 Stat. 993 (codified at 19 U.S.C.S. §§ 3801-3813 (LEXIS through P.L. 108-3)); see Elisabeth Bumiller, Bush Signs Trade Bill, Restoring Broad Presidential Authority, N.Y. Times, Aug. 7, 2002, at A5 (reporting on enactment of trade promotion legislation). For discussion of the congressional debate concerning investor protections, see infra notes 454-58 and accompanying text.

cently pushed through Congress, and it continues to be a basis of opposition to the proposed Free Trade Area of the Americas (FTAA).[14] Finally, the three nations that are parties to NAFTA have established study commissions to consider interpretation or amendment of the agreement to address problems with NAFTA's Chapter 11.[15]

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[14] The current negotiating text of the proposed Free Trade Area of the Americas (FTAA)—projected to extend to the thirty-four democratic states in the Western Hemisphere—incorporates language identical to that of NAFTA on compensation for expropriation. FTAA—Free Trade Area of the Americas, Second Draft Agreement, Chapter on Investment (Nov. 1, 2002), art. 10, http://www.ftaa-alca.org/ministerials/quito/draft_e6.doc. The United States has not yet submitted an official proposal on expropriation; the Office of the U.S. Trade Representative has stated that it supports the "classic expropriation disciplines" but that "FTAA countries must have a common understanding of [the expropriation] provision's relationship with governments' role to regulate to protect health, safety and the environment." Office of the U.S. Trade Representative, Negotiating Group on Investment, Public Summary of U.S. Position, at http://www.ustr.gov/regions/whemisphere/invest.pdf (last visited Jan. 11, 2003); see also Antonio R. Parra, Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment, 12 ICSID Rev.-Foreign Investment L.J. 287, 364 n.326 (1997) (describing early meetings and planning stages of FTAA).

For discussion of the controversy brewing over the FTAA, see Christopher M. Bruner, Hemispheric Integration and the Politics of Regionalism: The Free Trade Area of the Americas (FTAA), 33 U. Miami Inter-Am. L. Rev. 1, 13 & n.63 (2002) (noting criticism of expropriation and ISDM provisions in FTAA); Chris Tollefson, Games Without Frontiers: Investor Claims and Citizen Submissions Under the NAFTA Regime, 27 Yale J. Int'l L. 141, 185 (2002) (discussing attempt by coalition of environmental organizations to place limitations on FTAA's proposed international investment regime); Administration Mulls Government Veto Option for Investor Disputes, Inside U.S. Trade, Mar. 15, 2002, at 1, 23 (reporting on National League of Cities' concern that FTAA could expand definition of regulatory taking, threatening local governments' ability to regulate land use); National Wildlife Federation Letter on Kerry Amendment, Inside U.S. Trade, May 3, 2002, at 10, 10-11 (urging reconciliation of investment and environment in various free trade agreement negotiations to avoid "overreaching claims such as those made regarding Chapter 11").

[15] See Press Release, Office of the U.S. Trade Representative, NAFTA Free Trade Commission: Joint Statement, "A Foundation for Future Growth" (May 28, 2002), http://www.ustr.gov/releases/2002/05/2002-05-28-Statement.htm (reporting agreement by representatives of three NAFTA parties to conduct expert review of Chapter 11); see also Investment Chapters in Future Trade Accords to Differ from NAFTA, Official Says, 19 Int'l Trade Rep. (BNA) 987 (June 6, 2002) (citing Assistant U.S. Trade Representative as noting NGO criticism that NAFTA provides preferential treatment to foreigners and indicating that problems with NAFTA "can and will be corrected in future agreements"); Administration Proposes Higher Thresholds for Investor Suits, Inside U.S. Trade, Sept. 27, 2002, at 1, 18-19 (reporting Office of U.S. Trade Representative's proposed alternatives for expropriation standard); Agencies Mull Regulatory Takings Standards in Investment Disputes, Inside U.S. Trade, Sept. 20, 2002, at 1, 22-23 (reporting options for alternative expropriation standard proposed in U.S. interagency working group); Ian Jack, Canada Seeks Narrowing of NAFTA Lawsuit Terms, Financial Post (Toronto), Oct. 22, 2002, at FP10 (recounting Canadian position on preferred interpretation of Article 1110), 2002 WL 101856609; U.S. Official Sees Changed Investment Rules in NAFTA, Future Deals, Inside U.S. Trade, May 31, 2002, at 1, 2 (discussing potential alternatives for investor protections in future agreements, including different language on expropriation).

In this Article we attempt to shed light on two issues central to the debate over the investor protection provisions animating *Metalclad* and the other arbitral awards decided under NAFTA to date. First, we examine the relationship between the NAFTA tribunals' decisions on expropriation claims and U.S. domestic law on regulatory takings. Although many have argued that NAFTA simply "exports" the U.S. regulatory takings standard into international law,[16] we demonstrate that, in fact, the NAFTA tribunal decisions and dicta significantly exceed U.S. takings protections (already among the most protective in the world)[17] in several respects. Because only a few decisions have been rendered, and most of those discuss the expropriation provisions of NAFTA only in dicta, our discussion is necessarily speculative. Nevertheless, we show that the tribunals' nascent interpretations of Chapter 11 broaden the definition of compensable property interests in several significant ways,[18] extend compensation requirements not only to legislative and administrative changes to the law but also to judicial decisions,[19] and bypass ripeness and exhaustion requirements of U.S. domestic takings law.[20]

The Article then explores whether rationales traditionally recited for a compensation requirement in the United States justify imposing such a requirement for regulatory takings under international investment agreements. We initially examine the three leading justifications for the Fifth Amendment's compensation requirement—cost-internalization, fairness, and insurance—and find that none support an expansive definition of expropriation in the international investment context. First, because of the significant differences among the institutional and political structures of the approximately 160 countries that are signatories to international investment agreements, it is unlikely that compensation requirements will force those actually drafting and implementing environmental and land use regulations to internalize the costs of their decisions.[21] The fact that liability for violations of the agreements is imposed on the signatory state, rather than directly on its local governments or regulatory agencies, makes such internalization especially unlikely. Second, although there is potential for unfairness when the host government regulates foreign investors who

16 See generally David Schneiderman, NAFTA's Takings Rule: American Constitutionalism Comes to Canada, 46 U. Toronto L.J. 499 (1996).

17 For a comparison of the property protections afforded by the three NAFTA signatories, see, e.g., Terri L. Lilley, Note, Keeping NAFTA "Green" for Investors and the Environment, 75 S. Cal. L. Rev. 727, 749-53 (2002).

18 See infra Part III.A.

19 See infra Part III.B.

20 See infra Part III.C.

21 See infra Part IV.A.

have invested substantial assets in a country, that unfairness is mitigated in part by the effects regulatory overreaching would have on a country's reputation with investors choosing among nations competing for investment.[22] The most serious risk of overreaching also can be constrained by national treatment[23] and most-favored-nation[24] requirements in international investment agreements without resorting to regulatory takings doctrines. Further, an arbitral panel is not the appropriate forum for assessing the fairness of a domestic legislature's or regulator's attempts to balance investors' need for stability against society's need to adapt to changes in its knowledge about environmental threats. Finally, the need for compensation as ex post insurance for the risk of legal and regulatory change is obviated in part by the availability of ex ante insurance against political risk, including some forms of expropriation, in many of the countries that are signatories to international investment agreements. Data about the purchase of such insurance suggest that many investors are choosing to self-insure and therefore are unlikely to be the parties for whom compensation as insurance would be appropriate.[25]

Having found little support in the traditional rationales for an expanded compensation requirement commonly advanced in the U.S. domestic context, the Article turns to a fourth justification specific to the international arena: that developing countries want to provide such protections in order to attract foreign investments in a competitive market. But this argument similarly fails to persuade. Developing countries are free at any time to offer such protections on a unilateral basis. Moreover, the demand for such provisions in bilateral investment treaties did not come from developing countries but was driven instead by the United States's efforts to impose its preferred standard of compensation for nationalizations and other traditional forms of expropriation.[26] Aggressive U.S. promotion of expropriation provisions, coupled with the fact that compensation requirements place a disproportionate burden on countries that are both less wealthy and are undergoing periods of rapid regulatory change,[27] strongly suggests that developing countries do not favor expanded compensation requirements in bilateral investment treaties as a strategy for attracting investment. Even if developing countries were now to seek to provide such protection through international investment

[22] See infra Part IV.B.
[23] See infra note 35.
[24] See infra note 36.
[25] See infra Part IV.C.
[26] See infra Parts IV.D.1. & IV.D.2.
[27] See infra note 443 and accompanying text.

agreements to gain a competitive advantage in the market for foreign direct investment, we argue that the United States has too much to lose from broad compensation requirements for it to accept such constraints on its regulatory processes.[28]

The Article concludes by examining the risks of imposing a compensation requirement for regulatory takings through international investment and trade agreements. We argue that if our concerns about what the early tribunals' interpretations of the NAFTA expropriation provision foreshadow are realized, and NAFTA thereby becomes more expansive than U.S. takings law, there will be significant costs: Article 1110 will provide foreign investors with competitive advantages over domestic investors,[29] may deter efficient regulation, and may alter the balance of power between federal, state, and local governments.[30] Alternatively, the NAFTA decisions may have a "ratchet" effect, forcing U.S. regulatory takings law to expand as well. These risks are particularly troubling in light of the fact that NAFTA expanded the compensation requirements without the benefit of democratic debate over the wisdom of such a move, and indeed did so despite Congress's repeated rejection in recent years of proposals for similar expansions in domestic law.[31]

The Article proceeds as follows. Part II provides an introduction to NAFTA's overall scheme of investor protections and situates NAFTA's Article 1110 in relation to evolving international law standards on expropriation. Part III then analyzes how the awards NAFTA arbitral panels have rendered in investor-state disputes under Article 1110 differ from the regulatory takings protections of the Fifth Amendment to the U.S. Constitution. Part IV turns to the justifications normally asserted for requiring compensation for regulations that destroy or diminish property value, analyzing both general flaws in those arguments and problems specific to applying them to the international context. It concludes that the justifications asserted for a "regulatory takings" doctrine in the domestic context do not support a similar doctrine in international investment agreements. Part V explores the dangers of imposing a compensation requirement for regulatory takings through NAFTA and similar trade and investment agreements, and argues for a shift to more narrowly drawn expropriation protections.

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28 See infra Part IV.D.3.

29 See infra Part V.A.1.

30 See infra Parts V.A.2 & V.A.3.

31 See infra Part V.A.4.

II
Compensation Requirements Under NAFTA and International Law

Before turning to this Article's central theses in Parts III and IV, some background understanding both of NAFTA's overall approach to investor protection and of the treatment of expropriation under international law is necessary. This Part first explains how Article 1110 fits into Chapter 11's broader scheme, which incorporates a number of other investor protections and provides an investor-state dispute mechanism to enforce these protections. We then turn more specifically to Article 1110's substantive standard on expropriation. While this standard is the product of nearly a century of development of the international law of expropriation, considerable uncertainty remains as to how it applies to what we in the United States call "regulatory takings." This uncertainty increases the danger that NAFTA tribunals will interpret Article 1110 in a manner inconsistent with U.S. jurisprudence and highlights the need for a more rigorous theoretical inquiry into the justifications underlying treaty-based compensation requirements.

A. The Chapter 11 Approach to Investor Protection

1. NAFTA's "Investors' Bill of Rights"

As set forth above, NAFTA's Article 1110 requires that any direct or indirect expropriation, or "measure[s] tantamount to expropriation," be nondiscriminatory, motivated by a public purpose, effected with due process, and offer prompt, full, and adequate compensation.[32] This "takings" clause is not a stand-alone provision but rather one among several protections provided under Chapter 11's "investors' bill of rights." Because the NAFTA expropriation claims typically are joined with claims under a number of these other investor protections, the relationship between Article 1110 and the Chapter's other disciplines is important.

The Chapter includes two provisions analogous to the U.S. Constitution's Equal Protection[33] and Privileges and Immunities[34] Clauses. Article 1102, the "National Treatment" provision, requires

[32] NAFTA, supra note 1, art. 1110, 32 I.L.M. at 641-42. All four requirements of Article 1110(1) must be met: The fact that a measure is an exercise of a legitimate and nondiscriminatory police power does not exempt the government from the obligation to compensate investors for harm to their property interests. See supra note 4 and accompanying text.

[33] U.S. Const. amend. XIV, § 1, cl. 4.

[34] U.S. Const. amend. XIV, § 1, cl. 2.

signatory governments to treat foreign investors "no less favorabl[y]" than they treat domestic investors "in like circumstances."[35] Article 1103, the "Most-Favored-Nation" provision, requires signatory governments to treat foreign investors at least as well as they treat foreign investors of other parties or of nonparties in like circumstances.[36] If, for example, one of the parties has entered into an agreement with a nonparty to give that country's investors advantages over the investors of its NAFTA partners, the investors of the NAFTA parties become entitled to those advantages as well. Further, foreign investors are entitled to the better of national treatment or most-favored-nation treatment.[37] Chapter 11 also contains a third provision analogous to the U.S. Constitution's due process guarantee:[38] Article 1105 requires signatory parties to treat foreign investors of the other parties "in accordance with international law, including fair and equitable treatment and full protection and security."[39] This "minimum-standard-of-treatment" requirement is not comparative: Even if a state denies its own citizens and investors fair treatment, it may not deny such treatment to foreign investors. Finally, Article 1106 prohibits the imposition of certain "performance requirements" on foreign investors—for example, requirements that such investors export a certain percentage of their goods and services, that they give preference to host-country goods and services as production inputs, and so forth.[40]

The scope of government actions to which these provisions apply and the property interests that they protect is extremely broad. NAFTA's investor protections apply to "measures adopted or maintained by a Party relating to . . . investors of another Party; [and] investments of investors of another Party in the territory of the Party."[41] "Measure" in turn is defined as including "any law, regulation, procedure, requirement or practice."[42] As will be discussed below, the tribunals have interpreted this definition to embrace not only legislative and administrative actions but court decisions as well.[43]

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[35] NAFTA, supra note 1, art. 1102, 32 I.L.M. at 639. For a good discussion of the provisions of Chapter 11, see Mann & von Moltke, supra note 10, at 21-47.

[36] NAFTA, supra note 1, art. 1103, 32 I.L.M. at 639.

[37] Id. art. 1104, 32 I.L.M. at 639.

[38] U.S. Const. amend. XIV, § 1, cl. 3.

[39] NAFTA, supra note 1, art. 1105(1), 32 I.L.M. at 639.

[40] Id. art. 1106, 32 I.L.M. at 640.

[41] Id. art. 1101(1), 32 I.L.M. at 639. Although some of the disciplines in Chapter 11 do not apply to nonconforming laws and regulations in effect when NAFTA went into force, the expropriation provisions apply even to preexisting measures. See id. art. 1108, 32 I.L.M. at 640-41.

[42] Id. art. 201(1), 32 I.L.M. at 298.

[43] See infra Part III.B.

The "investments" protected under Chapter 11 include any "real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes."[44] The term also includes any enterprise (defined as a corporation, trust, partnership, sole proprietorship, joint venture, or other association or entity organized under applicable law);[45] equity or debt security of an enterprise; loan to an enterprise; or interest in an enterprise that entitles the owner to a share in income or profits or a share in the assets upon dissolution.[46] Finally, it includes any "interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory," such as construction or concession contracts.[47] This definition covers a great deal more than the property interests traditionally protected by the Fifth Amendment.[48] Moreover, it establishes a very low threshold for obtaining Chapter 11 protections.[49]

NAFTA provides that Article 1110 and the other investor protections are to be interpreted "in accordance with [NAFTA] and applicable rules of international law."[50] Many have argued that the investor protections can and should be balanced against environmental concerns, asserting that NAFTA and its environmental side agreement[51] contain language that supports such balancing.[52] NAFTA's Preamble, for example, contains precatory language concerning the parties' resolution to accomplish the goals of the agreement "in a manner consistent with environmental protection and conservation," to "preserve their flexibility to safeguard the public welfare," to "promote sustainable development," and to "strengthen the development and enforcement of environmental laws and regulations."[53] However, NAFTA's

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44 NAFTA, supra note 1, art. 1139, 32 I.L.M. at 647.

45 Id. art. 201(1), 32 I.L.M. at 298.

46 Id. art. 1139, 32 I.L.M. at 647.

47 Id.

48 See infra Part III.A.

49 As a result, "[i]t is foreseeable . . . that minimal foreign investments may found full challenges to environmental measures. For example, a foreign component might be strategically added to an otherwise domestic investment simply to have access to the extraordinary rights and remedies found in Chapter 11." Mann & von Moltke, supra note 10, at 24.

50 NAFTA, supra note 1, art. 1131(1), 32 I.L.M. at 645. In addition, NAFTA as a whole is to be interpreted "[in] light of its objectives" and "in accordance with applicable rules of international law." Id. art. 102(2), 32 I.L.M. at 297.

51 See infra note 56.

52 See, e.g., Jason L. Gudofsky, Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study, 21 Nw. J. Int'l L. & Bus. 243, 250-51 (2000); J. Martin Wagner, International Investment, Expropriation and Environmental Protection, 29 Golden Gate U. L. Rev. 465, 478-80 (1999).

53 NAFTA, supra note 1, pmbl., 32 I.L.M. at 297.

official "objectives" as stated in Article 102 explicitly include "promot[ing] conditions of fair competition" and "increas[ing] substantially investment opportunities" but make no reference to environmental or social protections.[54] Similarly, provisions in both NAFTA Chapter 11[55] and NAFTA's environmental "side agreement"—the North American Agreement on Environmental Cooperation (NAAEC)[56]—explicitly recognize the danger of a "race to the bottom" among the three parties and prohibit the parties from derogating from environmental and health-and-safety standards in order to promote trade or investment. But none of these provisions can be raised by the host-country government as a defense in a Chapter 11 claim nor do they impose any directly enforceable limitation on investor rights.[57]

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[54] Id. art. 102(1), 32 I.L.M. at 297.

[55] NAFTA Article 1114(2) prohibits a party from "waiv[ing] or otherwise derogat[ing] from, or offer[ing] to waive or otherwise derogate from, such [domestic health, safety or environmental] measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor." Id. art. 1114(2), 32 I.L.M. at 642. Article 1114(2) allows any party that believes another party is waiving health, safety, or environmental regulations in order to secure foreign investment to "request consultations with the other Party." Id. Chapter 20's state-to-state dispute mechanism is not available if the consultation does not resolve the controversy. See id. art. 2004, 32 I.L.M. at 694 ("Except for . . . matters . . . otherwise provided [for] in this Agreement, the dispute settlement provisions of this Chapter shall apply with respect to the avoidance or settlement of all disputes between the Parties regarding the interpretation or application of this Agreement . . . ."). Further, an NGO that believes one of the Parties is engaging in a race to the bottom has no mechanism through which to seek enforcement. Mann, supra note 2, at 12.

[56] The North American Agreement on Environmental Cooperation (NAEEC), adopted in connection with NAFTA, provides:

> Recognizing the right of each Party to establish its own levels of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental laws and regulations, each Party shall ensure that its laws and regulations provide for high levels of environmental protection and shall strive to continue to improve those laws and regulations.

North American Agreement on Environmental Cooperation, Sept. 14, 1993, art. 3, 32 I.L.M. 1480, 1483. NAAEC's relevance to the interpretation of NAFTA is supported by the Vienna Convention on the Law of Treaties, under which treaties are to be interpreted in the context of any agreement relating to the treaty that was made by the parties to the treaty. Vienna Convention on the Law of Treaties, May 23, 1969, art. 31(2)(a), 1155 U.N.T.S. 331, 340. For discussions of the NAAEC, see Francisco S. Nogales, The NAFTA Environmental Framework, Chapter 11 Investment Provisions, and the Environment, 8 Ann. Surv. Int'l & Comp. L. 97, 104-08 (2002); Tollefson, supra note 14, at 165-82; Brian T. Hodges, Note, Where the Grass Is Always Greener: Foreign Investor Actions Against Environmental Regulations Under NAFTA's Chapter 11, *S.D. Myers, Inc. v. Canada*, 14 Geo. Int'l Envtl. L. Rev. 367, 386-87 (2001).

[57] See Kevin Banks, NAFTA's Article 1110—Can Regulation Be Expropriation?, 5 NAFTA: L. & Bus. Rev. Am. 499, 510-11 (1999) (arguing that side agreements do not clarify whether measure violates Article 1110); Steve Charnovitz, The North American

Somewhat more promising for proponents of a balancing approach, Article 1114(1) provides that "[n]othing in this [investment] Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns."[58] But given that government actions have to be "otherwise consistent with" Chapter 11—meaning, presumably, that such actions cannot violate the investor protections—this provision in no way directly limits the application of Article 1110 or of the other investor protections.[59]

2. The Investor-State Dispute Mechanism

Individual investors from one of the NAFTA countries can seek to enforce the investor protections by initiating a claim against a host-country government under Chapter 11's "investor-state dispute mechanism" (ISDM).[60] Such claims require neither the participation nor acquiescence of the investor's home-country government. By giving standing to individual foreign investors, the ISDM bypasses the traditional requirement under international law that the grievances of foreign investors be brought on their behalf by their home-country

Free Trade Agreement: Green Law or Green Spin?, 26 Law & Pol'y Int'l Bus. 1, 24 (1994) (characterizing environmental provisions as "precatory, not mandatory"); John Wickham, Toward a Green Multilateral Investment Framework: NAFTA and the Search for Models, 12 Geo. Int'l Envtl. L. Rev. 617, 619-22 (2000) (arguing that NAFTA's "green" preambular language and prohibitions against lowering of environmental standards to attract investment impose no binding commitments).

58 NAFTA, supra note 1, art. 1114(1), 32 I.L.M. at 642.

59 This interpretation is supported by the language of Article 1106(2), which specifically exempts "[a] measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements" from the general prohibition on performance requirements. Id. art. 1106(2), 32 I.L.M. at 640. The exemption emphasizes, however, that the national treatment and most-favored-nation treatment requirements do apply to these kinds of measures. Id. The Article 1106 exemption does not discuss whether the expropriation provision also applies to "generally applicable health, safety or environmental requirement" actions, but Article 1110 itself makes clear that the mere presence of a "public purpose" does not exempt expropriatory actions from its compensation requirement. See id. arts. 1106(2), 1110, 32 I.L.M. at 640, 642; Beauvais, supra note 2, at 282-84 (discussing rejection by tribunals and commentators of argument that regulatory or "police-powers" character of government action is exempted from protection against expropriation).

60 For discussions of the NAFTA ISDM, see generally Gary N. Horlick & Alicia L. Marti, NAFTA Chapter 11B—A Private Right of Action to Enforce Market Access Through Investments, 14 J. Int'l Arb. 43 (1997); Kristin L. Oelstrom, Note, A Treaty for the Future: The Dispute Settlement Mechanisms of the NAFTA, 25 Law & Pol'y Int'l Bus. 783 (1994); see also Gary N. Horlick & F.A. DeBusk, Dispute Resolution Under NAFTA—Building on the US-Canada FTA, GATT and ICSID, 10 J. Int'l Arb. 51, 52-57 (1993).

governments.[61] Investor-state dispute mechanisms have been a part of bilateral investment treaties since at least 1981,[62] but few (if any) claims were brought under these agreements.[63] For a multilateral agreement, the scope of the investor-state dispute mechanism in Chapter 11 was pathbreaking.[64]

NAFTA's ISDM provisions require that investor claims against host states be submitted to arbitration.[65] The arbitral tribunals are composed of three members, one chosen by the investor, one by the host state, and a third presiding member selected through agreement

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61 For discussion of the traditional limitations on the legal personality and standing of non-state actors, see Louis Henkin et al., International Law: Cases and Materials 677-79 (3d ed. 1993); Justin Byrne, Comment, NAFTA Dispute Resolution: Implementing True Rule-Based Diplomacy Through Direct Access, 35 Tex. Int'l L.J. 415, 428-29 (2000) (contending that providing standing to investors enhances rule-based, instead of political, determination of claims, and mitigates governments' inability or unwillingness to represent all claims of their own nationals).

62 See infra note 92 and accompanying text (discussing origins of current expropriation language in 1981 U.S. Model BIT).

63 Lawrence L. Herman, Settlement of International Trade Disputes—Challenges to Sovereignty—A Canadian Perspective, 24 Can.-U.S. L.J. 121, 132 (1998) (noting that prior to NAFTA, "direct litigation between persons and States was a rarity"). Chapter 20 of NAFTA provides a state-to-state dispute settlement mechanism, but only one state-to-state arbitration has involved Chapter 11's investment protections. See In re Cross-Border Trucking Servs. (Mex. v. U.S.), NAFTA Arb. Rep. USA-Mex-98-2008-01, para. 1 (2001), http://www.sice.oas.org/DISPUTE/nafta/english/U98081ae.asp.

64 Mann & von Moltke, supra note 10, at 12. For discussion of dispute settlement mechanisms in subsequent proposed and adopted multilateral agreements, see infra notes 98-102 and accompanying text.

65 NAFTA Article 1120 ("Submission of a Claim to Arbitration") requires that investors of a signatory government submit claims against another signatory government under one of three specified arbitral forums. See NAFTA, supra note 1, art. 1120, 32 I.L.M. at 643. The first forum, the International Center for the Settlement of Investment Disputes (ICSID), is available only if the dispute is between a state that is a party to the convention and a complaining investor that is a national of another party to the convention. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, art. 25(1), 17 U.S.T. 1270, 1280, 575 U.N.T.S. 159, 174 [hereinafter ICSID Convention]. Although the United States is a party, Canada and Mexico currently are not, so NAFTA claims may not be brought under the convention. See List of Contracting Parties, at http://www.worldbank.org/icsid/constate/constate.htm (last visited Jan. 10, 2003). For a discussion of ICSID, see generally Moshe Hirsch, The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes (1993); Malcolm D. Rowat, Multilateral Approaches to Improving the Investment Climate of Developing Countries: The Cases of ICSID and MIGA, 33 Harv. Int'l L.J. 103, 105-18 (1992).

The second forum, the ICSID Additional Facility, is available only if either the disputing party or the party of the investor, but not both, are parties to the ICSID Convention. ICSID, Additional Facility for the Administration of Conciliation, Arbitration and Fact-Finding Proceedings, art. 2 (1978), http://www.worldbank.org/icsid/facility/3.htm (last visited Jan. 10, 2003).

The third available forum is the United Nations Commission on International Trade Law (UNCITRAL). See UNCITRAL Arbitration Rules, G.A. Res. 31/98, U.N. GAOR, 31st Sess., Supp. No. 39, U.N. Doc. A/31/39 (1976), http://www.uncitral.org/english/texts/arbitration/arb-rules.htm.

by the disputing parties.[66] These arbitrators are private individuals, typically distinguished international law practitioners, academics, or former government officials. To take advantage of the ISDM, an investor must consent to the arbitral panel's jurisdiction and waive the right to pursue claims for money damages before any administrative tribunal or court of law.[67] Arbitral awards may be enforced[68] under the Convention on the Settlement of Investment Disputes Between States and National of Other States (ICSID Convention),[69] the New York Convention,[70] or the Inter-American Convention,[71] under which they are to be treated as equivalent to a final judgment in the courts of the state in which they are enforced. There is no stare decisis[72] and no appeals mechanism,[73] in contrast to domestic courts and trade-related international dispute resolution forums such as the World Trade Organization's Dispute Settlement Body.[74]

In response to growing concerns about the lack of transparency in the arbitral process, Canada, the United States, and Mexico only recently agreed to make available to the public all documents submitted to, or issued by, a Chapter 11 tribunal.[75] There is no requirement, however, that the arbitral proceedings themselves be open to the public.[76] Each tribunal has complete discretion whether to allow nongov-

[66] NAFTA, supra note 1, art. 1123, 32 I.L.M. at 644. If the parties are unable to agree, the third arbitrator is selected by the Secretary General of ICSID. Id. art. 1124, 32 I.L.M. at 644.

[67] Id. art. 1121, 32 I.L.M. at 643. Investors may pursue injunctive or declaratory relief or extraordinary relief such as mandamus in parallel domestic proceedings. See id.

[68] Id. art. 1136(6), 32 I.L.M. at 646.

[69] ICSID Convention, supra note 65, art. 54, 17 U.S.T. at 1291-92, 575 U.N.T.S. at 194.

[70] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, art. 3, 21 U.S.T. 2517, 2519, 330 U.N.T.S. 38, 40.

[71] Inter-American Convention on International Commercial Arbitration, Jan. 30, 1975, art. 4, 104 Stat. 448, 449, 1438 U.N.T.S. 249, 249.

[72] See NAFTA, supra note 1, art. 1136(1), 32 I.L.M. at 646 (providing that arbitral awards are binding only on disputing parties and only in respect of particular case).

[73] Horlick & DeBusk, supra note 60, at 56.

[74] For the right to appeal World Trade Organization (WTO) panel rulings to the Appellate Body of the Dispute Settlement Body, see Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, Annex 2—Understanding on Rules and Procedures Governing the Settlement of Disputes, arts. 17-19, 33 I.L.M. 1226, 1236-37 (1994); Robert E. Hudec, The New WTO Dispute Settlement Procedure: An Overview of the First Three Years, 8 Minn. J. Global Trade 1, 2-3 (1999).

[75] See NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (July 31, 2001), http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-interpr-en.asp. However, the agreement specifies that the material may be redacted to keep secret any confidential business information. Id.

[76] Mann, supra note 2, at 11.

ernmental organizations to file amicus briefs in Chapter 11 proceedings.[77]

B. *Interpreting Treaty-Based Expropriation Provisions*

1. *Historical Development*

NAFTA's expropriation protections represent the culmination of nearly a century of development in international law.[78] Article 1110's language finds its origins in the "Hull Formula," first articulated by Secretary of State Cordell Hull in response to Mexico's nationalization of American petroleum companies in 1938.[79] Hull posited that international law requires "prompt, adequate and effective" compensation for the expropriation of foreign investments, and this view was ultimately incorporated in the United States's preferred standard of international law on expropriations.[80]

The Latin American response to the Hull Formula was the "Calvo Doctrine," named for the Argentine jurist credited with its development.[81] Calvo maintained that every sovereign state was entitled to freedom from interference by other states, either by diplomacy or force.[82] International law requires only that aliens be given the same rights as those given to nationals of the host state; national treat-

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[77] Methanex Corp. v. United States, Decision of the Tribunal on Petitions from Third Persons to Intervene as "Amici Curiae," paras. 47-53 (Jan. 15, 2001), http://www.international-economic-law.org/Methanex/Methanex%20-%20Amicus%20Decision.pdf; cf. Decision on Petition of the Council of Canadians, the Sierra Club of Canada and Greenpeace to Intervene in Attorney General of Canada v. S.D. Myers, 2001 FCT 317, paras. 20-21 (Apr. 11, 2001) (Can. Fed. Ct.), http://decisions.fct-cf.gc.ca/fct/2001/2001fct317.html (denying leave for environmental groups to intervene in domestic court proceedings involving S.D. Myers), aff'd, 2002 FCA 39 (Jan. 22, 2002) (Can. Fed. Ct. App.), http://decisions.fct-cf.gc.ca/fct/2002/2002fca39.html.

[78] For accounts of the history of expropriation protections under international law, see, for example, Rudolf Dolzer, New Foundations of the Law of Expropriation of Alien Property, 75 Am. J. Int'l L. 553, 557-72 (1981); Elihu Lauterpacht, International Law and Private Foreign Investment, 4 Ind. J. Global Legal Stud. 259, 263-67 (1997); Kenneth J. Vandevelde, Sustainable Liberalism and the International Investment Regime, 19 Mich. J. Int'l L. 373, 379-81, 384-90 (1998).

[79] Andreas F. Lowenfeld, International Economic Law 397-402 (2002). The correspondence between Secretary Hull and the Mexican government is reprinted in 3 Green H. Hackworth, Digest of International Law 655-64 (1942).

[80] See Lowenfeld, supra note 79, at 397, 414. The Restatement (Third) of Foreign Relations summarizes that standard as follows: "A state is responsible under international law for injury resulting from . . . a taking by the state of the property of a national of another state that (a) is not for a public purpose, or (b) is discriminatory, or (c) is not accompanied by provision for just [i.e. prompt, adequate, and effective] compensation . . . ." Restatement (Third) of the Foreign Relations Law of the United States § 712(1) (1987) [hereinafter Restatement (Third)].

[81] Donald R. Shea, The Calvo Clause 16-17 (1955).

[82] Id. at 19.

ment, in other words, governs the question of expropriation.[83] The Calvo Doctrine gained widespread acceptance in Latin America and was incorporated directly into the constitutions of Mexico and several other countries.[84]

The basic premises of the Calvo Doctrine also found broad support among developing and socialist states throughout the world during the 1960s and 1970s, as reflected in major United Nations General Assembly resolutions. Following decolonization, these countries became the majority in the General Assembly and used this forum to articulate their opposition to the industrialized countries' position on the international law of expropriation. In 1962, the General Assembly adopted its Resolution on Permanent Sovereignty over Natural Resources (PSNR), which affirmed the right to nationalize foreign-owned property and required only "appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty."[85] This "appropriate compensation" language was considered an attempt to paper over differences between the views of Western and developing states with a vague standard that was arguably consistent with the Hull Formula.[86] In 1974, the U.N. General Assembly decisively rejected the Hull Formula in favor of the Calvo Doctrine in adopting the Charter of Economic Rights and Duties of States (CERDS).[87] While Article 2(c) of

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[83] Id. at 18-19; Samuel K.B. Asante, International Law and Foreign Investment: A Reappraisal, 37 Int'l & Comp. L.Q. 588, 591 (1988); Paul C. Szasz, The Investment Disputes Convention and Latin America, 11 Va. J. Int'l L. 256, 261-62 (1971).

[84] See Manuel R. Garcia-Mora, The Calvo Clause in Latin American Constitutions and International Law, 33 Marq. L. Rev. 205, 206-07 (1950). For the Mexican Constitution's Calvo Clause, see Constitución Política de los Estados Mexicanos ch. I, art. 27, reprinted in 22 Constitutions of the Countries of the World: Mexico 1, 16-17 (Albert P. Blaustein & Gilbert H. Flanz eds., 1982).

[85] General Assembly Resolution on Permanent Sovereignty over Natural Resources, G.A. Res. 1803, U.N. GAOR, 17th Sess., Supp. No. 17, at 3, U.N. Doc. A/RES/1803 (1962). For background on the resolution and its antecedents, see generally Karol N. Gess, Permanent Sovereignty over Natural Resources: An Analytical Review of the United Nations Declaration and Its Genesis, 13 Int'l & Comp. L.Q. 398 (1964); Stephen M. Schwebel, The Story of the U.N.'s Declaration on Permanent Sovereignty over Natural Resources, 49 A.B.A. J. 463 (1963).

[86] See Lowenfeld, supra note 79, at 410 ("[D]ifferent interests could cite different provisions for their own purposes."); Dolzer, supra note 78, at 559, 562 (referring to "appropriate compensation" standard as imprecise but "arguably still within the meaning of the Hull Rule"); Detlev F. Vagts, Foreign Investment Risk Reconsidered: The View from the 1980s, 2 ICSID Rev.–Foreign Investment L.J. 1, 5 (1987) ("[The 1962 resolution] represented an effort to paper over growing differences in attitude between the new, capital-importing States and the older, industrialized capital exporters. In its vague compensation formula it sought to make all parties content.").

[87] Charter of Economic Rights and Duties of States, G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, at 50-55, U.N. Doc. A/9946 (1974) [hereinafter CERDS]. For discussion of the Charter, see Lowenfeld, supra note 79, at 412-14. See generally Burns H.

CERDS retains the "appropriate compensation" standard, it goes on to provide that

> [i]n any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.[88]

Article 2 was rejected by six industrialized states, including the United States.[89]

But even as the contest between the Hull Formula and the Calvo Doctrine was being fought, its relevance was being undermined by a new development in international law. Beginning in 1959, several European countries led by Germany began to negotiate bilateral investment treaties (BITs) that incorporated protections against expropriation of foreign investments.[90] By 1977, the United States

Weston, The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth, 75 Am. J. Int'l L. 437 (1981).

[88] CERDS, supra note 87, art. 2(c).

[89] Lowenfeld, supra note 79, at 413 n.73. The period during which the Permanent Sovereignty over Natural Resources (PSNR) and CERDS resolutions were adopted also saw a major wave of developing-country nationalization of foreign investments. See F.N. Burton & Hisashi Inoue, Expropriations of Foreign-Owned Firms in Developing Countries, 18 J. World Trade L. 396, 414 (1984) (noting that expropriation of foreign firms became more common during first half of 1970s); Stephen J. Kobrin, Foreign Enterprise and Forced Divestment in LDCs, 34 Int'l Org. 65, 73 (1980) (reporting that of 511 acts of expropriation between 1960 and 1976, seventy-three percent took place from 1970 to 1976 and thirty percent from 1974 to 1975 alone); Don C. Piper, New Directions in the Protection of American-Owned Property Abroad, 4 Int'l Trade L.J. 315, 330 (1979) (reporting that United Nations had identified 875 acts of expropriation in sixty-two countries between 1960 and 1974); Vagts, supra note 86, at 5-6 (recounting history of nationalizations in 1960s and 1970s). These expropriations included notorious cases such as the takeover of the Kennecott and Anaconda copper mines and ITT by the Allende administration in Chile and Peru's nationalizations of the Marcona Mining Corporation in 1975. Vagts, supra note 86, at 5-6; see also Eric N. Baklanoff, Expropriation of U.S. Investments in Cuba, Mexico, and Chile 75-106 (1975) (relating history and impact of nationalization of U.S. mining industry in Chile); Henry J. Steiner & Detlev F. Vagts, Transnational Legal Problems 510-24 (3d ed. 1986) (providing further discussion and documentation of Chilean expropriations); David A. Gantz, The Marcona Settlement: New Forms of Negotiation and Compensation for Nationalized Property, 71 Am. J. Int'l L. 474, 476-87 (1977) (describing Marcona nationalization).

[90] For an account of the development of bilateral investment treaties (BITs) in Europe, see, for example, Jeswald W. Salacuse, BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries, 24 Int'l Law. 655, 657 (1990); see also United Nations Conference on Trade and Development (UNCTAD), Bilateral Investment Treaties in the Mid-1990s, at 8-10, U.N. Doc. UNCTAD/ITE/IIT/7, U.N. Sales No. E98.II.D.8 (1998) (discussing history of BITs, beginning with Germany's negotiation of first BITs with Pakistan and Dominican Republic in 1959).

followed suit and launched its own BIT program.[91] The U.S. Model BIT included the U.S. international law standard on expropriation, which by 1981 had evolved to include the language on "indirect" expropriations and "measures tantamount to expropriation" later incorporated into NAFTA's Article 1110.[92] The Model BIT also provided for direct enforcement of the expropriation provision and other investor protections through an investor-state dispute mechanism. Only ten BITs were negotiated by the United States during the period between 1982 and 1986, but the program was reinvigorated following the collapse of the Soviet Union in 1989. Between 1989 and January 1993 the United States signed twelve BITs, including one with Argentina—formerly a strong adherent of the Calvo Doctrine—and with a number of former communist states.[93]

Since 1993, there has been an explosion in the number of BITs. There are now more than 1500 such treaties in force, involving more than 160 countries, and nearly half of all BITs are between industrialized or transitional countries and developing countries.[94] Virtually all of these agreements contain expropriation provisions, though only about half of them directly incorporate the language of the Hull Formula.[95] NAFTA's predecessor, the 1986 U.S.-Canada Free Trade Agreement, incorporated the U.S. Model BIT language on expropriation[96] but did not provide for mandatory arbitration under an ISDM.[97]

[91] See generally Kenneth J. Vandevelde, The Bilateral Investment Treaty Program of the United States, 21 Cornell Int'l L.J. 201 (1998) (discussing development of U.S. BIT program); see also Mark S. Bergman, Bilateral Investment Protection Treaties: An Examination of the Evolution and Significance of the U.S. Prototype Treaty, 16 N.Y.U. J. Int'l L. & Pol. 1 (1983) (comparing U.S. and European BITs).

[92] Model Bilateral Investment Treaty and Sample Provisions from Negotiated BITs, art. III, § 1 (revised Feb. 24, 1984), reprinted in 1 Basic Documents of International Economic Law 655, 657 (Stephen Zamora & Ronald A. Brand eds., 1990). Similar language is used in the 1994 amended version of the model treaty. 1994 Model Bilateral Investment Treaty, art. III, § 1, 1997 BDIEL AD LEXIS 6.

[93] Kenneth J. Vandevelde, U.S. Bilateral Investment Treaties: The Second Wave, 14 Mich. J. Int'l L. 621, 630-31 (1993).

[94] Price, supra note 7, at 2; see also UNCTAD, supra note 90, at 8-10 (tracking rapid expansion of BITs in 1980s and early 1990s). For a list of texts of bilateral treaties to which the United States was a party as of November 1, 2000, see List of U.S. Bilateral Investment Treaties, at http://www.state.gov/www/issues/economic/bit_treaty.html (last visited Jan. 12, 2003). For a list of BITs in the western hemisphere as of October of 1999, see Investment Agreements in the Western Hemisphere: A Compendium (Oct. 1999), at http://www.sice.oas.org/bitse.asp.

[95] A survey of 335 BITs found that over half adopted the Hull Formula and another forty-seven provide for "just," "full," "reasonable," or "fair and equitable" compensation. Just under a third of the agreements use a different compensation standard. Mohamed I. Khalil, Treatment of Foreign Investment in Bilateral Investment Treaties, 7 ICSID Rev.–Foreign Investment L.J. 339, 374 (1992).

[96] Free Trade Agreement, Jan. 2, 1988, U.S.-Can., art. 1605, 27 I.L.M. 281, 375.

Treaty-based expropriation provisions now have been incorporated in multilateral and regional investment agreements as well. In 1993, NAFTA combined, for the first time in a major multilateral investment agreement, the U.S. Model BIT language and enforcement by means of a mandatory direct ISDM.[98] The 1994 European Energy Charter Treaty followed the NAFTA model, requiring compensation for investments "nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation"[99] and providing for enforcement through a mandatory direct ISDM.[100] As noted above, the NAFTA model of expropriation protection also has been included in the proposed Multilateral Agreement on Investment[101] and the draft negotiating text for the Free Trade Area of the Americas.[102]

2. *The Uncertain Standard for Regulatory Expropriations*

In spite of the long pedigree of NAFTA's standard on expropriation, and the zeal with which U.S. negotiators have promoted its proliferation, it is far from clear what the standard means, particularly with regard to the "indirect expropriation" and "tantamount to expropriation" language. There is an ongoing debate about whether this language was intended to create a new treaty-specific standard for expropriation, or whether it was merely meant to express the preexisting customary international law standard.[103] Treaties may codify custom-

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97 The U.S.-Canada agreement instead provides for referral of disputes to an intergovernmental commission, which has discretion to refuse to refer them to arbitration. See id. arts. 1801-06, 27 I.L.M. at 383-85. A somewhat different "gatekeeper" mechanism is used in NAFTA with regard to claims that taxation measures amount to expropriation. Article 2103(6) specifically subjects general measures of taxation to the provisions on expropriation, but it requires that complaints about tax measures be dismissed if the tax authorities of both countries decide within six months of the filing that the tax did not amount to an expropriation. NAFTA, supra note 1, art. 2103(6), 32 I.L.M. at 700.

98 Beauvais, supra note 2, at 254 & n.42.

99 Energy Charter Treaty, Dec. 17, 1994, art. 13(1), 34 I.L.M. 360, 391.

100 Id. art. 26, 34 I.L.M. at 399-401.

101 See supra note 12 and accompanying text.

102 See supra note 14. In addition, the 1996 Canada-Chile Free Trade Agreement's provisions on expropriation and investor-state dispute settlement are virtually identical to those of NAFTA. Free Trade Agreement, Dec. 5, 1996, Can.-Chile, arts. G-10, G-16 to G-39, 36 I.L.M. 1067, 1116, 1118-22.

103 Customary international law is formed by widespread state practice in conformity with a particular norm, coupled with opinio juris—or state judgment that such conduct is required by international law. See Ian Brownlie, Principles of Public International Law 4-11 (4th ed. 1990) (describing "international custom"); see also Statute of the International Court of Justice, June 26, 1945, art. 38(1)(b), 59 Stat. 1055, 1060 (referring to "international custom, as evidence of a general practice accepted as law" in context of enumerating sources of international law), reprinted in International Law: Selected Documents 29, 37 (Barry E. Carter & Phillip R. Trimble eds., 1995); Henkin, supra note 61, at 54-93 (provid-

ary international law, or they may deviate from it by providing that a special standard, or *lex specialis*, governs the signatory parties.[104] Several NAFTA claimants have argued that the "tantamount to" language was meant to create such a *lex specialis*, requiring compensation for any deprivation of some benefit of property, not just the total or near-total deprivations of use and enjoyment that traditionally had been the subject of international law on direct expropriation.[105] The United States has argued in submissions to the NAFTA tribunals that NAFTA was not intended to create a "new" definition for expropriation beyond that provided by preexisting customary international law,[106] and Mexico and Canada have supported this position.[107] The

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ing precedents and secondary excerpts on international custom); Dolzer, supra note 78, at 557-72 (analyzing international law status of Hull Formula and Calvo Doctrine with regard to state practice and opinio juris). State practice and opinio juris need not be universal in order to establish a customary international law norm, but the degree of generality and consistency required is a matter of continuing debate. See, e.g., Brownlie, supra, at 5-11; Henkin, supra note 61, at 55-57.

[104] See, e.g., Dolzer, supra note 78, at 566 ("Treaty practice either may be seen as a restatement of accepted customary law or as the establishment of a legal relationship that the parties believe must be specially agreed upon owing to the very absence of a corresponding rule.").

[105] See, e.g., Statement of Claim, S.D. Myers, Inc. v. Gov't of Canada, para. 49 (Oct. 30, 1998) [hereinafter S.D. Myers Claim], http://www.appletonlaw.com/cases/mclaim.pdf (arguing that "tantamount to expropriation" standard requires compensation for any "act by which governmental authority is used to deny some benefit of property").

[106] Submission of the Gov't of the United States, Metalclad Corp. v. United Mexican States, paras. 9-14 (Nov. 9, 1999), http://www.state.gov/documents/organization/4178.pdf. Daniel Price, one of the U.S. drafters and negotiators of NAFTA, reports that the "tantamount" language in Article 1110 was not "intended to go beyond the classical international law formulation" on expropriation. Price, supra note 7, at 5. However, "under the NAFTA formulation, as under public international law, . . . a measure that diminishes the value of an investment but does not necessarily transfer ownership to a third party, may still be scrutinized under the rubric of expropriation." Id. at 5-6.

[107] See Joseph de Pencier, Investment, Environment and Dispute Settlement: Arbitration Under NAFTA Chapter Eleven, 23 Hastings Int'l & Comp. L. Rev. 409, 415 (2000) (noting trilateral agreement on position that "tantamount" language does not expand "established international law content of 'expropriation'"). This interpretation of Article 1110 can be contrasted with the language of certain BIT provisions protecting against, inter alia, "the impairment of [the investment's] management, control or economic value." Rudolf Dolzer & Margrete Stevens, Bilateral Investment Treaties 102 (1995) (quoting Treaty Concerning the Reciprocal Encouragement and Protection of Investment, Aug. 3, 1984, U.S.-Zaire, Protocol para. 5, S. Treaty Doc. No. 99-17 (1986) (clarifying Article III, Compensation for Expropriation), available at 1984 U.S.T. Lexis 246 at *47). Dolzer and Stevens contend that

> [t]he latter provision represents possibly the broadest scope in investment treaties with respect to indirect expropriation insofar as the inclusion of measures that cause the "impairment . . . of [the] economic value" of an investment, equates expropriation with a host of measures which might not otherwise be considered as such under general international law, let alone under liberal systems of domestic law.

only tribunals to have ruled on the merits of Article 1110 claims have concurred with this conclusion.[108]

But even assuming the three parties reached consensus that NAFTA does not create "new" obligations and the tribunals followed this guidance, there is little agreement about what the preexisting customary international law had to say about the issue of regulatory takings. Two issues need to be distinguished here. Our earlier discussion of the tension between the Hull Formula and the Calvo Doctrine points to a longstanding debate as to what customary international law requires in a clear case of expropriation—specifically, whether and what manner of compensation is due and how much.[109] But this debate is largely irrelevant to the discussion of NAFTA Article 1110 because the agreement's expropriation provision explicitly provides that full, adequate, and effective compensation is to be paid in the case of any direct or indirect expropriation or a measure tantamount to expropriation.[110] Our concern here is not the measure of compensation due when an expropriation occurs, but rather what types of government regulation, if any, constitute an expropriation within the meaning of the provision. The NAFTA tribunals themselves give evidence of the uncertainty of international law on this question: Even while acknowledging that customary international law provides the

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Id. This interpretation also may be contrasted with certain decisions of the Iran-United States Claims Tribunal relating to "measures affecting property rights" but not necessarily rising to expropriations under general international law. See infra notes 130-34 and accompanying text.

[108] See S.D. Myers, Inc. v. Canada, Partial Award, para. 286 (Nov. 13, 2000), http://www.dfait-maeci.gc.ca/tna-nac/documents/myersvcanadapartialaward_final_13-11-00.pdf (concluding that "tantamount to expropriation" refers to "so-called 'creeping expropriation,' rather than to expand the internationally accepted scope of the term expropriation"); Pope & Talbot, Inc. v. Canada, Interim Award by Arbitral Tribunal, para. 104 (June 26, 2000), http://www.dfait-maeci.gc.ca/tna-nac/documents/pubdoc7.pdf (holding that "tantamount" means "equivalent" and "[s]omething that is equivalent to something else cannot logically encompass more").

[109] For a discussion of this debate, see Dolzer, supra note 78, at 557-72. For treatment of the related question of whether the widespread adoption of BITs and multilateral investment agreements, including the Hull Formula, has incorporated this standard into customary international law, see Asante, supra note 83, at 596-97 (arguing that BIT practice has not incorporated Hull Formula into customary international law); Dolzer, supra note 78, at 565-67 (same); Andrew T. Guzman, Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties, 38 Va. J. Int'l L. 639, 684-87 (1998) (same); Oscar Schachter, Compensation for Expropriation, 78 Am. J. Int'l L. 121, 126 (1984) (same); cf. Khalil, supra note 95, at 374 (finding, in survey of 335 BITs, that over half incorporated Hull Formula verbatim, another forty-seven incorporated formula similar to Hull, and remaining used some other formula).

[110] See supra note 4 and accompanying text.

governing standard,[111] different panels have applied significantly different standards to regulatory expropriation claims.[112]

The incorporation of the "indirect expropriation" and "measures tantamount to expropriation" language into the U.S. Model BIT and its successors was apparently intended to address the problem of "constructive takings" or "creeping" or "disguised" expropriation.[113] These terms collectively refer to the notion that governments, by means of regulatory or other measures, effectively can deprive an investor of the use and benefit of an investment without direct physical occupation or transfer of title.[114] As M. Sornarajah has pointed out, "[s]uch descriptions [as constructive or creeping expropriations], while providing a label for takings outside the obvious situation of direct takings of physical property, do little to further the identification of indirect takings" subject to compensation under international law.[115] No attempt was made, either in the Model BIT or in NAFTA itself, to address directly the problem of how to distinguish legitimate noncompensable regulations having an effect on the economic value of foreign investments and "regulatory takings" requiring compensation.

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111 See supra notes 106-08 and accompanying text.

112 See Beauvais, supra note 2, at 270-71, 273-74 (comparing treatment of expropriation provision in *Pope & Talbot* and *S.D. Myers*).

113 See supra notes 91-92 and accompanying text.

114 For the classic discussion of constructive takings, focusing on various combinations of regulatory measures that may constitute expropriations, see generally Burns H. Weston, "Constructive Takings" Under International Law: A Modest Foray into the Problem of "Creeping Expropriation," 16 Va. J. Int'l L. 103 (1976). Weston appears to equate the terms "indirect," "de facto," "disguised," "constructive," and "creeping" expropriation. Id. at 105-06; see also Restatement (Third), supra note 80, § 712 cmt. g (stating that expropriation provision applies, inter alia, to "actions of the government that have the effect of 'taking' the property, in whole or in large part, outright or in stages ('creeping expropriation')"); G.C. Christie, What Constitutes a Taking of Property Under International Law?, 38 Brit. Y.B. Int'l L. 307, 309 (1964) (noting, in early comprehensive study of international law of expropriations, that international courts and commentators agree that expropriation may occur even when there is no attempt to transfer title); Rudolf Dolzer, Indirect Expropriation of Alien Property, 1 ICSID Rev.-Foreign Investment L.J. 41, 44-64 (1986) (examining significance of indirect expropriation in international judicial decisions and state practice); Louis B. Sohn & R.R. Baxter, Responsibility of States for Injuries to the Economic Interests of Aliens, 55 Am. J. Int'l L. 545, 548, 553, 555, 558-59 (1961) (referring to problem of "indirect takings" and applying standard of "unreasonable interference" with use and enjoyment, in context of Article 10 on "Taking and Deprivation of Use or Enjoyment of Property" in "Draft Convention on the International Responsibility of States for Injuries to Aliens"). The term "creeping expropriation" connotes the confiscation of property by a series of actions, any one of which by itself might not constitute expropriation, but the sum of which deprives the owner of meaningful use of the property. See, e.g., Restatement (Third), supra note 80, § 712 reporters' note 7 to cmt. g (explaining term "creeping expropriation").

115 M. Sornarajah, The International Law on Foreign Investment 282 (1994).

This omission was deliberate according to Daniel Price, one of the principal U.S. negotiators of NAFTA:

> The negotiators considered whether or not they ought to try to draw a bright line in the text that would distinguish between legitimate, *bona fide* and nondiscriminatory regulation, on the one hand, and an expropriatory act requiring compensation, on the other hand. We quickly gave up that enterprise. If the United States Supreme Court and arbitral tribunals could not do it in over 200 years, it was unlikely that the negotiators were going to do it in a matter of weeks with one line in a treaty.[116]

The drafters' strategy appears to have been to leave the resolution of the thorny problem of regulatory takings to a sort of "common law" development by arbitral panels.[117] While this approach is certainly not novel,[118] it is particularly problematic in the context of international investment agreements because of the pervasive uncertainty about regulatory expropriations under international law. Writing in 1986, Rudolf Dolzer acknowledged after an extensive review of judicial precedent and state practice that "one cannot but admit at this stage that the law of indirect expropriation can be established, at this moment, on the basis of primary sources of international law, only in a very sketchy and rough manner."[119] More recent decisions of international courts and tribunals do little to clarify the situation. There are few recorded "regulatory expropriation" cases prior to the advent of NAFTA.[120] Where international regulatory expropriations cases are available, their applicability to expropriation provisions such as the NAFTA Chapter 11 standard is unclear, as is evidenced by the two most prominent contemporary sources of

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116 Price, supra note 7, at 6.

117 Even this characterization is somewhat misleading, however, insofar as the tribunals are not bound by stare decisis and are not subject to centralized appellate review. See supra notes 72-73 and accompanying text. There is, as a result, no guarantee that delegation of the regulatory takings problem to adjudicative development will result in anything approaching uniform standards.

118 See, e.g., Christie, supra note 114, at 338 ("It is evident that the question of what kind of interference short of outright expropriation constitutes a 'taking' under international law presents a situation where the common law method of case by case development is pre-eminently the best method, in fact probably the only method, of legal development.").

119 Dolzer, supra note 114, at 59; see also Julie A. Soloway, NAFTA's Chapter 11—The Challenge of Private Party Participation, 16 J. Int'l Arb. 1, 7 (1999) ("There is ample jurisprudence on what constitutes direct expropriation, but there is almost a complete absence of a doctrinal basis for deciding what constitutes indirect expropriation.").

120 See Christie, supra note 114, at 309 (acknowledging paucity of reported cases); Jon A. Stanley, Keeping Big Brother out of Our Backyard: Regulatory Takings as Defined in International Law and Compared to American Fifth Amendment Jurisprudence, 15 Emory Int'l L. Rev. 349, 371-85 (2001) (chronicling few potentially relevant international decisions).

such jurisprudence: decisions arising under Article 1, Protocol 1 of the European Convention for the Protection of Human Rights and Fundamental Freedoms (European Convention) and the decisions of the Iran-United States Claims Tribunal (IUCT).

Both the European Court of Human Rights (ECHR)[121] and the European Court of Justice (ECJ)[122] have issued significant decisions on regulatory expropriations under Article 1, Protocol 1 of the European Convention.[123] While these decisions clearly are relevant to our understanding of the international law on expropriation, it must be emphasized that the European Convention standard differs significantly from the general international law standard. Article 1 of Protocol 1 provides, in relevant part, that "[n]o one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law."[124] However, it goes on specifically to indicate that the protec-

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121 The European Court of Human Rights (ECHR), located in Strasbourg, is the institution specifically charged with adjudication of claims arising under the Convention. For discussion of the history and functions of the ECHR, see European Human Rights Law: Text and Materials 64-92 (Mark W. Janis et al. eds., 2d ed. 2000); Human Rights in Europe: A Study of the European Convention on Human Rights 271-326 (J.G. Merrills & A.H. Robertson eds., 4th ed. 2001).

122 The European Court of Justice (ECJ), located in Luxembourg, is the European Community judicial institution charged with enforcing compliance with the European treaties by both European institutions and member states. This jurisdiction is significantly broader than that of the ECHR, but the ECJ routinely decides cases arising under the European Convention. For discussion of the potential for conflict between ECJ and ECHR interpretations of the European Convention, see generally Elizabeth F. Defeis, Human Rights and the European Union: Who Decides? Possible Conflicts Between the European Court of Justice and the European Court of Human Rights, 19 Dick. J. Int'l L. 301 (2001).

123 Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, opened for signature Mar. 20, 1952, art. 1, 213 U.N.T.S. 262 [hereinafter Protocol No. 1].

The leading ECHR case on regulatory expropriations is Sporrong and Lönnroth v. Sweden, 5 Eur. Ct. H.R. (ser. A) at 35 (1983). For discussion of the ECHR decisions interpreting Article 1 of Protocol 1, see, for example, European Convention on Human Rights 300-19 (Clare Ovey & Robin C.A. White eds., 3d ed. 2002); Human Rights in Europe, supra note 121, at 234-41.

The leading ECJ case is Case 44/79, Hauer v. Land Rheinland-Pfalz, 1979 E.C.R. 3727, 3 C.M.L.R. 42 (1980). For excerpts of other ECJ cases touching upon regulatory expropriations, see The European Court of Justice on the European Convention on Human Rights: Who Said What, When? 350-62 (Elspeth Guild & Guillaume Lesieur eds., 1998).

For further general discussion of expropriation cases decided by both the ECJ and ECHR under the European Human Rights Convention, see Stanley, supra note 120, at 381-88; Michael R. Antinori, Note, Does Lochner Live in Luxembourg?: An Analysis of the Property Rights Jurisprudence of the European Court of Justice, 18 Fordham Int'l L.J. 1778, 1803-05 (1995). See generally R. Anthony Salgado, Note, Protection of Nationals' Rights to Property Under the European Convention on Human Rights: Lithgow v. United Kingdom, 27 Va. J. Int'l L. 865 (1987).

124 Protocol No. 1, supra note 123, 213 U.N.T.S. at 262.

tion of property "shall not . . . in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest."[125] The ECHR and ECJ accordingly have adopted a balancing approach to public regulatory interest and burdens on private property that is premised on the specific language of that provision.[126] It is not at all clear that any such balancing is required by general international law, nor have the NAFTA tribunals adopted a similar approach.[127]

The largest body of international precedent on indirect expropriation is found in the decisions of the IUCT,[128] established primarily to settle claims by U.S. investors arising out of the events following the 1979 Iranian revolution.[129] While these decisions may, in some cases, provide some guidance to the NAFTA tribunals, there are at least two significant problems. First, the IUCT's jurisdiction extends to "expropriations or other measures affecting property rights,"[130] a standard that goes well beyond the NAFTA expropriation provision.[131] Even where the IUCT made findings of expropriations under international law—as opposed to measures "affecting property rights" under the

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125 Id.

126 See, e.g., Margaret DeMerieux, Deriving Environmental Rights from the European Convention for the Protection of Human Rights and Fundamental Freedoms, 21 Oxford J. Legal Stud. 521, 539-42 (2001) (discussing ECHR property rights jurisprudence and ECJ's "fair balance" approach).

127 See Beauvais, supra note 2, at 279-80 (summarizing tribunals' approach to environmental limits on investor protections); supra notes 52-59 and accompanying text.

128 See Charles N. Brower & Jason D. Brueschke, The Iran-United States Claims Tribunal 669 (1998) (noting that Iran-United States Claims Tribunal (IUCT) has contributed largest body of precedent in public international law and influenced development of international principles of commercial law).

129 For accounts of the expropriation jurisprudence of the IUCT, see generally The Iran-United States Claims Tribunal: Its Contribution to the Law of State Responsibility (Richard B. Lillich & Daniel Barstow Magraw eds., 1998); Allahyar Mouri, The International Law of Expropriation as Reflected in the Work of the Iran-U.S. Claims Tribunal (1994); George H. Aldrich, What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal, 88 Am. J. Int'l L. 585 (1994).

130 Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran (Claims Settlement Declaration), Jan. 19, 1981, art. II, para. 1, reprinted in 1 Iran-U.S. Cl. Trib. Rep. 9 (1983).

131 See Sornarajah, supra note 115, at 282-83 (arguing that "such a wide definition of taking will not be acceptable in international law"); see also Pope & Talbot, Inc. v. Canada, Interim Award by Arbitral Tribunal, para. 104 (June 26, 2000), http://www.dfait-maeci.gc.ca/tna-nac/documents/pubdoc7.pdf (holding that NAFTA claimant's "[r]eferences to the decisions of the Iran-U.S. Claims Tribunal ignore the fact that that tribunal's mandate expressly extends beyond expropriation to include 'other measures affecting property rights'"). But see generally Maurizio Brunetti, The Iran-United States Claims Tribunal, NAFTA Chapter 11, and the Doctrine of Indirect Expropriation, 2 Chi. J. Int'l L. 203 (2001) (arguing for relevance of IUCT jurisprudence in interpreting Chapter 11).

Algiers accord[132]—the factual scenarios underlying the IUCT claims are vastly different from those that NAFTA and similar contemporary tribunals are likely to face: The IUCT decisions deal primarily with postrevolutionary actions such as governmental appointment of managers or supervisors of foreign companies, de facto nationalization, and failure to permit the exportation of foreign-owned equipment.[133] These actions and the context in which they occurred are, in many ways, radically different from the sorts of environmental and land use regulations that have been the subject of the NAFTA claims.[134] The IUCT decisions thus provide a particularly dramatic example of the perennial and pervasive problem that expropriations decisions are hard to generalize because they are, as the U.S. Supreme Court has acknowledged, essentially "ad hoc, factual inquiries."[135]

This Article does not attempt to resolve the dispute over the existing standard of international law on regulatory expropriation nor the question of whether the early decisions of the NAFTA tribunals conform to this standard.[136] However, the uncertainty of the international standard is relevant to this Article's central arguments in two key respects. First, the uncertainty of the standard makes it susceptible to expansive interpretation. As we will argue in Part III, the NAFTA tribunals' early discussions of Article 1110 portend that the provision may be interpreted to extend property protections for Mexican and Canadian investors in the U.S. significantly beyond those enjoyed by domestic property owners under the Fifth Amendment of the U.S. Constitution, which imposes a compensation requirement already considered to be among the most protective in the world. Second, the uncertainty of the legal standard strongly suggests that international law scholarship on the subject can benefit from some of

[132] See Brunetti, supra note 131, at 204-05 (distinguishing IUCT decisions under customary international law of expropriation from decisions relating to "other measures affecting property rights").

[133] See generally Aldrich, supra note 129 (discussing decisions of IUCT).

[134] Cf. Weston, supra note 114, at 153-54 (distinguishing between different types of "economic" regulation of foreign investment).

[135] Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 123-24 (1978). For testimony that the same problem operates in the international law context, see Christie, supra note 114, at 336; Weston, supra note 114, at 106.

[136] For discussion of these debates, see, for example, Yves Nouvel, Les Mesures Equivalant a Une Expropriation Dans la Pratique Recente des Tribunaux Arbitraux, 106 Revue Générale de Droit International Public 79, 95-96 (2002) (arguing that NAFTA tribunals' refusal to consider intent of allegedly expropriatory regulations is consistent with international law); Chris Tollefson, *Metalclad v. United Mexican States* Revisited: Judicial Oversight of NAFTA's Chapter Eleven Investor-State Claim Process, 11 Minn. J. Global Trade 183, 185 (2002) (arguing that *Metalclad* tribunal "adopted a definition of compensable taking . . . that is much broader than most observers believe prevails under customary international law").

the theoretical insights developed in the context of U.S. takings law. While international law commentators occasionally have made gestures to the "how" of U.S. takings jurisprudence—that is, to the doctrinal standards enunciated in Supreme Court decisions[137]—there has been little or no attention paid to the extensive U.S. scholarship on the underlying justifications for compensation requirements. As we argue in Part IV, the rationales commonly offered for compensation requirements prove tenuous at best in the international context.

III
How Arbitral Interpretations of Article 1110 Threaten to Impose a Compensation Requirement More Expansive Than the Fifth Amendment to the U.S. Constitution

Five arbitrations raising expropriation claims under Chapter 11 have resulted in awards on the merits.[138] Only one, *Metalclad*, resulted in a finding that the government's regulation constituted an expropriation.[139] Both *Metalclad* and the language (though not the results) of the other awards suggest, however, that Article 1110 may be interpreted to require compensation in several circumstances in which the Fifth Amendment has never before been applied. We cannot, of course, predict the direction of NAFTA "jurisprudence" based only on one holding and several discussions that were peripheral to the tribunals' actual decisions. Nevertheless, the tribunals' initial forays into the issues portend interpretations of Article 1110 that may go beyond U.S. regulatory takings law in several important substantive and procedural respects. First, the awards suggest that a far broader definition of property may be used under NAFTA than under domestic regulatory takings doctrines. The awards also indicate that the actions of a country's judiciary may be considered regulatory takings, contrary to the U.S. rule that legal change resulting from the common law process does not give rise to a requirement of compensation. Finally, the awards demonstrate how NAFTA's dispute settle-

[137] See, e.g., Wälde & Dow, supra note 8, at 26-28 (discussing applicability of U.S. judicial practice to "regulatory taking" issue in international law).

[138] For detailed descriptions of the awards and pending claims, see Been, supra note 2, at 11,004-12; Mann, supra note 2, at 71-109; Beauvais, supra note 2, at 266-77. While four tribunals ruled on the merits of Article 1110 expropriation claims, the *Mondev* tribunal dismissed the expropriation claim as time-barred, reaching the merits of only the Article 1105 claim. See Mondev Int'l Ltd. v. United States, Award, ICSID Case No. ARB(AF)/99/2, paras. 60-62, 75 (Oct. 11, 2002), http://www.state.gov/documents/organization/14442.pdf.

[139] Metalclad Corp. v. United Mexican States, Award, ICSID Case No. ARB(AF)/97/1, para. 107 (Aug. 30, 2000).

ment mechanism provides procedural advantages over litigation under the Fifth Amendment.

The following Sections explore these differences between Article 1110 and U.S. takings jurisprudence. The differences are important not because U.S. takings jurisprudence is "right" or because U.S. law should be the metric against which multilateral agreements or international law are measured.[140] Instead, they are important because they refute the oft-heard claim that NAFTA simply adopted the U.S. Fifth Amendment.[141] In addition, the differences highlight the costs to the U.S. of entering into trade agreements that contain expansive definitions of regulatory takings.[142]

A. *Expanding the Scope of Regulatory Takings*

Both scholars and judges in the United States have bemoaned the difficulty of articulating the exact contours of U.S. regulatory takings law. Justice Stevens complained, for example, that "[e]ven the wisest lawyers would have to acknowledge great uncertainty about the scope of this Court's takings jurisprudence."[143] Before embarking upon a 166-page attempt to sort things out, one scholar despaired that "it is difficult to imagine a body of case law in greater doctrinal and conceptual disarray."[144] Accordingly, any comparison between U.S. regulatory takings law and the law of other jurisdictions or tribunals is somewhat hazardous.

Nevertheless, it is possible to articulate generally the way in which U.S. courts approach the Fifth Amendment's mandate, "nor shall private property be taken for public use, without just compensation."[145] There are two "per se" regulatory takings rules. First, a permanent physical invasion of (an entry upon) private property by the government, or someone authorized by the government, always will

[140] We take no position on how well U.S. takings jurisprudence promotes either fairness or efficiency. Nor do we take a position on what role U.S. law should play in the interpretation either of the bilateral or multilateral agreements in which the U.S. is a party or of customary international law.

[141] See, e.g., Schneiderman, supra note 16.

[142] See infra Part V.A.

[143] Nollan v. Cal. Coastal Comm'n, 483 U.S. 825, 866 (1987) (Stevens, J., dissenting).

[144] Andrea L. Peterson, The Takings Clause: In Search of Underlying Principles Part I—A Critique of Current Takings Clause Doctrine, 77 Cal. L. Rev. 1299, 1304 (1989) [hereinafter Peterson, Part I]; see also Andrea L. Peterson, The Takings Clause: In Search of Underlying Principles Part II—Takings as Intentional Deprivations of Property Without Moral Justification, 78 Cal. L. Rev. 53, 58 (1990) [hereinafter Peterson, Part II] ("[I]t is virtually impossible to predict how the Court will explain a takings decision. But despite this chaos, there seems to be a general pattern to the *results* reached by the Court in its takings decisions.").

[145] U.S. Const. amend. V.

require compensation, except perhaps in a public emergency such as a fire.[146] Second, where a regulation "deprives land of all economically beneficial use," compensation must be paid unless the regulation "inhere[s] in the title itself, in the restrictions that background principles of the State's law of property and nuisance already place upon land ownership."[147]

Outside those two situations—permanent physical occupation or a one hundred percent destruction of value—courts determine whether a regulation constitutes a taking by engaging in the "ad hoc, factual inquir[y]" first articulated in *Penn Central Transportation Co. v. New York City*.[148] Among the factors "that have particular significance" in that inquiry are "[t]he economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations," as well as "the character of the governmental action."[149] The inquiry into the economic impact of the regulation depends critically upon how the property is defined. If a developer has a parcel of land, for example, and environmental regulation requires that wetlands on one-tenth of the land be left undeveloped, the regulation will destroy one hundred percent of the value if the property is defined as the wetlands but only ten percent of the value if the property is instead defined as the entire parcel.[150] Whether the regulation interferes with "investment-backed expectations" depends, of course, on what counts as a reasonable expectation. U.S. takings law has not articulated clear answers to either of those issues nor to many of the myriad other problems that arise when judges try to draw the line between compensable takings and noncompensable regulation. At bottom, however, it is extremely difficult to prove a regulatory taking under U.S. takings jurisprudence: U.S. courts almost never find that a regulation has destroyed one hun-

146 See Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 426, 441 (1982).

147 Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1027, 1029 (1992).

148 438 U.S. 104, 124 (1978).

149 Id.

150 For representative discussions of the so-called "denominator" problem, see, for example, William W. Fisher III, The Trouble with *Lucas*, 45 Stan. L. Rev. 1393, 1402-05 (1993); John A. Humbach, "Taking" the Imperial Judiciary Seriously: Segmenting Property Interests and Judicial Revision of Legislative Judgments, 42 Cath. U. L. Rev. 771, 795-99 (1993); Gerald Torres, Taking and Giving: Police Power, Public Value, and Private Right, 26 Envtl. L. 1, 17-18 (1996). See generally Marc R. Lisker, Regulatory Takings and the Denominator Problem, 27 Rutgers L.J. 663 (1996); Daniel R. Mandelker, New Property Rights Under the Takings Clause, 81 Marq. L. Rev. 9 (1997).

dred percent of the value of the property,[151] and they seldom find that a regulation effects a taking under the *Penn Central* analysis.[152]

At the level of generality just used to describe U.S. takings law, *Metalclad*'s finding of a taking and the other tribunals' discussions of what might constitute an expropriation under Chapter 11 do not seem very different from U.S. law. *Metalclad*, for example, involved a hazardous waste facility that was prevented from operating because city officials refused to issue a building permit and because the province's governor declared the area a critical habitat for a rare cactus. *Metalclad* is therefore commonly cited as applying the U.S. courts' per se rule requiring compensation whenever a regulation destroys one

151 See Ronald H. Rosenberg, The Non-Impact of the United States Supreme Court Regulatory Takings Cases on the State Courts: Does the Supreme Court Really Matter?, 6 Fordham Envtl. L.J. 523, 544-46 (1995) (finding that, in few years after *Lucas* announced per se rule for one hundred percent destruction in value, only trivial number of decisions required compensation under that rule); Victoria Sutton, Constitutional Taking Doctrine—Did *Lucas* Really Make a Difference?, 18 Pace Envtl. L. Rev. 505, 514, 516-17 (2001) (arguing that while *Lucas* has been applied only to very narrow set of cases, it has had indirect impacts on takings law).

Indeed, even in *Lucas*, it is doubtful that the Supreme Court would have found that the coastal management act at issue destroyed one hundred percent of the value of the property if it had addressed that issue. Because of the procedural posture of the case, however, the Supreme Court assumed a total destruction of value. *Lucas*, 505 U.S. at 1020 n.9. But see id. at 1036 (Blackmun, J., dissenting) (criticizing majority for "[r]elying on an unreviewed (and implausible) state trial court finding that this restriction left Lucas' property valueless" and noting that "[a]lmost certainly" total destruction of value "did not happen in this case").

152 See Basil H. Mattingly, Forum over Substance: The Empty Ritual of Balancing in Regulatory Takings Jurisprudence, 36 Willamette L. Rev. 695, 699 (2000) (providing analysis of random sample of federal takings cases showing that "the property owner is unlikely to prevail under the [*Penn Central*] 'balancing' test. In short, the 'balancing' test appears to be nothing more than a strong presumption in favor of no compensation, regardless of the impact of the regulation"); R.S. Radford & J. David Breemer, Great Expectations: Will *Palazzolo v. Rhode Island* Clarify the Murky Doctrine of Investment-Backed Expectations in Regulatory Takings Law?, 9 N.Y.U. Envtl. L.J. 449, 495-96 (2001) (

> It is no easy feat for a takings claimant to satisfy the full *Penn Central* balancing test. The "character of the government action" inquiry has generally militated in favor of liability only when there has been a permanent physical invasion or occupation. Similarly, a compensable taking is only rarely found by consideration of the economic impact factor when less than all beneficial use of the property has been destroyed.).

Only in the Federal Circuit, the most pro-property bench in the nation, does the *Penn Central* test often have any bite. See Fla. Rock Indus. v. United States, 45 Fed. Cl. 21, 43-44 (1999) (holding that *Penn Central* taking occurred when Army Corps of Engineers denied dredge-and-fill permit, depriving plaintiff of 73.1% of property's value); Douglas T. Kendall & Charles P. Lord, The Takings Project: A Critical Analysis and Assessment of the Progress So Far, 25 B.C. Envtl. Aff. L. Rev. 509, 558-61 (1998) (discussing Federal Circuit's willingness to overcome jurisdictional impediments to hear takings cases); Courtney C. Tedrowe, Note, Conceptual Severance and Takings in the Federal Circuit, 85 Cornell L. Rev. 586, 602-25 (2000) (discussing Federal Circuit's perspective on takings law).

hundred percent of the value of the property.[153] However, once one looks hard at *Metalclad* and the other NAFTA awards, one sees many ways in which the tribunals' interpretations of Article 1110 thus far differ quite markedly from U.S. takings jurisprudence.

1. *Expanding the Definition of Property*

U.S. takings law is heavily oriented toward real property—land—and expectations of profit from the use of land. As noted previously, however, the definition of "investment" under NAFTA goes beyond real property,[154] and both the *Pope & Talbot* and the *S.D. Myers* awards elevate personal property rights to a far more protected status than U.S. courts would accord such interests.

a. Allowing Conceptual Severance

U.S. takings law is far from precise about what interests constitute "property" for the purposes of the Fifth Amendment's Takings Clause.[155] Because of its emphasis on land, U.S. takings law has tended to focus on either the "relevant parcel" issue mentioned previously[156]—what are the relevant boundaries of the land affected by the

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[153] The *Metalclad* award found a taking primarily because the arbitrators believed the property owner had reasonably relied upon the federal government's representations that it did not need a local building permit to build and operate a hazardous waste landfill, but then was stymied by the municipality's insistence that the landfill required a permit and its denial of that permit. That ground of the decision was inconsistent with the U.S. law of estoppel and vested rights, as discussed infra Part III.A.2.b. But the estoppel prong of the *Metalclad* decision was later overturned by the Supreme Court of British Columbia, which held that the *Metalclad* tribunal misstated the applicable law by importing a transparency requirement into Article 1105. The tribunal's mistake of law in turn "infected" its finding that Metalclad's property was expropriated, and the court set aside both findings as outside scope of submission to arbitration. See United Mexican States v. Metalclad Corp., 2001 BCSC 664, paras. 78-79, [2001] 89 B.C.L.R.3d 359, 381-82, available at http://www.worldbank.org/icsid/cases/metalclad_reasons_for_judgment.pdf. A second ground for the award, the tribunal's conclusion that the property also had been taken when the governor declared the area to be a habitat for an endangered cactus and thereby "barr[ed] forever the operation of the landfill," was allowed to stand. Id. paras. 83, 105, 89 B.C.L.R.3d at 383, 387-88. Because the award did not explore whether there were any other uses of the land or facility that the owners might have been allowed to pursue, it is hard to evaluate whether the habitat designation would be considered a one hundred percent diminution in value under *Lucas*. For a more extensive discussion of *Metalclad*, see Been, supra note 2, at 11,008-09; Lucien J. Dhooge, The North American Free Trade Agreement and the Environment: The Lessons of *Metalclad Corporation v. United Mexican States*, 10 Minn. J. Global Trade 209 (2001).

[154] See supra notes 44-49 and accompanying text.

[155] For discussion of the critical importance of defining property before determining what should constitute a regulatory taking, see Laura S. Underkuffler, On Property: An Essay, 100 Yale L.J. 127, 129 (1990); Laura S. Underkuffler-Freund, Takings and the Nature of Property, 9 Can. J.L. & Jurisprudence 161, 203-05 (1996).

[156] See supra note 150 and accompanying text.

regulation—or on whether the right affected by the challenged regulation is so essential to "ownership" that the abrogation of that particular right has the same effect as physical appropriation of the land. Although the U.S. Supreme Court has vacillated somewhat in its approach,[157] it recently firmly rejected[158] what is referred to as "conceptual severance"—the strategy of "'sever[ing]' from the whole bundle of rights just those strands that are interfered with by the regulation, and then hypothetically or conceptually constru[ing] those strands in the aggregate as a separate whole thing."[159]

The Supreme Court has been particularly skeptical of that strategy in the context of personal property.[160] In *Andrus v. Allard*, for example, the owner of Native American artifacts that contained eagle feathers challenged a prohibition on the sale of products containing feathers as a taking.[161] The Court rejected the claim, noting that the owners were allowed to do other things with the artifacts, such as exhibit them in a museum,[162] and "where an owner possesses a full 'bun-

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157 Compare Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 130 (1978) ("'Taking' jurisprudence does not divide a single parcel into discrete segments and attempt to determine whether rights in a particular segment have been entirely abrogated."), and Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 501 (1987) (rejecting argument that prohibition on mining of coal constituting separate "support" estate under Pennsylvania state law effected taking because, inter alia, support estate "is merely a part of the entire bundle of rights possessed by the owner of either the coal or the surface"), with Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1016 n.7 (1992) (referring to *Penn Central*'s view of relevant property as "extreme—and, we think, unsupportable").

158 Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 122 S. Ct. 1465, 1481 (2002) ("Justice Brennan's opinion for the Court in *Penn Central* did, however, make it clear that . . . we must focus on 'the parcel as a whole' . . . ." (quoting *Penn Central*, 428 U.S. at 130-31)).

159 Margaret Jane Radin, The Liberal Conception of Property: Cross Currents in the Jurisprudence of Takings, 88 Colum. L. Rev. 1667, 1676 (1988). For more academic commentaries on the problem of how to define the property interest, see Robert H. Freilich et al., Regulatory Takings: Factoring Partial Deprivations into the Taking Equation, in Takings: Land-Development Conditions and Regulatory Takings after *Dolan* and *Lucas* 165, 167-79 (David L. Callies ed., 1996) [hereinafter Callies, Takings]; Robert Meltz et al., The Takings Issue: Constitutional Limits on Land-Use Control and Environmental Regulation 144-54 (1999); Susan Rose-Ackerman, Against Ad Hocery: A Comment on Michelman, 88 Colum. L. Rev. 1697, 1705-06 (1988); see also supra note 150.

160 See *Lucas*, 505 U.S. at 1027-28 (

> [I]n the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, he ought to be aware of the possibility that new regulation might even render his property economically worthless (at least if the property's only economically productive use is sale or manufacture for sale).).

161 444 U.S. 51, 54-55 (1979).

162 Id. at 66; see also Conti v. United States, 291 F.3d 1334, 1344-45 (Fed. Cir. 2002) (rejecting takings claim where regulation prohibited drift gillnet swordfishing because plaintiff was not deprived of property in boat and fishing equipment, even if ban eliminated most profitable use of property or only use to which owner wishes to put property);

dle' of property rights, the destruction of one 'strand' of the bundle is not a taking, because the aggregate must be viewed in its entirety."[163] The Court also explained that "the interest in anticipated gains has traditionally been viewed as less compelling than other property-related interests."[164]

Two of the awards issued thus far under NAFTA's Chapter 11 take a very different approach. Both *Pope & Talbot* and *S.D. Myers* suggest that the right to sell one's product in a particular market may be considered property separate from the totality of the investor's business activities. *Pope & Talbot* involved a challenge to Canada's implementation of its 1996 Softwood Lumber Agreement (SLA) with the United States.[165] The SLA required Canada to limit the amount of softwood lumber exported from four of its provinces to the U.S. without import duties, and Canada did so by allocating the quota imposed by the SLA among the four provinces and, within provinces, among individual producers. Pope & Talbot is a U.S. corporation that wholly owns a subsidiary that in turn wholly owns a Canadian corporation manufacturing and selling softwood lumber from facilities in British Columbia. It complained about the share of the quota allocated to British Columbia and about its individual quota allocation,[166] claiming that Canada had expropriated its investment by depriving it of its "ordinary ability to alienate its product to its traditional and natural market" and by costing the company export fees that it otherwise would not have had to pay.[167] The arbitral tribunal agreed with Pope & Talbot that "access to the U.S. market"[168] is a "property inter-

United States v. Kornwolf, 276 F.3d 1014, 1016-17 (8th Cir. 2002) (applying *Allard* in holding that prohibition on sale of eagle feathers was not taking where owner acquired feathers before prohibition was enacted); Schreiner Farms, Inc. v. Smitch, 940 P.2d 274, 279-80 (Wash. Ct. App. 1997) (holding prohibition on sale, transfer, or release of elk was not taking).

163 *Allard*, 444 U.S. at 65-66; see also *Keystone Bituminous Coal*, 480 U.S. at 501 (determining that right to mine certain coal was not separate property interest). But see Hodel v. Irving, 481 U.S. 704, 717-18 (1987) (finding taking where legislation "completely abolished" rights of certain landowners to dispose of their property by descent or devise, even though landowners retained right to possess land and to make inter vivos transfers). Compare id. at 719 (Scalia, J., concurring) ("[*Hodel*] effectively limits *Allard* to its facts."), with id. at 718 (Brennan, J., concurring) (stating that *Hodel* was "unusual" and thus had no impact on *Allard*).

164 *Allard*, 444 U.S. at 66.

165 For a complete description of the *Pope & Talbot* claim and awards, see Been, supra note 2, at 11,005-06; Beauvais, supra note 2, at 269-72.

166 Pope & Talbot, Inc. v. Canada, Interim Award by Arbitral Tribunal, paras. 5-6 (June 26, 2000), http://www.dfait-maeci.gc.ca/tna-nac/documents/pubdoc7.pdf.

167 Id. para. 81.

168 Access to a particular market also was the "property" at issue in the *Methanex* claim. See Methanex Claim, supra note 5, at 69-70; Methanex Second Amended Claim, supra note 5, at 128-29.

est" subject to protection under NAFTA,[169] although it then went on to find that the interference with Pope & Talbot's property interest was not sufficiently substantial to constitute expropriation.[170]

In *S.D. Myers*,[171] a U.S. corporation owned a polychlorinated biphenyl (PCB)[172] remediation facility in Tallmadge, Ohio, about one hundred kilometers south of the U.S.-Canada border. In the early 1990s, S.D. Myers decided to try to exploit the Canadian market for PCB remediation, and the major shareholders of S.D. Myers accordingly incorporated a Canadian company.[173] Through that company, S.D. Myers began to market its services to Canadian PCB holders.[174] When Canada forbade the export of PCBs to the United States, S.D. Myers claimed that Canada had taken its investment, in violation of NAFTA's Chapter 11, by causing it to lose "contracts and opportunities in Canada"[175] and by "eliminating [its] competitive advantage."[176] Canada defended against the claim by arguing, among other things, that S.D. Myers had no investment or property in Canada.[177] The tribunal found, however, that the Canadian corporation owned by S.D. Myers's major shareholders met the definition of investment because it was an "enterprise."[178] The tribunal went on to find that the investment had not been expropriated because the export prohibition was only temporary, Canada realized no benefit from the measure, and the prohibition did not transfer the property directly to others.[179]

[169] *Pope & Talbot Award*, para. 96. The tribunal reasoned that "the true interests at stake are the Investment's asset base, the value of which is largely dependent on its export business." Id. para. 98.

[170] Id. para. 96. The tribunal specifically noted that the investor retained control over its business, continued to export substantial quantities of softwood, and continued to make substantial profits on those exports. Id. paras. 100-01.

[171] For a complete description of *S.D. Myers*, see Been, supra note 2, at 11,006-07; Beauvais, supra note 2, at 272-74; Hodges, supra note 56, at 370-83.

[172] Polychlorinated biphenyl (PCB), a chemical used primarily in electrical equipment, is highly toxic and biodegrades very slowly. S.D. Myers, Inc. v. Canada, Partial Award, para. 94 (Nov. 13, 2000), http://www.dfait-maeci.gc.ca/tna-nac/documents/myersvcanadapartialaward_final_13-11-00.pdf.

[173] Id. paras. 92, 111.

[174] Id. para. 117.

[175] Id. para. 290.

[176] Id. para. 284; see also id. para. 232 (discussing grounds that S.D. Myers might assert to establish standing for its claims, including claim that its market share constituted investment).

[177] Id. paras. 145, 226-27.

[178] Id. paras. 227-31; see also S.D. Myers, Inc. v. Canada, paras. 39-40 (Nov. 12, 2000) (separate opinion of Dr. Bryan Schwartz), http://www.dfait-maeci.gc.ca/tna-nac/documents/Swartz.pdf [hereinafter Separate Opinion of Dr. Bryan Schwartz] (agreeing with majority that Canadian corporation was enterprise but arguing that it should be considered investment of S.D. Myers because S.D. Myers had made loan to Canadian corporation).

[179] *S.D. Myers Award*, paras. 283-88.

Although neither the *Pope & Talbot* nor the *S.D. Myers* tribunals found that the claimant's property had been taken, both tribunals considered the opportunity to sell one's products in a particular market to be a property interest that could trigger the compensation requirement. Both awards, therefore, are inconsistent with U.S. takings jurisprudence and threaten to expand the reach of regulatory takings principles to a wide range of investor interests not protected under domestic law.

b. Considering Money as Property

In U.S. takings jurisprudence, recent cases have cast doubt on whether making a business enterprise liable for monetary payments ever can be considered a taking except in the special context of development exactions.[180] In *Eastern Enterprises v. Apfel*,[181] a former coal company challenged provisions of the Coal Industry Retiree Health Benefit Act of 1992[182] as both a taking and a due process violation.[183] The Act required Eastern to fund health care benefits retroactively for retired miners who had worked for the company prior to 1966.[184] In a plurality decision, Justices Stevens, Souter, Ginsburg, Breyer, and Kennedy held that the Takings Clause applies only to regulations that affect a specific and identified property or right, not to those that merely impose monetary liability upon a particular individual or enterprise.[185] The lower federal courts and the state courts generally

180 Monetary payments required as a condition for the approval of land development may constitute a taking. See Ehrlich v. City of Culver City, 911 P.2d 429, 443-50 (Cal. 1996) (exploring circumstances under which fees imposed as condition to development might constitute taking); cf. Dolan v. City of Tigard, 512 U.S. 374, 385, 391 (1994) (requiring landowner to dedicate land as condition of development permit would be taking unless there was both essential nexus and rough proportionality between legitimate state interest in regulating and permit condition being imposed); Nollan v. Cal. Coastal Comm'n, 483 U.S. 825, 837 (1987) (ruling that imposing public-access easement as condition of development permit constitutes taking unless permit condition serves same governmental purpose as development ban).

181 524 U.S. 498 (1998).

182 26 U.S.C. §§ 9701-9722 (2000).

183 *Eastern Enters.*, 524 U.S. at 503-04. The Due Process Clause of the U.S. Constitution prohibits the government from "depriv[ing] any person of . . . property, without due process of law." U.S. Const. amend. XIV, § 1.

184 *Eastern Enters.*, 524 U.S. at 517.

185 See id. at 541 (Kennedy, J., concurring in judgment); id. at 554 (Breyer, J., dissenting). The five Justices of the plurality disagreed, however, about whether the Act's imposition of monetary liability violated the Due Process Clause's proscription against the deprivation of property without due process of law. Compare id. at 547-50 (Kennedy, J., concurring in the judgment), with id. at 553 (Stevens, J., dissenting). For related statements by the Court, see United States v. Sperry Corp., 493 U.S. 52, 62 n.9 (1989) (rejecting challenge to requirement that beneficiaries of arbitral award from Iran-United States Claims Tribunal pay portion of award to U.S., reasoning in part that "[i]t is artificial to

have since adopted the stance that monetary liability is not actionable as a taking.[186]

This is in sharp contrast to the NAFTA tribunals' approach to expropriation claims based on monetary liability. Recall, first, that Pope & Talbot claimed a taking on the basis of the costs it would incur as a result of not being able to sell more lumber without paying duties.[187] In a pending arbitration, *Loewen Group v. United States*, a Canadian company claims that its American subsidiary suffered an expropriation when a Mississippi jury found the subsidiary liable for $400 million in punitive damages in a $5 million contractual dispute.[188] Loewen claims that the excessive award, combined with a Mississippi requirement that appellants post an appeal bond equal to 125% of the award and the court's refusal to exercise its discretion to reduce the bond, all forced the company to settle the dispute for $175 million, far more than the claim should have been worth.[189] The *Loewen* tribunal issued a jurisdictional award allowing the investor's expropriation claim to proceed on the basis of these alleged facts.[190] Although neither the *Pope & Talbot* award on the merits nor the *Loewen* jurisdictional award held that a taking had occurred, both seemed to assume that the claimant could challenge regulations or other actions resulting in an imposition of monetary liability as violations of NAFTA Article 1110. Thus, the tribunals again interpreted NAFTA to cover a range of compensable property interests broader than that protected by the Fifth Amendment.

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view deductions of a percentage of a monetary award as physical appropriations of property. Unlike real or personal property, money is fungible").

For commentary on *Eastern Enterprises*, see, for example, Thomas W. Merrill, The Landscape of Constitutional Property, 86 Va. L. Rev. 885, 900–07 (2000). See generally John Decker Bristow, Note, *Eastern Enterprises v. Apfel*: Is the Court One Step Closer to Unraveling the Takings and Due Process Clauses?, 77 N.C. L. Rev. 1525 (1999).

186 See, e.g., Commonwealth Edison Co. v. United States, 271 F.3d 1327, 1340 (Fed. Cir. 2001) (en banc) ("[T]he mere imposition of an obligation to pay money, as here, does not give rise to a claim under the Takings Clause of the Fifth Amendment."); Atlas Corp. v. United States, 895 F.2d 745, 756 (Fed. Cir. 1990) ("Requiring money to be spent is not a taking of property.").

187 See supra notes 165-170 and accompanying text.

188 Loewen Claim, supra note 5, paras. 3, 6-7. For a discussion of *Loewen*, see Been, supra note 2, at 11,011-12.

189 Loewen Claim, supra note 5, paras. 3, 5-7.

190 Loewen Group, Inc. v. United States, Decision on Hearing of Respondent's Objection to Competence and Jurisdiction, ICSID Case No. ARB(AF)/98/3, paras. 60, 74-76 (Jan. 5, 2001), http://www.state.gov/documents/organization/3921.pdf.

2. *Ignoring the Reasonableness of Claimed Expectations*

a. Expectations Within a Heavily Regulated Industry

One of the factors that *Penn Central* identified as having special importance in determining whether a regulation constitutes a taking is whether it interferes with "investment-backed expectations." The Supreme Court has since added the modifier "reasonable" to delineate which investment-backed expectations are protected by the Fifth Amendment.[191] The Court has explained that a "reasonable investment-backed expectation" must be more than a "unilateral expectation or an abstract need."[192] In addition, the Court has made clear that the expectations regarding use are likely to be more reasonable when the property at stake is land rather than personal property.[193]

Where a particular economic activity is already subject to heavy government regulation, the Court has held that it may be unreasonable for investors to expect that there will be no further changes in its regulation.[194] In *Concrete Pipe and Products, Inc. v. Construction*

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[191] See Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 122 S. Ct. 1465, 1475 (2002); Palazzolo v. Rhode Island, 533 U.S. 606, 617 (2001); Hodel v. Irving, 481 U.S. 704, 714 (1987); Kaiser Aetna v. United States, 444 U.S. 164, 175 (1979).

[192] Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1005 (1984) (quoting Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980)). At least in the case of real property, the Supreme Court also has made clear that the mere fact that a landowner invested in the property after receiving notice of the regulation the landowner later challenges is not an absolute bar to a takings claim. *Palazzolo*, 533 U.S. at 626-28. The Court did not resolve exactly what role such notice would play in a takings determination. Compare, e.g., id. at 632-36 (O'Connor, J., concurring), with id. at 636-37 (Scalia, J., concurring). Nor did it attempt to reconcile its statements that extensive regulation within an industry could render the expectations of an owner of personal property unreasonable with its view that regulation (and knowledge of that regulation) would not necessarily defeat the reasonableness of a real property owner's expectation to develop the land.

[193] In *Lucas v. South Carolina Coastal Council*, for example, the Court noted:

> [I]n the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, he ought to be aware of the possibility that new regulation might even render his property economically worthless (at least if the property's only economically productive use is sale or manufacture for sale). In the case of land, however, we think the notion pressed by the Council that title is somehow held subject to the "implied limitation" that the State may subsequently eliminate all economically valuable use is inconsistent with the historical compact recorded in the Takings Clause that has become part of our constitutional culture.

505 U.S. 1003, 1027-28 (1992) (citations omitted).

[194] The U.S. Supreme Court never has held that extensive government regulation necessarily precludes an investor from developing a reasonable investment-backed expectation, nor necessarily precludes a finding that additional regulation effects a taking of a property interest, and some lower federal courts have explicitly rejected such a "blanket no-takings rule with respect to regulated industries." Maritrans Inc. v. United States, 40 Fed. Cl. 790, 797 (1998). Instead, the Supreme Court, the lower federal courts, and the state courts generally have viewed the extent to which the industry is heavily regulated as one factor among others that may affect the reasonableness of the expectation the takings claimant

Laborers Pension Trust,[195] for example, the U.S. Supreme Court rejected a claim that the Multiemployer Pension Plan Amendments Act of 1980[196] effected a taking by requiring an employer withdrawing from a multiemployer plan to incur "withdrawal liability" and thereby allegedly forcing Concrete Pipe to pay out forty-six percent of its entire shareholder equity. The Court noted that at the time Concrete Pipe began participating in the pension plan, such plans "had long been subject to federal regulation, and '[t]hose who do business in the regulated field cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end.'"[197] In other words, Concrete Pipe should have expected further regulation of its pension plan.

The NAFTA tribunals, on the other hand, have shown little concern for the reasonableness of the expectations upon which investors have based their claims. In *S.D. Myers*, for example, the arbitral panel did not question whether S.D. Myers's expectation that Canada would allow the export of PCBs was reasonable.[198] The facts of the

asserts. See, e.g., Lindsey Coal Mining Co. v. Chater, 90 F.3d 688, 695 (3d Cir. 1996); Meriden Trust and Safe Deposit Co. v. F.D.I.C., 62 F.3d 449, 455 (2d Cir. 1995); Rick's Amusement, Inc. v. State, 570 S.E.2d 155, 158 (S.C. 2001).

[195] 508 U.S. 602 (1993).

[196] Pub. L. No. 96-364, 94 Stat. 1208 (1980) (codified at 29 U.S.C. §§ 1001 (2000). For the section addressing withdrawal liability, see id. tit. I, § 104(2), 94 Stat. at 1217 (codified at 29 U.S.C. § 1381 (2000)).

[197] *Concrete Pipe*, 508 U.S. at 645 (quoting FHA v. The Darlington, Inc., 358 U.S. 84, 91 (1958)); see also Wash. Legal Found. v. Legal Found. of Wash., 271 F.3d 835, 861 (9th Cir. 2001) (en banc) (rejecting takings challenge where lawyers where required to pay interest earned on escrowed client funds to nonprofit organization, noting that both banking and legal profession were highly regulated industries), cert. granted, 122 S. Ct. 2344 (June 10, 2002); Rith Energy, Inc. v. United States, 270 F.3d 1347, 1351 (Fed. Cir. 2001) ("A party in Rith's position necessarily understands that it can expect the regulatory regime to impose some restraints on its right to mine coal under a coal lease."); Good v. United States, 189 F.3d 1355, 1363 (Fed. Cir. 1999) ("In light of the growing consciousness of and sensitivity toward environmental issues, Appellant must also have been aware that standards could change to his detriment, and that regulatory approval could become harder to get."); Mitchell Arms, Inc. v. United States, 26 Cl. Ct. 1, 5 (1992) (rejecting claim that suspension of import permits constituted taking, noting that "government as we know it would soon cease to exist if such exclusively governmental functions as the control over foreign commerce could not be accomplished without the payment of compensation to those business interests that have chosen to operate within this highly regulated area"). But see Philip Morris, Inc. v. Reilly, 312 F.3d 24 (1st Cir. 2002) (en banc) (finding that requirement to disclose ingredients constituted taking of manufacturers' trade secrets, despite pervasive regulation of cigarettes), rev'g 267 F.3d 45 (1st Cir. 2001).

[198] The *S.D. Myers* tribunal refused to find that the border closing had expropriated property, reasoning that the border closing was temporary, and no property or benefit was transferred directly to Canada or to other individuals. S.D. Myers, Inc. v. Canada, Partial Award, paras. 284, 287-88 (Nov. 13, 2000), http://www.dfait-maeci.gc.ca/tna-nac/documents/myersvcanadapartialaward_final_13-11-00.pdf. If the factors listed were not present, the tribunal might have rejected the expropriation claim on other grounds. But on its face, the

dispute, however, ought to have given the panel pause. In 1980, the United States closed its borders to the import and export of PCBs, and in 1989, Canada and a number of other countries signed the Basel Convention, which significantly limited transnational movements of PCBs and other waste.[199] Between 1991 and 1993, S.D. Myers filed four separate petitions with the EPA seeking permission to import PCB wastes from Canada; the EPA denied each.[200] In the mid-1990s, the Commission on Environmental Cooperation (CEC), formed under the North American Agreement on Environmental Cooperation,[201] sponsored discussions among the NAFTA partners about whether to allow transboundary movement of PCB wastes.[202] Those discussions revealed considerable controversy over an open border policy.[203] It was only after an intense lobbying campaign that S.D. Myers finally convinced the EPA in 1995 to allow imports.[204] Even then, the EPA acted only through the somewhat unusual mechanism of an enforcement discretion letter.[205] The EPA regulations that implemented the enforcement discretion were immediately challenged by U.S. environmental groups and eventually were struck down by the Ninth Circuit.[206]

Given this long history of limitations imposed on transboundary shipments of waste and given the obvious precariousness of S.D. Myers's lobbying victory before the EPA, U.S. courts probably would not have found S.D. Myers's expectation that it would be allowed to import waste across the Canadian border reasonable. Rather, under U.S. takings jurisprudence, a court most likely would have found that S.D. Myers took a risk by investing in the transportation of waste from Canada and that it should not be allowed to shift its loss from that risk to the government.[207]

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tribunal's award failed to consider whether S.D. Myers's expectations were sufficiently reasonable to warrant protection as property.

199 *S.D. Myers Award*, paras. 101, 105-06.

200 Disposition of Pending Exemption Petitions, 59 Fed. Reg. 62,877, 62,877-80 (Dec. 6, 1994); Hodges, supra note 56, at 375-76.

201 See supra note 56.

202 Hodges, supra note 56, at 377.

203 See id.; Comm'n for Envtl. Cooperation, Status of PCB Management in North America 1-26 (1996), http://www.earthscape.org/p1/cec18/cec18.pdf.

204 Hodges, supra note 56, at 378.

205 Id.

206 See Sierra Club v. EPA, 118 F.3d 1324, 1327 (9th Cir. 1997) (striking regulations as violative of Toxic Substances Control Act).

207 Cf. Hodges, supra note 56, at 403 (

> By investing in projects known to be in violation of United States and Canadian law, S.D. Myers expressly bore the risk of this investment not coming to fruition. S.D. Myers continued to bear the risk of contractual failure after the issuance of EPA enforcement discretion letters because the letters informed

b. Ignoring the Reasonableness of Reliance Interests

Property owners' claims that they developed property (or took other actions affecting property rights) in reliance upon government representations that turned out to be erroneous generally are considered by U.S. courts under a subset of takings law referred to as the law of "vested rights" and "estoppel."[208] Under the vested rights doctrine, courts generally will allow a property owner to proceed with a development project, despite changes in the law that would otherwise preclude development, only if the owner has made substantial expenditures in good faith reliance upon the valid issuance of a building permit or other final discretionary approval for the project.[209] Under the estoppel doctrine, a majority of courts strictly limit the circumstances under which a property developer that relied upon an erroneously issued or otherwise invalid building permit may acquire vested rights.[210]

Metalclad likely would have been decided in the U.S. under those principles. In *Metalclad*, COTERIN, a Mexican corporation, was denied a municipal permit to construct a hazardous waste landfill on land that it owned near Guadalcazar, Mexico, in the state of San Luis Potosí (SLP).[211] COTERIN, however, did secure permits to build the

the company that the investment activities continued to be a violation of U.S. law.).

208 See, e.g., Dwight H. Merriam, Reengineering Regulation to Avoid Takings, 33 Urb. Law. 1, 2-13 (2001); Theodore C. Taub, Vested Rights and Equitable Estoppel, SF08 A.L.I.-A.B.A. 913, 915-17 (2000).

209 For a survey of these cases, see John J. Delaney & Emily J. Vaias, Recognizing Vested Development Rights as Protected Property in Fifth Amendment Due Process and Takings Claims, 49 Wash. U. J. Urb. & Contemp. L. 27 (1996).

210 See, e.g., Plymouth Foam Prods., Inc. v. City of Becker, 120 F.3d 153, 156 (8th Cir. 1997) ("There is a heavy burden to establish estoppel against a governmental entity; it requires proof that the entity acted wrongfully and that a serious injustice would result if it were not estopped."); Turco v. Town of Barnstead, 615 A.2d 1237, 1239 (N.H. 1992) (stating that to establish estoppel against municipal government, plaintiffs must show that (1) government officials misrepresented or concealed material facts, knowing of facts and intending that plaintiffs should act upon misrepresentation; (2) plaintiffs were ignorant of truth and acted upon misrepresentation to their prejudice; (3) reliance was reasonable; and (4) government official was authorized to make representation); Maguire Oil Co. v. City of Houston, 69 S.W.3d 350, 366 (Tex. Ct. App. 2002) (finding estoppel against government only where (1) landowner is relying on authorized act of city official or employee; (2) justice requires application of estoppel; and (3) application of estoppel would not interfere with exercise of city's governmental functions).

211 United Mexican States v. Metalclad Corp., 2001 BCSC 664, para. 6, [2001] 89 B.C.L.R.3d 359, 364, available at http://www.worldbank.org/icsid/cases/metalclad_reasons_for_judgment.pdf. The description in the text focuses on the portion of the *Metalclad* tribunal's award that addressed whether the local government's denial of a building permit constituted a taking. For a full description of the controversy and the tribunal's award, see Been, supra note 2, at 11,008-09; Beauvais, supra note 2, at 268-69.

landfill from the federal National Ecological Institute (INE).[212] Metalclad, a U.S. corporation, then contracted for a six-month option to buy COTERIN and its permits[213] on the condition that COTERIN obtain either a municipal building permit or a definitive judgment from the Mexican courts that a building permit was not necessary.[214]

SLP then issued a state land use permit for construction of the landfill. Metalclad met with federal officials and received assurances that all the permits necessary for the landfill had been issued and that the federal government would obtain support for the project from Guadalcazar and SLP.[215] Metalclad thereafter exercised its option to purchase COTERIN, the landfill site, and the state and federal permits.[216]

In October 1994, Guadalcazar issued a stop-work order because Metalclad had not obtained a municipal building permit for the construction.[217] Metalclad complained to federal officials, who again assured Metalclad that it had all the necessary permits to construct and operate the landfill and that the municipality had no basis for denying a construction permit.[218] The federal officials suggested that Metalclad nevertheless go through the motions of applying for the building permit in order to appease the municipality.[219] Metalclad did apply for the permit, then resumed construction and completed the landfill in March 1995.[220] The landfill's opening was impeded by protesters, and in December 1995, Guadalcazar denied Metalclad's application for the building permit on four grounds: (1) It had earlier denied COTERIN's applications for such permits; (2) Metalclad improperly began construction without a permit; (3) the municipality had environmental concerns about the landfill; and (4) Guadalcazar's residents opposed the grant of the permit.[221]

Metalclad filed a claim under NAFTA. The arbitral tribunal first found that Mexico's conduct violated Article 1105 of NAFTA, which the tribunal believed was intended to promote "transparency," or the idea "that all relevant legal requirements for the purpose of initiating,

212 Metalclad Corp. v. United Mexican States, Award, ICSID Case No. ARB(AF)/97/1, para. 29 (Aug. 30, 2000), 16 ICSID Rev.–Foreign Investment L.J. 168, 179 (2001), available at http://www.worldbank.org/icsid/cases/mm-award-e.pdf.

213 Id. para. 30.

214 *Metalclad*, 2001 BCSC 664, para. 8, [2001] 89 B.C.L.R.3d at 365.

215 *Metalclad*, ICSID Case No. ARB(AF)/97/1, paras. 31-34, 80.

216 Id. para. 35.

217 Id. para. 40.

218 Id. para. 41.

219 Id. paras. 41, 87-89.

220 Id. para. 45.

221 *Metalclad*, 2001 BCSC 664, para. 13, [2001] 89 B.C.L.R.3d at 365-66.

completing and successfully operating investments made, or intended to be made . . . should be capable of being readily known to all affected investors."[222] The tribunal reasoned that Metalclad was entitled to rely upon the representations of the federal government that no local construction permit was necessary and that the municipality would have no legal basis for denying the permit.

The tribunal further held that even if a municipal permit was required under Mexican law, the municipality only had authority over matters related to physical construction or defects in the site and thus had wrongly denied the permit.[223] The impropriety of the municipality's denial of the permit, coupled with Metalclad's reasonable reliance on the federal government's representations and the "absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit," amounted to a failure to "ensure a transparent and predictable framework" for investment in violation of Article 1105(1).[224]

The tribunal then reached Metalclad's expropriation claim and found that because the municipality acted outside its limited authority concerning physical construction defects by denying the construction permit in part for environmental reasons, and because Metalclad reasonably relied on the representations of the Mexican federal government, Mexico "must be held to have taken a measure tantamount to expropriation."[225] The tribunal found alternatively[226] that an ecological decree issued by the Governor of SLP effected a taking of Metalclad's property.[227]

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222 *Metalclad*, ICSID Case No. ARB(AF)/97/1, para. 76.

223 Id. para. 86.

224 Id. paras. 88-101.

225 Id. paras. 104, 107.

226 Id. paras. 109, 111. As noted previously, the tribunal did not address whether the ecological decree destroyed all value of the property, or whether the restriction on the destruction of endangered species was an inherent limitation on title. It is thus difficult to discern whether the tribunal's ruling on the ecological decree was consistent with the "one-hundred-percent diminution in value" per se rule of U.S. takings jurisprudence.

227 Mexico challenged the award in the Supreme Court of British Columbia, which overturned the tribunal's decision regarding the denial of the building permit but allowed the finding regarding the ecological decree to stand. United Mexican States v. Metalclad Corp., 2001 BCSC 664, paras. 70-105, [2001] 89 B.C.L.R.3d 359, 380-88, available at http://www.worldbank.org/icsid/cases/metalclad_reasons_for_judgment.pdf. The court first set aside the tribunal's rulings as to Article 1105 because the tribunal had "misstated the applicable law" to import a transparency obligation into Article 1105. Id. para. 70, [2001] 89 B.C.L.R.3d at 380. Because the tribunal's finding that the denial of the building permit had indirectly expropriated Metalclad's property was "infected" by its erroneous view that Article 1105 included a transparency requirement, that finding also had to be set aside as

Courts in the United States probably would have rejected such a vested rights or estoppel claim. First, to the extent the tribunal's judgment was based upon the fact that the investor had made substantial expenditures that were rendered less valuable (or perhaps valueless) by the denial of the building permit, U.S. courts have rejected similar takings claims by developers that built without first securing a building permit (or other final discretionary permit), even when the developer had invested very considerable sums in the construction. In *Allied-General Nuclear Services v. United States*, for example, Allied-General invested $200 million in building a plant to recycle spent fuel from nuclear power plants.[228] Although the Nuclear Regulatory Commission initially had "induced" Allied-General to undertake the project by donating the land on which the plant was built and by providing various forms of technical assistance, the federal government eventually declined to issue the final permit necessary for the operation of the facility because President Carter imposed a moratorium on the commercial recycling of spent fuel.[229] The Court of Appeals for the Federal Circuit rejected the argument that the developer's reliance upon the government's inducements made the denial of the permit a taking, noting "[w]hile the record is replete with government 'inducement,' we note an entire absence of any evidence that the government in any manner, express or implied, contracted to share whatever risks there might be in the venture, to warrant that it would succeed, or otherwise shield it against vicissitudes."[230] Further, the court found that the importance of the government's interest in preventing the proliferation of nuclear weapons,[231] along with Allied-General's ac-

beyond the scope of the submission to arbitration. Id. paras. 78-79, [2001] 89 B.C.L.R.3d at 381-82.

228 839 F.2d 1572, 1572-73 (Fed. Cir. 1988).

229 Id. at 1573-74.

230 Id.

231 *Allied-General* was decided prior to the U.S. Supreme Court's holding in *Lucas*, discussed supra note 147 and accompanying text. Even assuming that one hundred percent of the value of Allied's investment was destroyed, however, it is unlikely that the result would be different under *Lucas*. The per se rule of *Lucas* applies only if the challenged regulation did not "inhere in the title itself." Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1029 (1992). The example the *Lucas* Court gave of such an inherent limitation—a nuclear power plant shut down upon the discovery that it sat on an earthquake fault line, id. at 1029-30—is analogous to the situation in *Allied-General*.

In general, because the "property" at issue in most vested-rights claims involves investments already made to develop the property (which are likely to be useless if the development is not allowed to proceed), it is unclear how vested-rights claims will be affected by the *Lucas* "total take" rule. In *Metalclad*, the property held to have been taken appears to have been the waste facility, and the tribunal did not decide whether other uses remained for either the land or the facility. Accordingly, it is unclear whether the *Lucas* rule would apply even if it is held to override the law of vested rights.

ceptance of the regulatory scheme and the risks that it entailed, meant that no compensation was required for the denial of the permit.[232]

In *Allied-General*, an exceptionally strong public interest—national security—was at stake, and arguably that interest is more serious than the concerns about the safety of the hazardous waste involved in *Metalclad*.[233] U.S. courts, however, have refused to find vested rights for construction expenditures made prior to the issuance of a valid building permit in a wide range of circumstances, not just when national security was involved. In *Avco Community Developers, Inc. v. South Coast Regional Commission*,[234] for example, Avco owned thousands of acres of land which it intended to develop as a planned community development. The government zoned the tract to allow the development and issued rough grading permits to the developer.[235] Avco spent millions of dollars to build the infrastructure for the planned community, but before it secured building permits for the project, the California legislature passed a law requiring any person wishing to develop within the coastal zone to secure permission from the coastal commission.[236] Avco objected to the new requirement, claiming it had a vested right to construct the planned community without a permit from the commission.[237] The *Avco* court rejected the claim, however, concluding that because the developer had not yet acquired the final discretionary permit necessary to complete the development, it had no vested right to proceed without first obtaining permission from the coastal commission.[238]

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232 Id. at 1576-77; see also, e.g., Mitchell Arms, Inc. v. United States, 7 F.3d 212, 217 (Fed. Cir. 1993) (holding that firearms importer that entered into contract with Yugoslavia to buy firearms and obtained permits to import firearms from Bureau of Alcohol, Tobacco, and Firearms (ATF), as well as assurances from ATF that he could rely upon those permits, nevertheless had no property interest that would trigger Fifth Amendment's compensation requirement when ATF banned importation of assault rifles and refused entry to Mitchell's shipment).

233 See, e.g., Maritrans Inc. v. United States, 40 Fed. Cl. 790, 795-96 (1998) (distinguishing *Allied-General* because of "the novelty of nuclear fission" and "fearsome effect of its use in war").

234 553 P.2d 546 (Cal. 1976).

235 Id. at 549.

236 Id. at 548-49.

237 Id. at 549.

238 Id. at 554; see also, e.g., Browning-Ferris Indus. v. Guilford County Bd. of Adjustment, 484 S.E.2d 411, 415 (N.C. Ct. App. 1997) (holding that municipal ordinance did not give rise to vested right to construct waste transfer station where discretionary building permit was required and not obtained). See generally John J. Delaney, Vested Rights and the Development Chronology 2000 Update, SF08 A.L.I.-A.B.A. 379, 418 (2000) (

> Case law is not consistent, although it seems clear that in pre-building permit situations, the developer loses more often than not. Exceptions may be found where estoppel situations exist, where the government's motives are not the

As in *Avco*, the majority of U.S. courts do not recognize vested rights, even if some of the necessary permits have been issued, until all discretionary permits required have been granted.[239] Under U.S. jurisprudence, therefore, the fact that the federal and state permits had been issued in *Metalclad* would not have entitled the property owner to vested rights until the final discretionary building permit was issued. In the U.S. cases just discussed, there was no dispute about the need for the final discretionary permit, while part of the controversy in *Metalclad* involved whether the municipality had the right to insist upon a building permit.[240] The *Metalclad* tribunal did not resolve the issue, except to note that even if the building permit was required, it could be denied only for reasons relating to construction considerations, not for the environmental reasons upon which the municipality had relied.[241] In the U.S., however, if the legality of a development is contested, as it surely was in *Metalclad*, the developer proceeds at its own risk in building until the issue has been resolved. Accordingly, when a developer constructs a project knowing that the legality of its zoning changes, variances, or permits is being challenged in litigation, the developer does not acquire vested rights to continue a project found to be illegal based on the expenditures made while the litigation is pending.[242] Indeed, a developer in Florida recently was required to demolish homes that the developer had built despite pending litigation over the validity of the local government's approval of the project.[243] Metalclad was well aware of the controversy over whether a

purest, or where it is not evident that any serious injury to the public interest will occur by allowing the project to proceed.).

239 See generally Thomas G. Pelham et al., "What Do You Mean I Can't Build!?" A Comparative Analysis of When Property Rights Vest, 31 Urb. Law. 901 (1999) (comparing several states' law on different stages of construction at which states recognize vested rights).

240 Metalclad Corp. v. United Mexican States, Award, ICSID Case No. ARB(AF)/97/1, paras. 79-87 (Aug. 30, 2000), 16 ICSID Rev.–Foreign Investment L.J. 168, 190-92 (2001), available at http://www.worldbank.org/icsid/cases/mm-award-e.pdf.

241 Id. paras. 86, 92-93.

242 Delaney, supra note 238, at 412 ("Generally, one who proceeds with construction in the face of a court challenge to his permit is deemed to have proceeded at his own risk and will not be accorded vested rights in the event of a subsequent court reversal.").

243 Razing of Apartments Makes History in Florida, St. Petersburg Times, Sept. 7, 2002, at 5B; see also Pinecrest Lakes, Inc. v. Shidel, 795 So. 2d 191, 209 (Fla. Dist. Ct. App. 2001) (holding that demolition of apartment buildings built despite litigation was appropriate remedy where development was held to be in violation of comprehensive plan); Lake Bluff Hous. Partners v. City of South Milwaukee, 632 N.W.2d 485, 488 (Wis. Ct. App. 2001) (affirming order that developer raze two apartment buildings that developer had constructed while litigation was pending over his right to build, noting that "those who build in violation of lawful zoning regulations have no refuge from the requirements of [the law] merely because construction is completed before lawfulness of the regulations is determined").

building permit was required for the project, as evidenced by the fact that it made its agreement with COTERIN contingent upon its obtaining a building permit or a judicial decision that no permit was necessary.[244] Under U.S. jurisprudence, therefore, Metalclad would acquire no vested right to a facility it built before the controversy over the need for a building permit was resolved.

Second, U.S. courts strictly constrain a landowner's ability to claim estoppel. In U.S. courts, therefore, Metalclad's reliance upon the assurances of the federal government that no building permit was required,[245] or that the local government would have no grounds for denying such a permit, would not likely give rise to estoppel against the government. In *Parkview Associates v. City of New York*,[246] for example, New York's highest court refused to estop the government from forcing a property owner to remove twelve stories from an already constructed high-rise building that exceeded the applicable height limits, even though the developer had relied upon an erroneously issued building permit.[247]

In sum, U.S. courts are wary of claims that property has been taken if the property at issue was developed either without the required approvals or in reliance upon erroneous approvals by government agencies. The *Metalclad* tribunal, however, gave considerably less scrutiny to the reasonableness of Metalclad's decision to build in the face of considerable controversy and in the absence of the very building permit upon which it originally had conditioned its option to buy the property.

244 United Mexican States v. Metalclad Corp., 2001 BCSC 664, para. 8, [2001] 89 B.C.L.R.3d 359, 365, available at http://www.worldbank.org/icsid/cases/metalclad_reasons_for_judgment.pdf.

245 *Metalclad*, ICSID Case No. ARB(AF)/97/1, paras. 79-87.

246 519 N.E.2d 1372, 1372 (N.Y. 1988).

247 See Delaney, supra note 238, at 409, 411 (

> Generally, the holder of a building permit which is unlawfully or mistakenly issued obtains no vested right in same, even where construction has occurred. . . . A minority of courts recognize vested rights in unlawfully/mistakenly issued permits where there is evidence of good faith and due diligence coupled with substantial expenditures by the permittee.);

see also Waste Recovery Enter. v. Town of Unadilla, 742 N.Y.S.2d 715, 717 (N.Y. App. Div. 2002) (holding city was not estopped from enjoining operation of waste facility even though town officials, erroneously believing that state agency was responsible for permitting construction, told developer that town had no role in permitting despite fact that town ordinances prohibited facility); Merriam, supra note 208, at 11-12 ("If a municipality issues a building permit or approves construction of a project in error, courts generally allow the government to revoke the permit. There is no taking, no vested right, and the government is not estopped.").

B. *Expanding the Reach of the Compensation Requirement to the Judiciary*

NAFTA's compensation requirement differs from U.S. jurisprudence not only in the range of property interests it protects but also in the types of government action to which it applies. U.S. courts have never embraced the argument that a judicial decision can constitute a taking.[248] The U.S. Supreme Court repeatedly has reminded litigants challenging a change in common law that "[t]here is no constitutional right to have all general propositions of law once adopted remain unchanged."[249] Some litigants saw hope for a judicial takings theory when Justice Stewart, in a concurring opinion in *Hughes v. Washington*,[250] argued that if a state judicial decision unforeseeably changes the state's property law, "the Due Process Clause of the Fourteenth Amendment forbids such confiscation by a State, no less through its courts than through its legislature."[251] But the Supreme Court has declined to revisit the issue,[252] and all but one of the state

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248 For the best explorations of the notion that judicial actions should be considered takings, see generally Paul B. Stephan, Redistributive Litigation—Judicial Innovation, Private Expectations, and the Shadow of International Law, 88 Va. L. Rev. 789 (2002); Barton H. Thompson, Jr., Judicial Takings, 76 Va. L. Rev. 1449 (1990). See also David J. Bederman, The Curious Resurrection of Custom: Beach Access and Judicial Takings, 96 Colum. L. Rev. 1375, 1434-46 (1996) (examining judicial takings claims for public recreational easements on beaches).

249 Patterson v. Colorado, 205 U.S. 454, 461 (1907) ("[I]n general the decision of a court upon a question of law, however wrong and however contrary to previous decisions, is not an infraction of the Fourteenth Amendment merely because it is wrong or because earlier decisions are reversed."); see also Brinkerhoff-Faris Trust & Sav. Co. v. Hill, 281 U.S. 673, 680 (1930) ("[T]he mere fact that a state court has rendered an erroneous decision on a question of state law, or has overruled principles or doctrines established by previous decisions on which a party relied, does not give rise to a claim under the Fourteenth Amendment . . . ."); Tidal Oil Co. v. Flanagan, 263 U.S. 444, 450 (1924) ("[T]he mere fact that the state court reversed a former decision to the prejudice of one party does not take away his property without due process of law."); O'Neil v. N. Colo. Irrigation Co., 242 U.S. 20, 26-27 (1916) (rejecting suggestion that "the cases cited established a rule of property and that any departure from it violated the plaintiff's rights under the Fourteenth Amendment"); Chi. & Alton R.R. Co. v. Tranbarger, 238 U.S. 67, 76 (1915) ("[N]o person has a vested right in any general rule of law or policy of legislation entitling him to insist that it shall remain unchanged for his benefit . . . .").

250 389 U.S. 290 (1967).

251 Id. at 298 (Stewart, J., concurring). In *Hughes*, the Washington Supreme Court had held that state law governed quiet-title action and interpreted a state constitutional amendment to mean that all accretion to the plaintiff's waterfront land belonged to the state. Id. at 291. The United States Supreme Court reversed, holding that federal law controlled because of the national interest in water boundaries. Id. Justice Stewart asserted that the Washington Supreme Court's ruling had effected a taking "to the extent that it constitutes a sudden change in state law, unpredictable in terms of the relevant precedents." Id. at 296.

252 See, e.g., Stevens v. City of Cannon Beach, 510 U.S. 1207 (1994) (Scalia, J., dissenting from denial of certiorari) (arguing that Court should review problems stemming from

and lower federal courts confronted with the issue have declined to find a judicial taking.[253]

state court decision that allegedly changed rules of Oregon property law by adopting English doctrine of custom); id. at 1211-12 (citing *Hughes* concurrence and asserting that "[n]o more by judicial decree than by legislative fiat may a State transform private property into public property without compensation"); see also Ariyoshi v. Robinson, 477 U.S. 902, 902 (1986) (vacating and remanding Ninth Circuit's decision that Hawaii Supreme Court took property when it overruled longstanding prior case law and adopted riparian rights doctrine of English common law); Douglas W. Kmiec, 2 Zoning & Planning Deskbook § 7:21 & n.41 (2d ed. 2002) (noting Supreme Court's unwillingness to revisit issue of judicial takings); Thompson, supra note 248, at 1469 & n.84 (providing numerous cases in which plaintiffs unsuccessfully claimed judicial takings based on Justice Stewart's opinion in *Hughes*).

The Supreme Court alluded to the judicial takings issue in an opinion in Bonelli Cattle Co. v. Arizona, 414 U.S. 313 (1973), which involved a dispute over ownership of land that had reemerged from the river. The state court, applying state law, found that the land belonged to the state. Id. at 316-17. The Supreme Court reversed, holding that the dispute was governed by federal law and that title belonged to the owner of the land adjoining the river. Id. at 317. At the end of its opinion, the Court remarked that "recognition of the State's claim to the subject land would raise a serious constitutional issue as to whether the State's assertion of title is a taking without compensation." Id. at 331. When the Supreme Court reversed *Bonelli* a few years later in Oregon v. Corvallis Sand & Gravel Co., 429 U.S. 363 (1977), it apparently forgot its concern about a judicial taking. Id. at 382.

[253] See, e.g., SEC v. Credit Bancorp, Ltd., 290 F.3d 80, 91 (2d Cir. 2002) (denying claim that court had effected taking by ordering pro rata distribution of certain funds among fraud victims); Johnson v. United States, 49 Fed. Cl. 648, 655-56 (2001) (finding takings clause not implicated by district court's action in ordering compliance with consent decree); see also Kesselring v. F/T Arctic Hero, 30 F.3d 1123, 1126 (9th Cir. 1994) (holding that judicial enforcement of liens could not be taking); Elks Nat'l Found. v. Weber, 942 F.2d 1480, 1485 (9th Cir. 1991) (deciding that claimants should not be allowed to claim in federal court that state court decision constituted taking); Corp. of Presiding Bishop of Church of Jesus Christ of Latter-Day Saints v. Hodel, 830 F.2d 374, 381 (D.C. Cir. 1987) (rejecting claim that court took property when it resolved title dispute adversely to plaintiff); Reynolds v. Georgia, 640 F.2d 702, 703 (5th Cir. 1981) (affirming dismissal on jurisdictional grounds of claim that decision of Georgia Supreme Court effected taking of property because federal courts are not "designed to serve as additional appellate reviewers of State Court judgments"); Public Access Shoreline Haw. v. Hawai'i County Planning Comm'n, 903 P.2d 1246, 1272 (Haw. 1995) (questioning whether judicial takings theory has any validity but rejecting takings claim on ground that even assuming theory is viable, it would be limited to instances in which judicial decision involved retroactive alteration of property rights); Ryan v. Tanabe Corp., 37 P.3d 554, 564 (Haw. Ct. App. 1999) (remarking that plaintiff's claim "defie[d] common sense" in arguing that trial court decision to modify its earlier ruling constituted taking).

The one case holding that a judicial decision that overturned prior case law could be considered a taking, Robinson v. Ariyoshi, 753 F.2d 1468, 1474 (9th Cir. 1985), was subsequently vacated by the Supreme Court on other grounds, 477 U.S. 902, 902 (1986), and eventually dismissed as unripe, 887 F.2d 215, 219 (9th Cir. 1989), and is therefore of questionable precedential value. Cf. Ultimate Sportsbar, Inc. v. United States, 48 Fed. Cl. 540, 550 (2001) (stating in dicta that "judicial taking occurs where a court's decision that does not even 'arguably conform[ ] to reasonable expectations' in terms of relevant law of property rights effects a 'retroactive transformation of private into public property'") (quoting Justice Stewart's concurrence in *Hughes*, 389 U.S. at 296, 298); Forest Pres. Dist. v. W. Suburban Bank, 621 N.E.2d 215, 218 (Ill. App. Ct. 1993) (calling judge's entry of preliminary injunction forbidding landowner from converting farmland to parking lot "taking" in

By contrast, two NAFTA awards suggest that even the judiciary in signatory states can be found to have expropriated property under Article 1110.[254] In *Azinian v. Mexico*, a Mexican corporation whose shareholders were Americans challenged the decision of the City of Naucalpan to cancel the corporation's contract for the collection and treatment of the city's solid waste even though that decision had been upheld by Mexico's national courts.[255] The tribunal found no expropriation, but dicta in the award nevertheless raises the troubling prospect that NAFTA's expropriation provisions could reach the decisions of national courts. The award emphasizes that Chapter 11 does not give NAFTA tribunals appellate jurisdiction over national court decisions.[256] But it suggests that NAFTA tribunals can question whether a national court's decision effected "a denial of justice, or a pretence of

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context of opinion reversing grant of preliminary injunction as beyond judge's authority because it allowed condemnor to circumvent state's inverse condemnation procedures).

254 See Azinian v. United Mexican States, Award, ICSID Case No. ARB(AF)/97/2, paras. 99-100 (Nov. 1, 1999), http://www.worldbank.org/icsid/cases/robert_award.pdf; Loewen Group, Inc. v. United States, Decision on Hearing of Respondent's Objection to Competence and Jurisdiction, ICSID Case No. ARB(AF)/98/3, para. 52 (Jan. 5, 2001), http://www.state.gov/documents/organization/3921.pdf.

Several other pending claims also allege that judicial actions constitute expropriations. The claimants in *Adams v. United Mexican States* are U.S. citizens who purchased lots and built vacation homes in a resort they believed belonged to the Mexican government. Mexican courts later determined the lots had been unlawfully expropriated and accordingly ordered them returned to their original owners. The American investors claim that the judicial decrees ordering that the land and improvements be returned to the original landowners expropriated their property in violation of Article 1110. Notice of Arbitration, Adams v. United Mexican States, at 17-18 (Feb. 16, 2001), http://www.international-economic-law.org/Mexicans/Adams%20et%20al%20and%20Mexico%20%20-%20Notice%20of%20Arbitration.PDF. Similarly, the claimant in *Calmark Commercial Development v. United Mexican States* asserts that judicial actions expropriated property in violation of Article 1110. Notice of Intent to Commence Arbitration Pursuant to Chapter XI of the North American Free Trade Agreement, Calmark Commercial Dev., Inc. v. United Mexican States, paras. 71-72 (Jan. 11, 2002), http://www.international-economic-law.org/Mexicans/Calmark_Redacted_NOI.pdf. The claimant in *Mondev International v. United States* contended that rulings by Massachusetts courts in a dispute arising out of Mondev's attempt to exercise an alleged option to purchase certain property effected an expropriation. Notice of Arbitration, Mondev Int'l Ltd. v. United States, paras. 127-33 (Sept. 1, 1999), http://www.state.gov/documents/organization/3931.pdf. The *Mondev* tribunal ultimately dismissed the Article 1110 claim as time-barred. Mondev Int'l Ltd. v. United States, Award, ICSID Case No. ARB(AF)/99/2, paras. 61-62, 70-73 (Oct. 11, 2002), http://www.state.gov/documents/organization/14442.pdf. The tribunal found that the alleged expropriatory acts would have to have been completed no later than 1991, prior to the commencement of the judicial action in questions and prior to NAFTA's entry into force. Id. paras. 61, 73. There was, according to the tribunal, "no continuing wrongful act in breach (or potentially in breach) of Article 1110 at the date NAFTA entered into force." Id. para. 73.

255 *Azinian*, ICSID Case No. ARB(AF)/97/2, paras. 1, 28.

256 Id. paras. 97-99.

form to achieve an internationally unlawful end."[257] The *Azinian* tribunal opined that a national court decision can deny justice "if the relevant courts refuse to entertain a suit, if they subject it to undue delay, [ ] if they administer justice in a seriously inadequate way"[258] or if there is a "clear and malicious misapplication of the law."[259] The *Azinian* tribunal did not define a "pretence of form" but did say that unless the claimants could show that the national court's finding "was so insubstantial, or so bereft of a basis in law, that the judgments were in effect arbitrary or malicious," they could not prevail.[260]

As mentioned above, the claimant in the pending *Loewen* arbitration alleges that a Mississippi jury's $400 million punitive damages verdict, a Mississippi law requiring an appellant to post bond for 125% of the verdict, and the state court's refusal to use its discretion to waive the bond requirement, all combined to force the claimant to settle for $175 million.[261] Loewen claims that this "coerced" settlement constituted an expropriation under NAFTA's Article 1110. The United States objected to the panel's jurisdiction on the ground that a judicial decision cannot be a "measure" under NAFTA and therefore cannot violate Chapter 11.[262] The tribunal, relying in part upon the dicta in *Azinian*, rejected the argument, finding that judicial actions can constitute measures of expropriation under Chapter 11.[263]

The implication of the dicta in the *Azinian* award on the merits and the *Loewen* jurisdictional award, that judicial decisions can be actionable as expropriations, is a significant departure from U.S. takings law. Even the few judges in the United States who have expressed sympathy for a judicial takings theory would apply it only when the judge's decision has overruled longstanding property law.[264] On the other hand, the *Azinian* award and the claims in *Loewen* and other pending actions, involve alleged misapplications of existing law or errors in the exercise of a court's discretion, not retroactive changes in the law.[265] None of the judicial actions at issue in those NAFTA

[257] Id. para. 99.
[258] Id. para. 102.
[259] Id. para. 103.
[260] Id. para. 105.
[261] See supra notes 188-90 and accompanying text.
[262] Loewen Group, Inc. v. United States, Decision on Hearing of Respondent's Objection to Competence and Jurisdiction, ICSID Case No. ARB(AF)/98/3, para. 32 (Jan. 5, 2001), http://www.state.gov/documents/organization/3921.pdf. Daniel M. Price has argued that this is an unwise position for the United States, as "[i]t is the peripatetic U.S. investors who are most at risk around the world from arbitrary exercises of judicial authority." Price, supra note 7, at 8.
[263] *Loewen*, ICSID Case No. ARB(AF)/98/3, para. 49.
[264] See supra notes 252-23 and accompanying text.
[265] See supra note 254 for descriptions of the pending claims.

claims would be considered takings even under the most expansive judicial takings theory, in large part because if claimants contesting a state court's interpretation of state law "were entitled to pursue their claim in federal court, every disappointed litigant in a property dispute would contend in federal court that the state court decision constituted a taking without due process."[266] Unless the implication of *Azinian* and *Loewen* that judicial decisions can be considered expropriations under NAFTA is soundly rejected in the near future, NAFTA will become a powerful tool for property owners who have lost disputes over property rights in domestic courts.

C. *Providing a Less Procedurally Demanding Forum for Regulatory Takings Challenges*

Even if Article 1110 were interpreted to go no further substantively than the current U.S. regulatory takings doctrine, three procedural aspects of Article 1110 still would allow NAFTA to be used to expand significantly the number of regulatory takings claims filed to challenge environmental and land use regulations.

First, Article 1110 allows property owners who can claim foreign-investor status to bypass domestic courts and the exhaustion requirements those courts have placed in the way of takings claims. The U.S. Supreme Court has held that a property owner has no federal constitutional takings claim unless and until the owner has pursued unsuccessfully the administrative or judicial procedures the federal or state government has provided for seeking compensation.[267] The Court explained:

> The Fifth Amendment does not proscribe the taking of property; it proscribes taking without just compensation. Nor does the Fifth Amendment require that just compensation be paid in advance of, or contemporaneously with, the taking; all that is required is that a "reasonable, certain and adequate provision for obtaining compensation" exist at the time of the taking. . . . [I]f a State provides an adequate procedure for seeking just compensation, the property owner cannot claim a violation of the Just Compensation Clause until it has used the procedure and been denied just compensation.[268]

[266] Elks Nat'l Found. v. Weber, 942 F.2d 1480, 1485 (9th Cir. 1991).

[267] Williamson County Reg'l Planning Comm'n v. Hamilton Bank, 473 U.S. 172, 194-95 (1985).

[268] Id. (citations omitted). There is controversy over whether *Williamson County*'s exhaustion-of-state-remedies requirement is an element of the Fifth Amendment or is merely a prudential limitation upon the Court's jurisdiction. For overviews of that controversy, see generally Vicki Been, The Finality Requirement in Takings Litigation After *Palazzolo*, in Taking Sides on Takings Issues 485 (Thomas E. Roberts ed., 2002); Max Kidalov &

In contrast, both the *Azinian* and *Metalclad* awards indicate that an investor is not required to exhaust national remedies before filing an Article 1110 claim.[269] Indeed, Article 1121(1)(b) requires NAFTA claimants to waive their right to initiate or continue dispute settlement procedures other than the NAFTA ISDM, except for actions not involving the payment of damages.[270] NAFTA accordingly allows an investor to eschew the administrative or judicial remedial compensation procedures of the nation accused of expropriation and resort immediately to NAFTA tribunals.[271] Because many property owners find the exhaustion of state remedies requirements in U.S. takings jurisprudence onerous,[272] NAFTA tribunals are likely to become the fo-

Richard H. Seamon, The Missing Pieces of the Debate over Federal Property Rights Legislation, 27 Hastings Const. L.Q. 1 (1999); Thomas E. Roberts, Procedural Implications of *Williamson County/First English* in Regulatory Takings Litigation: Reservations, Removal, Diversity, Supplemental Jurisdiction, *Rooker-Feldman*, and Res Judicata, 31 Envtl. L. Rep. 10,353 (2001); Thomas E. Roberts, Ripeness and Forum Selection in Land-Use Litigation, in Callies, Takings, supra note 159, at 46-69.

269 See Azinian v. United Mexican States, Award, ICSID Case No. ARB(AF)/97/2, para. 36 (Nov. 1, 1999), http://www.worldbank.org/icsid/cases/robert_award.pdf (noting that claimants waived their right to pursue domestic remedies); Metalclad Corp. v. United Mexican States, Award, ICSID Case No. ARB(AF)/97/1, para. 7 (Aug. 30, 2000), 16 ICSID Rev.–Foreign Investment L.J. 168, 173 (2001), available at http://www.worldbank.org/icsid/cases/mm-award-e.pdf. The *Loewen* tribunal's decision on the United States's jurisdictional objections deferred to the hearing on the merits the issue of how Loewen's failure to exhaust an appeal of the Mississippi trial court's decision would affect its claim that the trial court violated NAFTA. Loewen Group, Inc. v. United States, Decision on Hearing of Respondent's Objection to Competence and Jurisdiction, ICSID Case No. ARB(AF)/98/3, para. 74 (Jan. 5, 2001), http://www.state.gov/documents/organization/3921.pdf.

270 NAFTA, supra note 1, art. 1121(1)(b), 32 I.L.M. at 643.

271 See William S. Dodge, National Courts and International Arbitration: Exhaustion of Remedies and Res Judicata Under Chapter Eleven of NAFTA, 23 Hastings Int'l & Comp. L. Rev. 357, 358-59 (2000) (arguing that if foreign investor "were required to exhaust local remedies prior to bringing a Chapter Eleven claim and if the resulting decision were binding as *res judicata*, then . . . [it] would be plainly inconsistent with the purpose of Chapter Eleven").

272 See generally Michael M. Berger, The "Ripeness" Mess in Federal Land Use Cases or How the Supreme Court Converted Federal Judges into Fruit Peddlers, in Institute on Planning, Zoning, and Eminent Domain § 7 (Carol J. Holgren ed., 1991) (discussing difficulty of making federal land-use claims due to ripeness doctrine); Brian W. Blaesser, Closing the Federal Courthouse Door on Property Owners: The Ripeness and Abstention Doctrines in Section 1983 Land Use Cases, 2 Hofstra Prop. L.J. 73 (1988) (same); John J. Delaney & Duane J. Desiderio, Who Will Clean Up the "Ripeness Mess"? A Call for Reform So Takings Plaintiffs Can Enter the Federal Courthouse, 31 Urb. Law. 195 (1999) (same); Gideon Kanner, Hunting the Snark, Not the Quark: Has the U.S. Supreme Court Been Competent in Its Effort to Formulate Coherent Regulatory Takings Law?, 30 Urb. Law. 307 (1998) (same); Timothy V. Kassouni, The Ripeness Doctrine and the Judicial Relegation of Constitutionally Protected Property Rights, 29 Cal. W. L. Rev. 1 (1992) (same); see also Senate Comm. on the Judiciary, Report on the Private Property Rights Implementation Act of 1998, S. Rep. No. 105-242 (1998). For defenses of the requirements, see generally Been, supra note 268, at 497-500; Douglas T. Kendall et al., Choice of Forum and Finality Ripeness: The Unappreciated Hot Topics in Regulatory Takings Cases,

rum of choice for litigation against the United States for any property owner who can claim foreign-investor status, unless NAFTA is interpreted to be substantively less hospitable to such claims than the Fifth Amendment.

Second, U.S. takings jurisprudence has strict "ripeness" rules that require a property owner to allow "the government entity charged with implementing the regulations [to] reach[ ] a final decision regarding the application of the regulations to the property at issue."[273] The property owner accordingly first must propose a reasonable plan for the development of the property.[274] If the regulatory system denies that proposal because it violates applicable regulations, but provides variances or other exceptions to those regulations, the property owner must pursue those opportunities to avoid or soften the impact of the regulation.[275]

The U.S. Supreme Court has explained that its insistence on a final decision is "compelled by the very nature of the inquiry required by the Just Compensation Clause" because elements of that inquiry, such as the "economic impact of the challenged action and the extent to which it interferes with reasonable investment-backed expectations . . . simply cannot be evaluated until the administrative agency has arrived at a final, definitive position regarding how it will apply the regulations at issue to the particular land in question."[276] Like its ex-

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33 Urb. Law. 405 (2001); R. Jeffrey Lyman, Finality Ripeness in Federal Land Use Cases from *Hamilton Bank* to *Lucas*, 9 J. Land Use & Envtl. L. 101 (1994); Michael K. Whitman, The Ripeness Doctrine in the Land-Use Context: The Municipality's Ally and the Landowner's Nemesis, 29 Urb. Law. 13 (1997).

273 Williamson County Reg'l Planning Comm'n v. Hamilton Bank, 473 U.S. 172, 186 (1985); see also Palazzolo v. Rhode Island, 533 U.S. 606, 620-21 (2001) (

> Under our ripeness rules a takings claim based on a law or regulation which is alleged to go too far in burdening property depends upon the landowner's first having followed reasonable and necessary steps to allow regulatory agencies to exercise their full discretion in considering development plans for the property, including the opportunity to grant any variances or waivers allowed by law. As a general rule, until these ordinary processes have been followed the extent of the restriction on property is not known and a regulatory taking has not yet been established.).

274 See MacDonald, Sommer & Frates v. County of Yolo, 477 U.S. 340, 352-53 & nn.8-9 (1986) (holding property owner's submission of "exceedingly grandiose development plans" did not satisfy ripeness requirement); Agins v. City of Tiburon, 447 U.S. 255, 260 (1980) (preventing court could not find that property had been taken when property owners had not yet submitted development proposal); cf. Palazzolo, 533 U.S. at 620 (holding that landowner is not required to submit application for development if it is "clear that the agency lacks the discretion to permit any development").

275 *Williamson County*, 473 U.S. at 187-88; see also Hodel v. Va. Surface Mining & Reclamation Ass'n, 452 U.S. 264, 297 (1981) (holding that takings challenge against surface mining regulations was not ripe where plaintiffs had not availed themselves of administrative relief by requesting variance or waiver).

276 *Williamson County*, 473 U.S. at 190-91.

haustion-of-state-remedies requirement, however, the Court's ripeness rules are unpopular with property owners.[277]

The NAFTA tribunals thus far have imposed no ripeness requirements on expropriation claims. In *Metalclad*, the tribunal's determination that the governor's critical-habitat decree expropriated property failed to discuss whether the decree allowed development other than hazardous waste landfills on the land, whether the property owners had explored those options, or whether the decree provided any variance or hardship procedures that the property owner could use to mitigate the impact the decree had on the value of the property.[278] *Metalclad*'s discussion of the habitat decree was extremely brief (perhaps because it was offered as an alternative ground for the holding) and did not address specifically whether Article 1110 claims of expropriation would be subject to ripeness rules similar to those *Williamson County* has imposed on U.S. takings litigation. Because property owners in the United States find the ripeness rules of *Williamson County* so onerous, however, even the possibility that NAFTA tribunals might not impose such requirements will make Article 1110 an attractive alternative to litigation in U.S. courts.[279]

Third, even for those property owners that choose to pursue Fifth Amendment claims through the courts of the United States (or similar domestic claims through Canada's or Mexico's courts), NAFTA holds the promise of another bite at the apple. As noted above, the *Azinian* award and the jurisdictional award of the *Loewen* tribunal suggest that claimants can challenge a domestic court's denial of compensation as "a denial of justice."[280] Although that standard should be difficult to meet, the prospect that property owners disappointed in a domestic court's rejection of their takings challenge could have yet another forum in which to press the claim may cause state and local governments to withdraw or soften the regulation at issue rather than face further costs to defend the regulation.

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[277] See supra note 272. Indeed, legislation to limit the Supreme Court's exhaustion and ripeness requirements was one of the top priorities of various industry and property rights groups for several years, although the legislation never passed the Senate. See Citizens Access to Justice Act of 1999, S. 1028, 106th Cong. (1999); Citizens Access to Justice Act of 1998, H.R. 1534, 105th Cong. (1998); see also Kendall & Lord, supra note 152, at 550-51 (describing lobbying efforts to pass bills reforming procedural requirements for takings cases).

[278] Metalclad Corp. v. United Mexican States, Award, ICSID Case No. ARB(AF)/97/1, paras. 109-11 (Aug. 30, 2000), 16 ICSID Rev.–Foreign Investment L.J. 168, 196-97 (2001), available at http://www.worldbank.org/icsid/cases/mm-award-e.pdf.

[279] If the costs of NAFTA arbitrations turn out to be higher than the costs of "ripening" a takings claim and litigating in U.S. courts, the advantage of NAFTA's less demanding procedural and jurisdictional requirements will become less decisive.

[280] See supra note 257 and accompanying text.

IV
JUSTIFICATIONS FOR REQUIRING COMPENSATION FOR REGULATORY IMPACTS ON PROPERTY VALUES

Given the expansion of property rights that the awards and pending claims under NAFTA threaten, it is critical to step back to consider whether a regulatory takings doctrine makes sense at all on an international level. The debate about regulatory takings in the United States has centered around three main justifications for compensating those whose property diminishes in value as the result of regulatory actions. First, some argue that compensation is necessary to ensure that governments take only those regulatory actions that will maximize aggregate social welfare. This cost-internalization theory posits that governments will not be sufficiently attentive to the costs of their regulations unless they are forced to compensate the losers from the regulation for those costs. Once governments are forced to pay those costs, the theory continues, the government is much more likely to enact only those measures that result in greater benefits than costs. Second, the most common, albeit least precise, theory posits that compensation is necessary to ensure fairness—to prevent a small group of property owners from being forced to bear the burdens of regulation that should be spread more broadly. Most recent fairness theorists focus on the political process failure theory, which asserts that the political process systematically fails to protect certain kinds of property owners and argues that compensation should be paid to remedy those failures. Third, other theorists suggest that compensation is necessary to promote efficient use of resources because risk aversion will distort the investment decisions of investors if they fear that government regulation may destroy the fruits of their labor. This insurance rationale argues that government must ensure property owners that they will be compensated for any losses caused by governmental action in order to counter their risk-aversion. A fourth rationale, applicable only in the international context (and therefore not part of the debate over regulatory takings in the United States), is that developing countries need and want to offer such protection in order to attract investment. Treaty-based compensation requirements, it is argued, permit these countries to make more credible guarantees of investor security and thus encourage inflows of foreign direct investment, ultimately fostering economic development. This Part explores in detail, and ultimately rejects, each of these four theories as a justification for treaty-based compensation requirements for regulatory takings.

A. *Cost Internalization*

The standard law-and-economics model of tort law posits that rational economic actors in a market environment will produce the socially optimal quantity of a particular good or service only if the actor is forced to internalize the full costs of its activity. If a hazardous waste landfill (such as that involved in *Metalclad*) were to pollute the surrounding groundwater, and the facility's owners were allowed to ignore the costs that pollution imposed upon nearby homeowners, the facility would provide too much of its product. But if the facility were forced to internalize those costs by paying damages to the neighbors, or by offering to buy from the neighbors the privilege to pollute, the facility would continue to generate the pollution only as long as the total benefits of the product outweigh its total costs. Cost-internalization thus is essential to the efficiency of the free market.

The cost-internalization argument, that government should be liable for the costs it imposes on property owners through its regulations, follows the same form: Government must be forced to pay the full costs of its regulations so that it will choose the optimal level of regulation—the level at which the benefits from the regulation outweigh its costs. This argument was the cornerstone of Frank Michelman's famous article on the Fifth Amendment's compensation mandate,[281] and has remained a (if not the) major justification for requiring governments to compensate those whose property is rendered either unavailable or less valuable as a result of government action.[282] The argument often is referred to as one of "fiscal illusion" because it asserts that government policymakers will undervalue costs they do not

[281] Frank I. Michelman, Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law, 80 Harv. L. Rev. 1165, 1172-83 (1967).

[282] For more recent versions of the cost-internalization argument, see Richard A. Epstein, Takings: Private Property and the Power of Eminent Domain 197-99 (1985); Richard A. Posner, Economic Analysis of Law 64 (5th ed. 1998); William A. Fischel, The Political Economy of Just Compensation: Lessons from the Military Draft for the Takings Issue, 20 Harv. J.L. & Pub. Pol'y 23, 30-32 (1996); William A. Fischel & Perry Shapiro, Takings, Insurance, and Michelman: Comments on Economic Interpretations of "Just Compensation" Law, 17 J. Legal Stud. 269 (1988); Michael A. Heller & James E. Krier, Deterrence and Distribution in the Law of Takings, 112 Harv. L. Rev. 997, 1017-18 (1999); Thomas W. Merrill, *Dolan v. City of Tigard*: Constitutional Rights as Public Goods, 72 Denver U. L. Rev. 859, 882-83 (1995); Thomas J. Miceli & Kathleen Segerson, Regulatory Takings: When Should Compensation Be Paid?, 23 J. Legal Stud. 749, 758-59 (1994). For judicial endorsement of the theory, see, e.g., Pennell v. City of San Jose, 485 U.S. 1, 22-23 (1988) (Scalia J., concurring in part and dissenting in part) (noting that when cost of regulation is borne by nongovernmental parties it provides "political immunity" and decreased accountability).

bear and thus act under an illusion about the efficiency and value of their policies.[283]

In recent years, the cost-internalization argument has come under increasing scrutiny in debates over the correct interpretation of the Fifth Amendment.[284] Many of the concerns raised in those debates suggest that the cost-internalization argument will not support regulatory takings provisions in international investment protection agreements.

1. Which Level of Government, and Which Agency, Will Pay the Cost?

The cost-internalization argument depends upon the disciplining effect that paying compensation will have upon the elected official or government agency deciding to impose a regulation. If the decisionmaker does not have to write the check and is not directly accountable to whomever does write the check, then the compensation requirement will not force the internalization of the costs of the regulation; it simply will shift the loss from the victim of the regulatory expropriation to another hapless party with no control over the decision.[285] In the domestic context, the cost-internalization argument therefore is undermined by the fact that regulatory agencies often do not directly bear the cost of takings judgments.[286] The judgment sometimes is paid by insurers but often is borne by a judgment fund or by that portion of the jurisdiction's budget designated for legal costs or damage awards.[287] Ultimately, the taxpayers of the jurisdiction or

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283 Louis Kaplow, An Economic Analysis of Legal Transitions, 99 Harv. L. Rev. 509, 567 (1986).

284 The most perceptive critic of the cost-internalization argument is Daryl J. Levinson, Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs, 67 U. Chi. L. Rev. 345 (2000), and our analysis is significantly informed by Levinson's insights.

285 Stephan, supra note 248, at 843 (

> Where decisionmakers have the ability to externalize the costs of redistribution, because those who will bear those burdens have limited capacity to retaliate or otherwise to share their losses with those who will benefit from the redistribution, rational decisionmakers will redistribute even if the overall impact on welfare is negative.).

286 See Roderick M. Hills, Jr., The Eleventh Amendment as Curb on Bureaucratic Power, 53 Stan. L. Rev. 1225, 1225 (2001) ("The money necessary to pay damages rarely comes out of the revenues appropriated for an agency's operations.").

287 See id. at 1246-48 (noting that states typically pay damages awards from some sort of "Judgments Fund" or from judgment-specific line-item appropriations); Richard H. Seamon, The Asymmetry of State Sovereign Immunity, 76 Wash. L. Rev. 1067, 1138 n.341 (2001) (discussing use of judgment fund to pay takings awards against United States); Charles Tiefer, Controlling Federal Agencies by Claims on Their Appropriations? The Takings Bill and the Power of the Purse, 13 Yale J. on Reg. 501, 505-06 (1996) (discussing congressional payment of "inverse condemnations" through judgment fund).

the beneficiaries of programs or services, reduced to pay the judgment, will pay the cost. But those taxpayers or sacrificing beneficiaries are not the decisionmakers.

In the international context, the lack of congruity between the decisionmaker and the claims-payer is particularly problematic. Claims under NAFTA's investor-state dispute resolution mechanism are brought against, and awards are assessed against, the national government—the signatory party.[288] The national government ordered to pay damages for a NAFTA violation may be authorized by domestic laws to pass the cost on to the state or local government that enacted the regulation, or to the federal agency that enacted the regulation, but nothing in NAFTA requires the parties to do so. Even if NAFTA were amended to require the responsible party to bear the compensation award, or even if a signatory party decided to pass through compensation awards in order to ensure internalization, there are substantial political barriers and legal hurdles to effective internalization. Although a pass-through probably could be finely tailored to meet federalism and other legal objections,[289] any effort to recover the cost of the award from state or local governments would be quite sensitive politically.[290] Indeed, after Mexico was ordered to pay $16.7 million in the *Metalclad* dispute, the national government missed the deadline to make the payment because of disputes between the national and state governments about dividing the cost of the settlement.[291] In Canada, concerns about the national government's ability to pass the costs of NAFTA awards through to state and local governments have led the Federation of Canadian Municipalities to request that the national government "guarantee that it will never penalize municipalities for actions that are valid under domestic law but violate NAFTA."[292]

Second, arbitral complaints and awards need not be, and often are not, as precise as litigation in U.S. courts, so it is far from clear how the national government would decide how much of the award to pass through to which party. Because the respondent in an arbitration is the signatory party, neither the notice of claim nor the award need specify which level of government, or which agency within a particular

288 Mann & von Moltke, supra note 10, at 13, 16, 18.

289 See Been, supra note 2, at 11,012-14.

290 For further discussion of the costs of such efforts in the U.S. federal system, see infra Part V.A.3.

291 Anthony DePalma, NAFTA Dispute Is in Court Once Again, N.Y. Times, Oct. 19, 2001, at W1.

292 Fed'n of Canadian Municipalities, Municipal Questions Respecting Trade Agreements § II(F) (Nov. 5, 2001), at http://www.fcm.ca/newfcm/java/worldtrade1.htm.

government, is responsible for how much of each alleged infringement. If, for example, Mexico were to try to allocate the compensation award in *Metalclad*, there would be considerable finger-pointing because the tribunal held that both the municipality's denial of a permit (in light of the federal government's representations to the investor) and the provincial governor's ecological decree constituted takings.[293] The tribunal's findings regarding the building permit were held to be outside the scope of the submission to arbitration by the British Columbia court, leaving only the finding regarding the provincial ecological decree intact.[294] The municipality accordingly would argue that it should bear no responsibility for the award. Even if the British Columbia court had not vacated the tribunal's findings regarding the denial of the building permit, the municipality would try to avoid liability by insisting that the real problem lay in the federal government's unwise decision to reassure Metalclad that it didn't need local permits, rather than in the municipality's denial of the permits. While parties could request an arbitral panel to be more specific in allocating responsibility among the various governmental actors involved, such a mandate would require arbitral panels to delve far deeper into the host state's domestic laws, institutional arrangements, and intergovernmental relationships than may be appropriate or feasible.

Unless a NAFTA award is charged to the state, local, or federal agency whose officials actually made the decision to impose the offending regulation, an award will have no internalizing effect. But NAFTA is not structured to ensure either that the decisionmaker bears the cost of the award, or that the federal government that is party to the treaty will have the information it needs to impose the cost upon the government at "fault" for the regulation. The connection between the decision to regulate and liability for the costs of that regulation therefore is tenuous at best in the international context.

2. *Politics Versus Markets*

Furthermore, even if NAFTA awards were paid by the actual decisionmaker, there are substantial reasons to doubt that the decisionmaker will internalize the costs of his or her decision. As noted

[293] See Metalclad Corp. v. United Mexican States, Award, ICSID Case No. ARB(AF)/97/1, paras. 102-12 (Aug. 30, 2000), 16 ICSID Rev.–Foreign Investment L.J. 168, 202 (2001), available at http://www.worldbank.org/icsid/cases/mm-award-e.pdf.

[294] United Mexican States v. Metalclad Corp., 2001 BCSC 664, paras. 78-79, [2001] 89 B.C.L.R.3d 359, 381-82, available at http://www.worldbank.org/icsid/cases/metalclad_reasons_for_judgment.pdf.

above,[295] the cost-internalization argument for requiring compensation is based upon the theory that rational profit-maximizing firms will not produce the socially optimal level of goods or services unless they are forced to take into account the full costs of their activity. The notion that governments must be forced to pay compensation to ensure that they enact only efficient regulation implicitly assumes that government actors are the equivalent of rational profit-maximizing firms.[296] That is a big leap.[297] Political scientists and economists do not agree on exactly what governments (or the politicians and bureaucrats who comprise governments) do maximize, but it is clearly not "profits," or even necessarily monetary inflows.[298] Because politicians and bureaucrats do not maximize profits, having to expend funds to cover a compensation award will not necessarily have any effect on their decision, unless those expenditures make it harder for the decisionmaker to achieve whatever it is trying to maximize. If elected officials seek to maximize their chance of reelection in a simple majority rule electoral contest, for example, compensation awards are unlikely

[295] See supra notes 281-82 and accompanying text.

[296] Cf. Posner, supra note 282, at 64 ("Although government procurement decisions cannot be assumed to be made on the same profit-maximizing basis as private procurement decisions . . . it would be reckless to assume that the government is immune to budgetary considerations.").

[297] Governments have been assumed to act like firms in several of the major legal disciplines, such as the theory of state competition for corporate charters that has formed the bedrock of corporate law for a generation. There, too, the assumption is coming under sharp challenge. See, e.g., Marcel Kahan & Ehud Kamar, The Myth of State Competition in Corporate Law, 55 Stan. L. Rev. (forthcoming 2003); cf. Robert Daines, The Incorporation Choices of IPO Firms, 77 N.Y.U. L. Rev. 1559 (2002) (presenting empirical data that corporations do not shop among states for optimal legal rules but instead make binary choice between Delaware and their home state).

[298] See Ian Ayres & John Baithwaite, Responsive Regulation: Transcending the Deregulation Debate 4-7 (1992) (arguing that regulators should pursue "responsive" industry-specific strategies on behalf of public interest); Daniel A. Farber & Philip P. Frickey, Law and Public Choice: A Critical Introduction 21-33 (1992) (discussing competing theories of motivation for legislative decisionmaking); Sam Peltzman, Toward a More General Theory of Regulation, 19 J.L. & Econ. 211, 213-14 (1976) (assuming that regulators seek direct support through votes but acknowledging that dollars may be source of direct and indirect utility); Richard A. Posner, Theories of Economic Regulation, 5 Bell J. Econ. & Mgmt. Sci. 335, 338-40, 346-47 (1974) (focusing on regulators' competition for government appropriations, potential for monopolistic collusion among major political parties, and differences in how different political systems "supply" regulation); George J. Stigler, The Theory of Economic Regulation, 2 Bell J. Econ. & Mgmt. Sci. 3, 10-13 (1971) (exploring differences between politics and market with regard to firms' pursuit of protective regulation). For discussions of what motivates decisionmakers in the environmental and land use contexts, see generally William A. Fischel, The Economics of Zoning Laws: A Property Rights Approach to American Land Use Controls (1985); William A. Fischel, The Homeowner Hypothesis (2001); Paul E. Peterson, City Limits (1981); Urban Fortunes: The Political Economy of Place (John R. Logan & Harvey L. Molotch eds., 1987); Robert C. Ellickson, Suburban Growth Controls: An Economic and Legal Analysis, 86 Yale L.J. 385 (1977).

to influence the official to adopt only efficient regulations unless those awards cost the official more votes than the official gained by pursuing the policy that led to the compensation award.

As Daryl Levinson has argued, predicting the effect of compensation requirements requires "a model of government decisionmaking that explains how the social costs and benefits of government activity are systematically translated into private, political costs and benefits for government decisionmakers, and what role, if any, mandating financial outflows plays in this process."[299] We have no such model in the domestic context, much less in an international context in which the political and institutional structures of the nations signing an international investment agreement are likely to differ dramatically. Without such a model in the domestic context, "we should have little confidence in any of the conventional assumptions about the deterrent effects of making government pay money" for regulatory interferences with property.[300] In the international context, the variety of political and institutional dynamics at play in the countries that have signed investment agreements is likely to render attempts to force the internalization of costs through compensation requirements particularly prone to malfunction.

Metalclad illustrates the perils of relying upon the internalization justification without such a model. If the Mexican federal government were able to pass the costs of a compensation award in *Metalclad* back to the state of San Luis Potosí or the municipality of Guadalcazar,[301] the pass-through would force the taxpayers of the state or municipality, or the beneficiaries of programs whose budgets were cut in order to pay the award, to bear the costs of the Governor's or municipality's actions. There are, however, several reasons that such a pass-through might have no effect on the actual decisionmakers—in this case, the Governor or the members of the Guadalcazar Town Council. First, the taxpayers might barely notice an increase in their taxes to pay the award because the award would be spread over so many taxpayers.[302]

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299 Levinson, supra note 284, at 357.

300 Id. at 387.

301 See Been, supra note 2, at 11,012-14.

302 For discussions of how voters respond to tax increases, see, for example, Clemens Fuest & Bernd Huber, Tax Competition and Tax Coordination in a Median Voter Model, 107 Pub. Choice 97, 110 (2001); John Hall & Ian Preston, Tax Price Effects on Attitudes to Hypothecated Tax Increases, 75 J. Pub. Econ. 417, 418 (2000); Lawrence B. Lindsey, Individual Taxpayer Response to Tax Cuts: 1982-1984: With Implications for the Revenue Maximizing Tax Rate, 33 J. Pub. Econ. 173, 174 (1987); cf. William H. Hoyt, Leviathan, Local Government Expenditures, and Capitalization, 29 Regional Sci. & Urb. Econ. 155, 157 (1999) (noting that property taxes capitalize tax increases more in smaller cities, thereby negatively affecting popularity of government as compared to larger cities where such taxes are not fully capitalized in property taxes).

Second, the taxpayers might not even suffer an increase in their taxes if the state legislature instead decided to fund the award out of budgets for welfare benefits or long-term infrastructure improvements. Taxpayers might hardly notice the decrease in welfare allocations unless the beneficiaries have sufficient organizational ability and political power to make their plight well-known.[303] Similarly, taxpayers might not have sufficient information to understand the effects of deferred infrastructure maintenance until many years have elapsed.[304] Third, even if the taxpayers notice the increase in their taxes or a decrease in services or benefits, it may cost more to uncover the specific cause of the increase than the taxpayer (or the media or government watchdog groups) would be willing to spend. That cost is particularly high because the saga of the *Metalclad* dispute is long and complicated, with many opportunities for the state and local officials to point the blame at the federal level, or for local and federal authorities to blame the provincial governor. Fourth, even taxpayers who notice the increase and can trace its cause nevertheless may find that the costs of protesting the increase (not to mention organizing others to do so) outweigh the individual's share of the tax increase.

Even if taxpayers notice the increase and know who to blame for that increase, those taxpayers still may have little direct control over those decisionmakers. The Governor signed the ecological decree three days before his term ended, so (unless he plans to run for another office, or is concerned about the effect the controversy over the award may have on his place in history) he may care little about how the taxpayers view the tax increase resulting from the award. Perhaps public unhappiness over tax increases, reflected in votes and campaign contributions, would send a message to the current governor (and gubernatorial candidates in the future) that they should not take any action that would result in another NAFTA award. But there are reasons to doubt that the message will influence the behavior of current or future governors. Even assuming that the gubernatorial candidates are seeking to maximize their chances of election or reelection, they may believe that too few taxpayers are likely to change their vote solely on the basis of concern over NAFTA awards to affect the out-

303 See Daniel A. Farber, Public Choice and Just Compensation, 9 Const. Comment. 279, 293-94 (1992) (observing that diffuse federal taxpayer majority may be exploited by powerful minority interests).

304 See Ken Gwilliam & Zmarak Shalizi, Road Funds, User Charges, and Taxes, 14 World Bank Res. Observer 159, 163 (1999) (commenting that "current political pressures or the electoral cycle may result in myopic decisions" about investments in infrastructure because "[u]nfortunately, road deterioration reveals its symptoms late").

come of the election.[305] Or they may believe that the issue will not be salient to voters because the cost of ascertaining a candidate's stance on each regulation that might subject the jurisdiction to NAFTA liability may be too high for most voters to incur.[306] In addition, because gubernatorial or council races are rarely dominated by a single issue, a taxpayer-voter may have to choose between the candidate who addresses her concern about compensation awards occasioned by a NAFTA violation and a candidate who addresses some other concern.

Even if she chooses to vote for the candidate who promises to prevent regulations that would trigger NAFTA's compensation requirements, a constituent will then have to monitor the behavior of the candidate she elects to ensure that he does in fact prevent any NAFTA violations. Whether the official will do so will depend upon the clarity of the signal that his election was secured by his campaign promise to avoid NAFTA violations. It also will depend upon how easily the voting public can discern whether the elected official is acting or failing to act in a way that risks a compensation award. It additionally will depend on how well the elected official can control his appointees or the civil servants in the administrative agencies whose decisions may violate NAFTA. Most importantly, it depends upon what the official seeks to maximize. Once elected, for example, the official might seek to maximize her chances of election to higher office and might try to please a larger polity that might prefer the regulation that threatens NAFTA liability. Even if the official seeks to maximize her chances of reelection to the same office, the official might conclude that the votes of those who favor avoiding compensation awards are less important than the votes or campaign contributions of those concerned about the environment or the health and safety threats of a hazardous waste facility. Passing the costs of a NAFTA award through to individual taxpayers does not give any one taxpayer a stake similar to that of national and international environmental NGOs who

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305 See Susanne Lohmann, An Information Rationale for the Power of Special Interests, 92 Am. Pol. Sci. Rev. 809, 810 (1998) (

> We can expect political competition to work well in preventing an incumbent from acting against the interests of constituents only if an issue is salient in the public mind—or if it can be made salient in a future election by an interest group or challenger; otherwise, incumbents can and do shirk.).

306 See Anthony Downs, An Economic Theory of Democracy 243-44 (1957) (explaining why voters have limited incentive to acquire additional information about candidate positions); Mancur Olson, The Logic of Collective Action: Public Goods and the Theory of Groups 34-35 (1965) (arguing that in large heterogeneous groups, individual members have less incentive to pursue public goods because each member receives small marginal benefit for her efforts); Lohmann, supra note 305, at 811 ("[I]n many cases voters lack specialized information to understand that the incumbent acted against their interests, and they cannot acquire this specialized information at low cost.").

would oppose the facility, for example. Nor would we expect individual taxpayers to have the organizational ability enjoyed by groups that are repeat players in legislative and regulatory processes.

All those problems are based upon the political and institutional structures of the United States. But Mexico does not allocate authority among its national and subnational governments in the same way as the United States does. Political parties play different roles in the two countries: Legal and illegal "campaign" contributions may influence the electoral processes in each country differently. Those and many other distinctions between the two countries will complicate further the cost-internalization picture. At bottom, the effectiveness of any attempt to force cost internalization through a compensation award depends upon a host of contingencies about which we have insufficient understanding in the relative simplicity of the domestic context, much less in the greater complexity of the international context, to support a regulatory takings doctrine.

3. *Asymmetrical Treatment of Costs and Benefits*

A third problem with the cost-internalization argument is that it is one-sided: It posits that governments must compensate those who lose from a regulation in order to value and internalize the costs of the measure with accuracy, but it assumes that governments accurately value and internalize the benefits of the measure without being compensated for such benefits by those who gain from the regulation.[307] Some have argued that governments should be able to seek restitution from property owners benefiting from regulations,[308] but that argument often is summarily dismissed either as impractical or as inconsistent with the nature of government.[309] The latter claim is that governments are supposed to create benefits, so government decisionmakers will, by nature, produce benefits whether or not they can capture those benefits. But if governments, by nature, can accurately

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[307] Kaplow, supra note 283, at 567-68; Levinson, supra note 284, at 350; Thomas W. Merrill, Rent Seeking and the Compensation Principle, 80 Nw. U. L. Rev. 1561, 1583-84 (1986); John Quinn & Michael J. Trebilcock, Compensation, Transition Costs, and Regulatory Change, 32 U. Toronto L.J. 117, 135 (1982).

[308] For the classic statement of the argument that government should be able to seek recompense for its "givings," see generally Windfalls for Wipeouts: Land Value Capture and Compensation (Donald G. Hagman & Dean J. Misczynski eds., 1978). For more recent explorations of the argument, see generally Abraham Bell & Gideon Parchomovsky, Givings, 111 Yale L.J. 547 (2001); Eric Kades, Windfalls, 108 Yale L.J. 1489 (1999); Levinson, supra note 284.

[309] See, e.g., Kades, supra note 308, at 1492-93 (arguing that windfall taxation may involve significant transaction and administrative costs and may discourage productivity by accidentally affecting earnings); see also Bell & Parchomovsky, supra note 308, at 609-17 (identifying objections to charging citizens for "givings").

assess the benefits of measures without internalizing those benefits, why can they not accurately assess the costs without internalizing those costs?

Several explanations might be offered. One reason a government might seek to generate benefits, even if it cannot capture the monetary value of those benefits, is that those benefited will respond to the "giving" by voting for the government official responsible and by contributing funds to ensure the reelection of that official.[310] But the same could be said of those who lose from a regulation—they may respond to the taking by voting against the official responsible for the taking or by contributing funds to her opponent.

A second reason the government might generate benefits even if it could not fully capture those benefits is that it might be able to capture some of the benefits through taxation. If, for example, a local government passes a land use restriction that benefits neighboring land by either protecting or increasing its value, the government will capture at least some of that avoided loss (or gain) through property taxes. If a state government passes an environmental regulation to reduce pollution, it will be able to capture at least some of the benefits through decreased costs of cleanup within its jurisdiction, decreased health effects on its population, and so on. But again, the same can be said about costs—the government will bear a portion of the costs of such measures in the form of reduced property taxes on the restricted land or reduced income or sales taxes on the polluter's business.

Neither explanation suffices to explain the one-sidedness of the internalization argument in the domestic context. Nor do they suffice in the international context. Standard public choice analysis would tell us that decisionmakers will seek to concentrate the benefits of any regulation within their constituency and to impose as many costs of the regulation as possible upon those who are not constituents. Foreign investors generally cannot vote,[311] and their ability to contribute to political campaigns may be somewhat constrained.[312] So, it might be argued that in the international context, benefits are more likely than costs to be considered by decisionmakers, and a compensation requirement that focuses on forcing the internalization of costs, but

310 This assumes that government officials try to maximize their chances of reelection. As previously noted, supra note 298 and accompanying text, there is no consensus about what government officials seek to maximize through their actions.

311 If a foreign investor owns real property, a local government might give the franchise in local elections to property owners regardless of citizenship.

312 See Note, "Foreign" Campaign Contributions and the First Amendment, 110 Harv. L. Rev. 1886, 1888-90 (1997) (discussing U.S. restrictions on campaign contributions by noncitizens).

not benefits, is therefore appropriate. But not all benefits of a regulation accrue within the decisionmaker's jurisdiction, and foreign investors (and their domestic employees and suppliers) are not wholly unable to bring their concerns about regulations to the attention of decisionmakers. They also may form coalitions with similarly situated domestic investors and exercise influence through those coalitions.[313] Any disparity, therefore, between the likelihood that governments will internalize benefits and the likelihood that they will ignore costs in the international context is a slim reed upon which to rest a compensation requirement.

Further, even if we could assume that governments "naturally" internalize regulatory benefits but need to be forced to internalize regulatory costs, a compensation requirement is likely to result in a systematic undervaluation of benefits. First, the losses alleged in compensation demands are relatively easy to calculate, but the net social benefits of regulation are much harder to value in monetary terms.[314] This problem of valuing benefits is particularly evident in the case of environmental goods. The complex ways in which particular ecological communities, species, landscapes, and water resources interact to benefit humans is as yet only dimly understood, and the economic valuation of these goods remains a matter of hot debate.[315] Valuation becomes an even greater problem for environmental regulations that may have transboundary and global benefits, such as those mitigating global warming by limiting carbon emissions or promoting carbon sequestration, or those contributing to the preservation of global biodiversity. While foreign investors can be counted upon to quantify the potential harms they will suffer from regulations, local or national regulators (and supporters of the regulations) often will lack the ex-

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[313] Loewen, for example, certainly could form alliances with domestic manufacturers and businesses who oppose punitive damages.

[314] See, e.g., Frank Ackerman & Lisa Heinzerling, Pricing the Priceless: Cost-Benefit Analysis of Environmental Protection, 150 U. Pa. L. Rev. 1553, 1578-81 (2002) (analyzing problem of nonquantifiable environmental benefits and overstatement of regulatory costs).

[315] See, e.g., James Boyd, Dennis King & Lisa A. Wainger, Compensation for Lost Ecosystem Services: The Need for Benefit-Based Transfer Ratios and Restoration Criteria, 20 Stan. Envtl. L.J. 393, 410-11 (2001) (discussing challenge of valuing ecosystem services); Wallace E. Oates, From Research to Policy: The Case of Environmental Economics, 2000 U. Ill. L. Rev. 135, 149-50 (2000) (noting challenges of environmental valuation with regard to quantification, nonuse values, discount rates and distributional effects); Dale B. Thompson, Valuing the Environment: Courts' Struggles with Natural Resource Damages, 32 Envtl. L. 57, 78-87 (2002) (raising difficulties of quantifying environmental values through contingent valuation methodology in context of natural-resource damages cases); Miriam Montesinos, Comment, It May Be Silly, but It's an Answer: The Need to Accept Contingent Valuation Methodology in Natural Resource Damage Assessments, 26 Ecology L.Q. 48, 62-69 (1999) (reviewing problems in contingent valuation methodology for nonuse value of natural resources).

pertise, resources, or political impetus to assess accurately the extrajurisdictional benefits of the proposed regulation.[316] The net result of these problems is that compensation requirements are likely to be systematically biased: Regulators are likely to give greater weight to the potential costs of litigating and perhaps losing expropriation claims than they will give to the more-difficult-to-assess environmental and social benefits of the regulation in question.

In addition, the benefits of regulatory measures challenged under NAFTA are particularly likely to be undervalued because NAFTA's Chapter 11 focuses so clearly on the entitlements of private investors, while acknowledging the public's interests only vaguely.[317] As we saw above, the references to the environment in NAFTA and its environmental side agreement may be relevant to interpreting the investor protections, but they do not provide any clearly enforceable social or environmental protections to balance investor protections.[318] The lopsidedness of the attention paid to investor rights versus public rights in NAFTA and other investment agreements is likely to cause arbitrators, and those predicting arbitrators' decisions, to undervalue the benefits of the regulation relative to its costs.[319]

In sum, using bilateral and multilateral investment agreements to require compensation for the effects of regulation on the value of property may not work to force legislators and regulators to make more efficient decisions. Such agreements do not require the actual decisionmaker to bear the cost of awards decided under the agreement. Further, even if the agreements were restructured to require the actual decisionmaker to pay the cost of an award, there are many reasons to doubt that politicians and bureaucrats will respond to mon-

316 Public choice theory suggests that regulations with concentrated costs but diffused benefits are likely to meet greater opposition than those with more concentrated benefits. Stewart E. Sterk, Environmental Review in the Land Use Process: New York's Experience with SEQRA, 13 Cardozo L. Rev. 2041, 2049 (1992); Richard B. Stewart, Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy, 86 Yale L.J. 1196, 1213 (1977). Regulators accordingly will be reluctant to impose costs on investors in the interest of diffuse global environmental benefits even if they can assess those benefits accurately.

317 See Lilley, supra note 17, at 744 (contrasting "timidity" of mandates in NAFTA's environmental side agreement with "toothy" provisions of Chapter 11 itself).

318 See supra notes 51-57 and accompanying text.

319 This asymmetry of entitlements in the agreement may be magnified by the fact that the arbitrators deciding the claims typically have extensive experience in international investment and corporate and commercial litigation but little exposure to the problems of environmental and social regulation. See infra note 348 and accompanying text. It also is exacerbated by the procedures used to arbitrate claims, which provide no guarantee that nongovernmental organizations (or even the state or local government whose regulation is at issue in the claim) will have the right to participate in the proceedings. See supra note 77 and accompanying text.

etary incentives in the same way as rational profit-maximizing actors respond in the standard cost-internalization model. Finally, because investor protections force decisionmakers to internalize the costs of regulations but do nothing to ensure that they will value accurately the benefits of those regulations, investor protections threaten systematically to bias regulatory processes towards inefficiently low levels of regulation.

The desirability of forcing decisionmakers to bear the full costs of their decisions is a fundamental tenet of much of modern law. Despite all the problems we have highlighted about the application of cost-internalization theories to the regulators governed by international investment agreements, caution (not to mention humility) might suggest that, even with those problems, we should prefer the imperfection of cost internalization to the alternative of allowing regulators to impose costs upon property owners with financial impunity. But as we outlined in Part III, the extent of the financial liability the regulatory takings provisions of NAFTA and similar agreements threaten to impose upon governments is potentially vast and is unprecedented, at least in the history of the United States. As we set forth in Part V, moreover, the sweep of the requirement imposes substantial costs upon governments and the societies that governments are called upon to protect. When such a marked change in the relationship between governments and the owners of capital is at issue, we think it prudent to impose upon proponents of the change the burden of proving that cost-internalization theories truly justify the compensation requirement they seek.

B. Fairness

In the United States, courts and scholarly commentators often quote Justice Black for the proposition that the Fifth Amendment's just compensation requirement is "designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[320] As discussed in Part III, however, the U.S. Supreme Court has been unable to provide specific guidance about exactly when fairness and justice

320 Armstrong v. United States, 364 U.S. 40, 49 (1960). The Supreme Court quoted *Armstrong* recently in Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency, 122 S. Ct. 1465, 1478 (2002), Palazzolo v. Rhode Island, 533 U.S. 606, 617-18 (2001), Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1071 (1992), and First English Evangelical Lutheran Church v. County of Los Angeles, 482 U.S. 304, 318-19 (1987). Scholars relying upon the quote include Peterson, Part II, supra note 144, at 56, and William Michael Treanor, The Original Understanding of the Takings Clause and the Political Process, 95 Colum. L. Rev. 782, 877 (1995).

require compensation.[321] Although many scholars agree that compensation may be required to achieve a fair distribution of the benefits and burdens of regulations,[322] they also have been unable to delineate the precise content of "fairness."

Initially, fairness theorists tied the fairness of government action to notions of harm or other forms of wrongdoing. Andrea Peterson, for example, has argued:

> [N]o compensable taking occurs if the government is merely preventing or punishing wrongdoing by A. If the government requires A to give up property because it would be wrong of her not to do so, fairness does not require that compensation be paid. Nor does fairness require payment of compensation if the government requires A to give up her property to punish her for a wrongful act. Compensation must be paid, however, if the government's only justification for forcing A to give up her property is to promote the common good.[323]

Efforts to delineate between harm and benefit have proven unsatisfactory because definitions of harm are inevitably value-laden[324] and reflect controversial views of fault and causation.[325] In addition, the

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[321] See supra notes 143-152 and accompanying text.

[322] E.g., Michelman, supra note 281, at 1218-24; Peterson, Part II, supra note 144, at 60.

[323] Peterson, Part II, supra note 144, at 60. Peterson drew upon a long line of theorists that saw the key to the takings puzzle as being the distinction between harm and benefit. See Ernst Freund, The Police Power: Public Policy and Constitutional Rights 546-47 (1904) (distinguishing eminent domain, where government takes property because it is "useful" to public, and exercise of police power, where rights of property are impaired "because their free exercise is believed to be detrimental to public interests"); Ellickson, supra note 298, at 418-24 (arguing that no taking occurs if government prohibits "subnormal" land uses); Joseph L. Sax, Takings, Private Property and Public Rights, 81 Yale L.J. 149, 150-51 (1971) (basing takings inquiry on whether government acts as "entrepreneurial" participant in competition for resources or uses police power to mediate among private competitors).

[324] See, e.g., Jerold S. Kayden, Penn Central, Historic Preservation, and the Newer Just Compensation Clause Cases, SG040 A.L.I.-A.B.A. 637, 642 (2001) ("[C]haracterization of a regulation as preventing harm rather than promoting benefit is linguistic gamesmanship incapable of yielding a defensible takings jurisprudence."); Glynn S. Lunney, Jr., Responsibility, Causation, and the Harm-Benefit Line in Takings Jurisprudence, 6 Fordham Envtl. L.J. 433, 435 (1995) ("In the absence of some accepted standard of proper conduct, a court or legislature can describe any particular government-imposed rights change equally well as either harm prevention or benefit extraction.").

[325] See Ronald H. Coase, The Problem of Social Cost, 3 J.L. & Econ. 1, 2 (1960) (

> The traditional approach has tended to obscure the nature of the choice that has to be made. The question is commonly thought of as one in which A inflicts harm on B and what has to be decided is: how should we restrain A? But this is wrong. We are dealing with a problem of a reciprocal nature. To avoid the harm to B would inflict harm on A.).

For a discussion of the controversy over Coase's "causal agnosticism," see Thomas W. Merrill & Henry E. Smith, What Happened to Property in Law and Economics?, 111 Yale L.J. 357, 391-94 (2001).

concerns underlying the distinction may be addressed better through a utilitarian efficiency analysis.[326]

Most recent fairness theorists therefore are trying a different tactic—they argue that fairness should be understood largely in terms of process.[327] These political process theories assert that courts should require compensation for diminutions in property value caused by regulations only if the class of property owners affected is "particularly unlikely to receive fair consideration from majoritarian decisionmakers."[328] Such a compensation policy remedies failures in the political process that allow certain property owners to be singled out for regulatory burdens or that burden property owners who are "discrete and insular minorities" consistently shut out of politics.[329]

Some process theorists argue that process failure should be determined by focusing on the characteristics of the decisionmaker. William Fischel, for example, argues that owners of real property or other assets that cannot easily be removed from a jurisdiction should receive compensation for regulatory burdens when they are a minority "in a jurisdiction in which the usual minoritarian political protections are attenuated—that is, they are subject to local governments or to politically insulated special commissions."[330] He contends that local governments are too politically "efficient," that is, too responsive to majority will and therefore unresponsive to interest-group bargaining.[331] Fischel argues that local governments typically have quite homogenous electorates, lack structural checks such as bicameral legislatures, and deal with a limited variety of issues. Process failure therefore is endemic among local governments because they provide few opportunities for logrolling or other forms of pluralist deal-mak-

326 See Louis Kaplow & Steven Shavell, Fairness Versus Welfare, 114 Harv. L. Rev. 961, 1381-82 (2001).

327 See Farber, supra note 303, at 280; William A. Fischel, Exploring the Kozinski Paradox: Why Is More Efficient Regulation a Taking of Property?, 67 Chi.-Kent L. Rev. 865, 869 (1991); Treanor, supra note 320, at 868-77. For the argument that political process failures sometimes may require compensation not to protect those whose property is singled out but to protect the public from the superior political power of those property owners, see, for example, Glynn S. Lunney, Jr., A Critical Reexamination of the Takings Jurisprudence, 90 Mich. L. Rev. 1892, 1964-65 (1992).

328 Treanor, supra note 320, at 856.

329 The political process theories for compensation can thus be traced back to John Hart Ely, Democracy and Distrust: A Theory of Judicial Review 136 (1980) ("The constitutionality of most distributions . . . cannot be determined simply by looking to see who ended up with what, but rather can be approached intelligibly only by attending to the process that brought about the distribution in question . . . .").

330 Fischel, supra note 327, at 890.

331 Id. at 886.

ing.[332] Regulatory burdens imposed by larger units of government, characterized by pluralist politics, are unlikely to require compensation, but those imposed upon political minorities by local governments will.[333]

Other process-failure theorists focus on the characteristics of the property owners burdened by the regulation. Saul Levmore argues that compensation should be paid to protect "minorities that are unlikely to be able to take care of themselves through the political process" but need not be paid to "interest groups" that occasionally lose in the regulatory process.[334] He offers several criteria for what he acknowledges is an "awkwardly drawn line between 'interest groups' and 'unprotected minorities.'"[335] Compensation should be paid if the victim is an individual or small group who lacks the ability to organize and is not a "repeat player" in politics, and if the regulation singles out uniquely situated individuals, a single company, or a parcel of land.[336] In contrast, broad classifications and comprehensive coverage, such as industry-wide regulations and large-scale comprehensive zonings, are not likely to require just compensation because such regulations create natural political allies among the commonly burdened.[337]

Others would draw a still different line between those able to protect themselves in the political process and those in need of judicial protection. Daniel Farber, for example, disputes Levmore's claims that small groups are always organizationally disadvantaged and worries instead about the disproportionate power a political minority may wield over a diffuse majority.[338] Farber argues that democratic legislatures usually compensate those whose property is physically taken because the visibility of physical takings allows those affected to band together, and each of those threatened by a physical taking has a large stake in securing compensation. Those taxpayers who will see their

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332 William A. Fischel, Introduction: Utilitarian Balancing and Formalism in Takings, 88 Colum. L. Rev. 1581, 1582 (1988); Fischel, supra note 327, at 886.

333 See William A. Fischel, Regulatory Takings: Law, Economics, and Politics 289-324 (1995) (giving "examples of contrasting regulatory behavior among the types of government"); Fischel, supra note 327, at 911 (arguing that in "most extreme regulations enacted by larger units of government . . . economic and political science research provides reason to believe that pluralistic politics will give those subject to regulation a realistic opportunity to protect themselves"); Carol M. Rose, Takings, Federalism, Norms, 105 Yale L.J. 1121, 1126-27 (1996) (reviewing *Regulatory Takings* and commenting on Fishel's argument that state and national governments offer greater protection to landowners).

334 Saul Levmore, Just Compensation and Just Politics, 22 Conn. L. Rev. 285, 310 (1990).

335 Id. at 316.

336 Id. at 311-21.

337 Id.

338 Farber, supra note 303, at 289-90.

taxes increase to pay the compensation, on the other hand, have little at stake and are too diffuse to organize easily against compensation.[339] William Treanor, attempting to synthesize the various theories, argues that "[c]ompensation is due when a governmental action affects only the property interests of an individual or a small group of people and when, in the absence of compensation, there would be a lack of horizontal equity (i.e., when compensation is the norm in similar circumstances)."[340]

In an international context, the fairness and political process theories would require that foreign investors receive compensation either whenever they are burdened by regulations imposed by levels or types of governments whose processes do not afford the advantages of pluralist politics, or whenever particular kinds of foreign investors or foreign investors as a class are "singled out" by regulations and are unable to protect themselves against legislative or regulatory change in normal political processes.[341] More general fairness theories would require compensation unless the challenged regulation sought merely to prevent a property owner from wrongdoing.[342] Disagreements among the theorists over how to define which groups are unable to protect themselves politically, or which regulations target harms rather than seek benefits, illustrate that the first problem with fairness theories is their indeterminacy. Deciding when fairness requires compensation demands agreement upon the criteria that should be used to separate the fair from the unfair, harms from benefits, or process failures from the ebb and flow of political fortunes. Settling on these criteria, in turn, requires resolution of several very difficult "big picture" questions.

What is fair—what is wrongdoing or harm, or what is a process failure—depends critically, for example, upon how the "transaction" at issue is framed.[343] The fairness of compensating Methanex for the losses occasioned by California's phase-out of MTBE is likely to look quite different if the regulatory "transaction" is considered to be only the phase-out than if it is considered to be both the regulatory processes that created the market for MTBE and the subsequent phase-out that allegedly destroyed that market.[344] Similarly, the fair-

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339 Id. at 293-94.

340 Treanor, supra note 320, at 872.

341 We emphasize the need for protection from changes in regulations or legislation for the reasons discussed infra note 350 and accompanying text.

342 Peterson, Part II, supra note 144, at 106.

343 Daryl J. Levinson, Framing Transactions in Constitutional Law, 111 Yale L.J. 1311, 1338-45 (2002).

344 Methyl Tertiary Butyl Ether (MTBE) is primarily used as an additive in gasoline and has been the subject of substantial environmental research and regulation. Been, supra

ness of the political processes involved in any regulation depend critically upon whether we focus only on the first level of decisionmaking, or whether we also look at the recourse the burdened group has to higher levels of government.[345] But there is no agreement on how to decide which elements of a particular property owner's relationship with the government should be considered in determining whether compensation is due. Nor is there agreement over the point where a political process has begun or ended.

These sorts of issues have bedeviled attempts to define a regulatory takings doctrine in U.S. jurisprudence. Taken to an international level, their resolution becomes considerably more problematic. First, there are diverse views about property among different cultures and legal systems. This makes it especially unlikely that arbitrators chosen by the states bound to bilateral and multilateral investor protection agreements will be able to define with any specificity the circumstances in which compensation is due.[346] Second, even if arbitrators could reach an agreement on such a definition, the nature of the arbitral panels makes it unlikely that the definition would be acceptable to the polities of the parties to the treaty. There is considerable debate in the U.S. about the extent to which regulatory takings doctrines should allow judges to substitute their views about the appropriate balance between the needs of property owners and society's desire for environmental quality for the views of elected, representative legislatures.[347] Importing a regulatory takings doctrine into NAFTA's investor protection provisions allows arbitral panels who have even less

note 2, at 11,010-11, for a discussion of Methanex's claim and the role the government played in creating the market for MTBE that Methanex now considers its property.

345 See, e.g., Vicki Been, The Perils of Paradoxes—Comment on William A. Fischel, "Exploring the Kozinski Paradox: Why Is More Efficient Regulation a Taking of Property?", 67 Chi.-Kent L. Rev. 913, 920-22 (1991) (arguing that property owner's opportunities to exercise "voice" at state and federal level should be considered in evaluating potential for unfairness in political processes).

346 For an analogous discussion of how changing views of property within the U.S. culture alone complicate the effort to define the fairness of limitations upon property, see generally Eric T. Freyfogle, Property Rights, the Market, and Environmental Change in 20th Century America, 32 Envtl. L. Rep. 10,254 (2002).

347 See, e.g., Dolan v. City of Tigard, 512 U.S. 374, 406-07 (1994) (Stevens, J., dissenting) ("The so-called 'regulatory takings' doctrine . . . has an obvious kinship with the line of substantive due process cases that *Lochner* exemplified. Besides having similar ancestry, both doctrines are potentially open-ended sources of judicial power to invalidate state economic regulations that Members of this Court view as unwise or unfair."). For a flavor of the debate in the academic literature, see, for example, Fischel, supra note 333, at 100-40; J. Peter Byrne, Ten Arguments for the Abolition of the Regulatory Takings Doctrine, 22 Ecology L.Q. 89, 102-06 (1995); Molly S. McUsic, The Ghost of *Lochner*: Modern Takings Doctrine and Its Impact on Economic Legislation, 76 B.U. L. Rev. 605, 667 (1996).

structural independence and democratic legitimacy than domestic judges[348] to second-guess legislative judgments.

The second major problem with the fairness theories is that they ignore the choice investors have both about whether to invest initially and whether to exit if a country's regulatory system becomes too onerous. Foreign investors decide whether to invest in a particular country on the basis of many factors, including the country's regulatory climate. If an investor finds the environmental or land use regulations of a particular jurisdiction less favorable than those of other jurisdictions, the investor may spend its capital elsewhere. If it chooses to locate in the jurisdiction because other factors outweigh its dislike of the regulations, the investor must take the complete package—the bitter with the sweet. It should have no claim to compensation for the effects of the regulation if it chooses to invest despite the regulation.[349] Indeed, if the justification for a regulatory takings doctrine for foreign investors is the inability of those investors to protect themselves in the political arena, it would be quite odd to require compensation for burdens they knew about prior to deciding whether to invest in the country at issue.

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348 For discussion of the characteristics of private arbitrators, see generally Andreas F. Lowenfeld, The Party-Appointed Arbitrator in International Controversies: Some Reflections, 30 Tex. Int'l L.J. 59 (1995); Alan Scott Rau, Integrity in Private Judging, 38 S. Tex. L. Rev. 485 (1997).

349 Takings jurisprudence in the United States has not yet resolved whether there are circumstances in which a property owner could prevail on a takings claim even if the owner acquired the property knowing that it was burdened by the regulation the owner challenges. The Supreme Court recently held that notice of the challenged regulation is not an absolute bar to a takings claim, but it did not resolve exactly what role such notice would play in the takings determination. Compare, e.g., Palazzolo v. Rhode Island, 533 U.S. 606, 635-36 (2001) (O'Connor, J., concurring) (arguing notice of regulation should be balanced against other factors in determining whether regulation effects taking), with id. at 636-37 (Scalia, J., concurring) (arguing notice of regulation should have no bearing on determining existence of taking). See generally Radford & Breemer, supra note 152 (tracing development of doctrine of investment-backed expectations).

The best arguments given for allowing a property owner to challenge regulations even if it had notice of the regulation prior to purchasing are that a contrary rule might interfere with the marketability of property, and that the ripeness rules in U.S. takings jurisprudence would render a contrary rule unfair to the landowner who did not purchase property with notice but sold it to someone who did. These arguments would not be applicable in the context of NAFTA and similar treaties. As noted previously, those treaties define the investments protected by their compensation requirements to go far beyond the real property that is the primary focus of U.S. takings law. Further, the treaties have not been interpreted to impose the ripeness requirements that U.S. takings law deems essential. See supra Parts III.C. For discussion of the arguments regarding the role of notice in takings determinations, see Steven J. Eagle, The 1997 Regulatory Takings Quartet: Retreating from the "Rule of Law", 42 N.Y.L. Sch. L. Rev. 345 (1998); Fischel & Shapiro, supra note 282, at 287-89; Kaplow, supra note 283, at 526-27; Quinn & Trebilcock, supra note 307, at 153-62; Gregory M. Stein, Who Gets the Takings Claim? Changes in Land Use Law, Pre-Enactment Owners, and Post-Enactment Buyers, 61 Ohio St. L.J. 89 (2000).

Once an investor chooses to invest in a particular jurisdiction, its sunk costs make it harder to pull up stakes and move elsewhere if the jurisdiction changes its regulations.[350] Therefore, the owner of a "captive" investment may need to be protected from regulatory changes that would diminish the attractiveness of the investment. But there are several reasons a compensation policy is not required to serve that role.

First, unless the investment is unique, the jurisdiction will consider the effect its regulatory change will have upon its ability to attract similar investments in the future.[351] Competition from other jurisdictions for new investment will discipline the host jurisdiction's propensity to change its regulations in ways that make it a less desirable home for investors and thereby protect even those investors who already have investments in the jurisdiction.[352] Even if the captive investor is quite different from the new investors the host jurisdiction hopes to attract, those new investors will nevertheless consider the jurisdiction's general propensity to upset settled expectations in assessing the comparative regulatory climate of competing jurisdictions.

Second, the handicap suffered by foreign, relative to domestic, investors in the regulatory process is the fact that they have no vote within the jurisdiction (except perhaps as real property owners) and may be cast as "outsiders" in the minds of the public and elected representatives. But standard national treatment requirements in international investment agreements, and more generally, in international law principles, provide much more targeted protection against that concern than do expropriation clauses. As the *S.D. Myers* award illustrates,[353] when governments regulate foreign investors more harshly in order to protect domestic investors, the national treatment requirements force arbitrators' attention to the right issue—whether foreign investors are being treated differently than similarly situated domestic

[350] See, e.g., Vicki Been, "Exit" as a Constraint on Land Use Exactions: Rethinking the Unconstitutional Conditions Doctrine, 91 Colum. L. Rev. 473, 539-43 (1991) (discussing sunk costs and limited mobility of assets as constraints on property-owner "exit" from regulating jurisdiction).

[351] The need to reassure investors in the competitive market for foreign direct investment forms the basis for the "investment attraction" rationale discussed in infra Part IV.D.

[352] We note in Part IV.D that there is little evidence that a country's participation in international investment agreements is strongly correlated with the flow of foreign investment, and we suggest several reasons for that. See infra notes 427-432 and accompanying text. Although a country's agreement to offer regulatory takings protection in a BIT may not influence significantly an investor's decisions, the negative publicity of an investor's decision to exit because of mistreatment and the reputational consequences to the host country of that publicity, may be more salient to future investors than the vague promises of compensation for regulatory takings that are contained in BITs.

[353] See Been, supra note 2, at 11,006-07; Beauvais, supra note 2, at 272-74.

investors. The expropriation clause is, at best, a much less precise tool for directing that inquiry.[354] To the extent that NAFTA panels interpret national treatment standards too strictly, those decisions may raise some of the same problems that are posed by an expansive regulatory takings doctrine.[355] But locating equality concerns within the national treatment clause, rather than within the expropriation provisions, focuses attention more appropriately upon how the standards arbitrators apply under the national treatment provision compare with those applied under U.S. Equal Protection and Commerce Clause jurisprudence, customary international law, and other trade and investment agreements such as the GATT.[356]

In short, imposing a compensation requirement through international investment agreements is a problematic and unnecessary way to ensure that investors are treated fairly. The arbitral panels established under NAFTA and other agreements have neither the structural protections nor the institutional credibility necessary to review the fairness of the balance legislatures have struck between the interests of investors and those of society. Nor is such a review necessary given the role that reputational interests play in constraining regulators in a competitive market for foreign investment and given the availability of other protections designed to ensure that foreign investors are treated no differently than domestic investors.

[354] In the United States, some property-rights oriented justices and scholars have similarly attempted to collapse equal protection (and due process) principles into the takings inquiry. For the academic debate on the wisdom of blending the different inquiries, see generally Lawrence Berger, Public Use, Substantive Due Process and Takings—An Integration, 74 Neb. L. Rev. 843, 844 (1995); John D. Echeverria, Does a Regulation That Fails to Advance a Legitimate Governmental Interest Result in a Regulatory Taking?, 29 Envtl. L. 853 (1999); John D. Echeverria & Sharon Dennis, The Takings Issue and the Due Process Clause: A Way Out of a Doctrinal Confusion, 17 Vt. L. Rev. 695 (1993); McUsic, supra note 347; Edward J. Sullivan, Emperors and Clothes: The Genealogy and Operation of the *Agins'* Tests, 33 Urb. Law. 343 (2001); Edward J. Sullivan, Substantive Due Process Resurrected Through the Takings Clause: *Nollan*, *Dolan*, and *Ehrlich*, 25 Envtl. L. 155 (1995); Robert Ashbrook, Comment, Land Development, the *Graham* Doctrine, and the Extinction of Economic Substantive Due Process, 150 U. Pa. L. Rev. 1255 (2002); Glen E. Summers, Comment, Private Property Without *Lochner*: Toward a Takings Jurisprudence Uncorrupted by Substantive Due Process, 142 U. Pa. L. Rev. 837 (1993).

[355] See Beauvais, supra note 2, at 285-86 (arguing that national-treatment and minimum-standard-of-treatment provisions may provide more cause for concern for environmental regulation than regulatory expropriations claims).

[356] See, e.g., Daniel C. Esty, Greening the GATT 111-36 (1994) (proposing standards based in part upon U.S. Commerce Clause jurisprudence); John O. McGinnis & Mark L. Movsesian, The World Trade Constitution, 114 Harv. L. Rev. 511, 514-16, 536-38, 563-64 (2000) (same).

C. *The Insurance Rationale*

The risk that changes in regulations will decrease the value of one's investment imposes costs upon investors, just as the risk that fire may destroy the investment imposes costs. Generally, investors insure against risks in order to reduce the costs such risks impose, so one would expect investors to insure against the risks of legal changes.[357] Insurance against many forms of physical expropriations and against virtually all regulatory impacts upon the value of property is not widely available on the private market for domestic investors, in large part because of the difficulties of adverse selection[358] and moral hazard.[359] The same problems that prevent the private market from offering insurance also will prevent governments from offering their citizens insurance ex ante against future legal changes.[360] Accordingly, the insurance rationale for compensating for regulatory changes, most fully articulated by Daniel Rubinfeld and Lawrence Blume, asserts that government should remedy the private market's failure to provide insurance for legal transitions by providing ex post compensation for such changes.[361]

To be efficient, ex post compensation that substitutes for ex ante insurance would have to minimize the sum of three costs: the cost of

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[357] See generally Lawrence Blume & Daniel L. Rubinfeld, Compensation for Takings: An Economic Analysis, 72 Cal. L. Rev. 569 (1984) (conceiving takings compensation as payment of insurance). A more formal version of the argument is Lawrence Blume, Daniel L. Rubinfeld & Perry Shapiro, The Taking of Land: When Should Compensation Be Paid?, 99 Q.J. Econ. 71 (1984).

[358] The problem of adverse selection arises when the insurer is unable to set premiums that accurately distinguish between lower- and higher-risk property owners; consequently, those property owners who perceive themselves to be at high risk of being negatively affected by regulatory changes purchase the insurance while those who perceive themselves to be at lower risk do not. Blume & Rubinfeld, supra note 357, at 595-96.

[359] The problem of moral hazard stems from the risk that the party to be insured "can affect the probability or the magnitude of the event that triggers payment." Id. at 593. Just as health insurers must worry about the fact that a person who has health insurance may be more likely to seek medical attention, insurers against regulatory changes would have to be concerned that property owners subject to regulatory changes might not oppose those changes with the same vigor if they are insured against loss. Worse, such property owners might seek regulatory changes in order to trigger payment of the insurance if for some reason the insurance payout would be worth more than the property itself. Id. at 594.

[360] The moral hazard problem might be especially problematic if governments offered insurance, because the government might distort its regulatory policies to target only uninsured properties. Id. at 597-99. Special problems of adverse selection also could arise because self-serving government agents in possession of "inside" information might tip off those whom the agent knows will soon be the victim of regulatory changes in exchange for a share of the insurance payout. Id.

[361] Id. at 572-73.

the risks that property owners must bear;[362] the administrative costs of compensation; and the costs that the compensation policy may impose by causing the government to regulate inefficiently (either by adopting a regulation when its costs outweigh its benefits or by failing to adopt a regulation when its benefits outweigh its costs).[363] Blume and Rubinfeld therefore argue that the government should compensate only when individuals confronted with the administrative costs of the compensation policy would have purchased private insurance if it were available. As administrative costs increase, only those property owners who are substantially risk averse would choose to purchase insurance ex ante, and thus only those property owners should be compensated ex post.[364] It is difficult to discern the risk aversion of investors, of course, but the wealth of the investor serves as a rough proxy: "[T]he compensating body will approximate risk aversion if its decisions to award compensation vary inversely with the wealth of the [property owner]."[365]

Further, even for those investors who are substantially risk averse, compensation should be paid only when the regulatory change results in a substantial loss that would reduce significantly the owner's overall wealth. That requirement follows from the fact that investors

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362 The cost of the risk that property owners may see their investment diminished by changes in regulation is that property will be not be put to the use that would yield the highest expected return. Blume and Rubinfeld illustrate:

> Investor A has for sale a parcel of land potentially subject to government regulation that will render the land essentially valueless. Investor B contemplates a project for the site that will generate $500,000 in economic profits. Investor C contemplates a project for the site which would generate $470,000. If there were no possibility of government regulation, B would outbid C and the land would be used for B's project. This is the most efficient outcome.
>
> Suppose, however, that there is a 0.1 probability that the proposed regulation will actually be enacted, and that if this occurs, no compensation will be paid. In this case, B's project has an expected value of $450,000 (0.9 x $500,000 + 0.1 x $0), and C's project has an expected value of only $423,000 (0.9 x $470,000 + 0.1 x $0). But suppose that C's risk premium [the amount C would pay to avoid the risk] for the gamble is $2,000, while B's is $32,000. B would bid at most $418,000 for the land, whereas C would bid $421,000. The land would be used for C's project, even though B's project has a higher expected return. . . . If . . . individuals vary in their aversion to risk, the possibility of an uncompensated government taking allows land to be used in an inefficient manner.

Id. at 587-88. Insurance can redistribute the risk so that B's and C's risk premiums are just the costs of purchasing the insurance. Id. at 589. Assuming that the cost of insurance to each would be equal, the land then would be sold to B, who would be willing to bid up to $450,000 minus the cost of insurance.

363 Id. at 582-83.

364 Id. at 605-06. Blume, Rubinfeld & Shapiro, supra note 357, at 78-86, present formal proofs about the efficiency of various compensation rules when investors are risk-neutral.

365 Blume & Rubinfeld, supra note 357, at 606.

can self-insure against losses caused by regulatory change by diversifying their investments—purchasing a large number of parcels or investing in assets other than real property.[366] In sum, Blume and Rubinfeld posit that compensation will generally be efficient only when the loss significantly reduces the owners' net worth and when the property owner is substantially risk averse (measured by the rough proxy of wealth because, in general, the wealthier the property owner, the less likely she is to be risk averse).[367] Blume and Rubinfeld's insurance theory suggests that compensation should be paid only for very substantial diminutions in the value of property, in situations in which the reduction in property value would affect a large part of an investor's total wealth.[368]

Most importantly, Blume and Rubinfeld's analysis shows that compensation should not be paid when an investor had the opportunity to purchase insurance against the risk but chose not to. Such insurance exists in the international investment context. The major capital-exporting countries provide national investment insurance programs that cover some of the risks of expropriation.[369] The Multilateral Investment Guarantee Agency (MIGA) provides similar coverage,[370] as do many private insurers.[371]

The first national program was introduced in 1948 when the United States sought to encourage investment in postwar Europe by guaranteeing U.S. private investments against the risk of currency conversion restrictions.[372] The program was expanded incrementally to broaden the political risks covered and to apply to investments outside of Europe.[373] It is now administered by the Overseas Private Investment Corporation (OPIC),[374] which insures U.S. investments[375]

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366 Id. at 606-11.

367 Id. at 610-11.

368 In the international context, an investor's risk aversion might be measured not only by the proxy of overall wealth but also according to the riskiness of the investment itself. Surely an investor's risk aversion bears some relationship to its willingness to invest in a country with a very unstable political and economic situation.

369 See infra notes 372-377, 382-383 and accompanying text.

370 See infra notes 378-381, 383 and accompanying text.

371 For a description of the private political risk insurance market, see Maura B. Perry, A Model for Efficient Foreign Aid: The Case for the Political Risk Insurance Activities of the Overseas Private Investment Corporation, 36 Va. J. Int'l L. 511, 531-34 (1996).

372 For a description of the history of the U.S. program, see generally Marina von Neumann Whitman, The United States Investment Guaranty Program and Private Foreign Investment (1959).

373 Charles Lipson, The Development of Expropriation Insurance: The Role of Corporate Preferences and State Initiatives, 32 Int'l Org. 351, 351, 356 (1978).

374 See Foreign Assistance Act of 1969, Pub. L. No. 91-175, § 231, 83 Stat. 805, 809-10 (codified as amended at 22 U.S.C. §§ 2191-2200 (2000)). For an overview of the Overseas Private Investment Corporation (OPIC), see generally Perry, supra note 371.

in eligible countries against political risks, including expropriation, up to $250 million for up to twenty years.[376] Most developed countries have similar agencies that provide political risk insurance policies for their investors.[377] In addition, at the urging of the World Bank, MIGA was formed in 1988 to fill the gaps left by national programs.[378] It has since issued coverage totaling $7.1 billion against expropriation and other political risks in seventy-five developing countries.[379]

Neither OPIC nor MIGA cover all forms of regulatory expropriation. MIGA's expropriation provisions cover

> any legislative action or administrative action or omission attributable to the host government which has the effect of depriving the holder of a guarantee of his ownership or control of, or a substantial benefit from, his investment, with the exception of non-discriminatory measures of general application which the governments normally take for the purpose of regulating economic activity in their territories.[380]

Although that definition would not cover many legal transitions, it would reach regulatory measures that discriminate against foreign investors, those "designed to have a confiscatory effect such as causing the investor to abandon his investment or to sell it at a distressed price," and those that constitute "a series of measures . . . which in their combined effect are expropriatory even if each individual measure, taken alone, would appear to fall within the [bona fide regulation] exception."[381]

OPIC's coverage of expropriation also is limited, reaching only

> total expropriation . . . if an act or series of acts satisfies all of the following requirements:

[375] Eligible investors are U.S. citizens, U.S. corporations that are majority-owned by U.S. citizens, and foreign corporations in which ninety-five percent of the shareholders are American citizens or corporations. OPIC Program Handbook 7 (2002), at http://www.opic.gov/pdf/publications/02-ProgramHandbook.pdf.

[376] OPIC Insurance Department Home Page, at http://www.opic.gov/Insurance/home.htm (last visited Mar. 6, 2003). OPIC holds over $4 billion in reserves and has paid over $783 million in claims as of September 2001. OPIC Program Handbook, supra note 375, at 21.

[377] OPIC, Frequently Asked Questions, at http://www.opic.gov/GeneralOPIC/faqs.htm (last visited Nov. 28, 2002).

[378] Convention Establishing the Multilateral Investment Guarantee Agency, Oct. 11, 1985, 1508 U.N.T.S. 99, available at http://www.miga.org/convent.htm [hereinafter MIGA Convention]. For an overview of the history of MIGA and of MIGA's operations, see generally Ibrahim F.I. Shihata, MIGA and Foreign Investment (1988).

[379] MIGA, 2000 Annual Report 6, http://www.miga.org/screens/pubs/annrep00/pp6_22.pdf.

[380] MIGA Convention, supra note 378, art. 11(a)(ii), 1508 U.N.T.S. at 105.

[381] Multilateral Investment Guarantee Agency: Operational Regulations, June 22, 1988, §§ 1.36, 1.37, 27 I.L.M. 1227, 1236.

a) the acts are attributed to a foreign governing authority which is in de facto control of the part of the country in which the project is located;
b) the acts are violations of international law (without regard to the availability of local remedies) or material breaches of local law;
c) the acts directly deprive the Investor of fundamental rights in the insured investment (Rights are "fundamental" if without them the Investor is substantially deprived of the benefits of the investment.); and
d) the violations of law are not remedied and the expropriatory effect continues for six months.[382]

Thus, unless an alleged regulatory expropriation was a violation of customary international law (which it might be if it constituted "creeping expropriation" or violated minimum international standards of treatment) or a violation of local law (which it might be if it violated the Fifth Amendment), normal legal transitions would not be covered.[383]

Even though insurance programs such as OPIC or MIGA cover only some diminutions in value caused by regulations, they seriously compromise the compensation-as-insurance rationale for an international regulatory takings doctrine. First, they cover the most troublesome forms of regulatory infringements on property values, such as regulations that discriminate against foreign investors. Second, they serve as powerful evidence that when insurance is necessary to promote investment, the governments of capital-exporting nations and international agencies have provided insurance, thereby obviating the need for ex post compensation. Indeed, OPIC offers special policies tailored to meet the insurance needs of international investments particularly vulnerable to the effects of regulatory changes, such as natural resource projects.[384]

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382 See, e.g., OPIC Contract of Insurance, Form 234 KGT 12-85 § 4.01 (rev. June 1, 2002) (on file with the *New York University Law Review*); see also OPIC Claim Determinations, Memorandum of Determinations: Expropriation Claim of MidAmerican Energy Holdings Company (Nov. 1999), at http://www.opic.gov/foia/claim%20determinations/1999%20determinations/midamerican%20energy.htm (explaining four elements of expropriation claim as applied in particular case); OPIC Program Handbook, supra note 375, at 9 (stating that OPIC only covers "total expropriation").

383 OPIC's definition of expropriation refers to a "total expropriation," which might further limit coverage of regulatory expropriations to those regulations that destroy all value of the property. It is not clear, however, how OPIC would define the property interest at stake in determining whether there had been a "total" taking. See supra notes 150, 155-159 and accompanying text. For discussion of OPIC's approach to expropriation claims, see generally Vance R. Koven, Expropriation and the "Jurisprudence" of OPIC, 22 Harv. Int'l L.J. 269 (1981).

384 See, e.g., OPIC Program Handbook, supra note 375, at 14.

The burgeoning private insurance market also shows that when insurance against political risks is needed by investors, it will be provided. In recent years, the private market has exploded, with more than twenty insurers offering approximately $1.5 billion in coverage for expropriation risks and approximately $300 million for coverage of contract frustration risks in 1998.[385] The industry is actively debating new types of coverage, ranging from worldwide umbrella policies that would enable investors to better diversify risks to greater protection against government actions that decrease earnings.[386]

The absence of broader coverage for the effects regulations may have on investments in the standard political-risk policies thus suggests that foreign investors are not sufficiently averse to the risk of regulatory takings to demand such insurance.[387] Indeed, even for the

385 Technical Report: Political Risk—An Industry in Revolution, Reinsurance, Aug. 31, 1998, at 13, LEXIS, Nexis Library, Reinsurance Magazine File; see also Rowat, supra note 65, at 125 (describing origins and development of private political risk insurance market). Following September 11, the political insurance market has retrenched somewhat. See Lloyd's Leads Tightening of Political Risk Market, Ins. Day, Feb. 26, 2002, at 1 (reporting that capacity for contract frustration coverage fell from $810 million in 2001 to $650 million in 2002, while expropriation capacity fell from $1.55 billion to $830 million).

386 Technical Report, supra note 385, at 13 (noting that corporations increasingly are concerned less with protecting their assets—i.e., their balance sheets—and more with protecting their revenues and earnings, and disputing reasons traditionally given for not providing such coverage); see also Political Risk: New Ideas for Old Problems, Reinsurance, Aug. 31, 1998, at 20, LEXIS, Nexis Library, Reinsurance Magazine File (exploring idea of umbrella policies).

387 It should be noted, however, that the scope of expropriation coverage under OPIC and MIGA (though not necessarily private insurance) effectively may be tied to the scope of international law standards on expropriation because of these insurers' partial dependence on subrogation rights. Both MIGA and OPIC require that the host country be party to an international agreement providing the insurer with subrogation to the insured's rights against the host-country government. See Christopher K. Dalrymple, Politics and Foreign Direct Investment: The Multilateral Investment Guarantee Agency and the Calvo Clause, 29 Cornell Int'l. L.J. 161, 184 (1996) (describing subrogation under MIGA); John S. Diaconis, Political Risk Insurance: OPIC's Use of a "Fiduciary Agent" to Facilitate Resolution of Subrogation Claims, 23 Int'l Law. 271, 275-76 (1989) (explaining OPIC subrogation process). The insurer processes the insured's claim—of losses due to an alleged act of host-government expropriation covered under the policy, for example—and, in most cases, pays the insured. See Rowat, supra note 65, at 124 (reporting that, as of 1990, OPIC had "denied only twenty-two [policyholder] claims, and of these, only seven [had] gone to arbitration"). The insurer then may bring a claim against the host government on the basis of the insured's rights—in this case, against a governmental act of expropriation. Such claims are usually settled, but if not, the insurer is entitled to binding international arbitration of its claim to enforce the insured's rights. See MIGA Convention, supra note 378, annex II, arts. 2, 3(a), 3(b), 4(e), 1508 U.N.T.S. at 122-24 (MIGA arbitration provisions); Rowat, supra note 65, at 124 (noting that, as of 1990, OPIC had never had to resort to arbitration to resolve subrogation claim against host government); S. Linn Williams, Political and Other Risk Insurance: OPIC, MIGA, EXIMBANK, and Other Providers, 5 Pace Int'l L. Rev. 59, 75-76 (1993) (commenting on inclusion of OPIC-required arbitration provisions in bilateral agreements with host-country governments).

expropriations that are covered, the vast majority of investors appear to prefer to self-insure. OPIC, for example, "insures only a drop in the $28 billion ocean of U.S. foreign direct investment each year."[388] Without evidence that foreign investors are sufficiently risk averse to prefer insurance against regulatory changes that diminish the value of their property to diversification and other means of self-insurance, the justification for ex post compensation instead of ex ante insurance evaporates.

Further, the insurance rationale for compensation focuses on the costs of the risks of legal change. It pays insufficient attention to the administrative costs of insuring against those risks or to the distortions in regulatory policy that might result from the availability of compensation as insurance.[389] The desirability of paying compensation as ex post insurance depends in part, however, upon the adverse incentives the availability of insurance may give to the insured.[390] In the absence of compensation for legal transitions, "it will pay for firms to anticipate government regulation in order to avoid liability or wasted investments."[391] Once insurance (or compensation as insurance) becomes available, firms may not monitor adequately how regulations will (or should) change and thus may overinvest in inefficient technologies and underinvest in the research and development of new products or technologies. This is the problem of moral hazard: If insurance is available, firms do not bear the full costs of their decisions and thus may choose to invest more than is efficient. In the international context, it may be particularly important to provide incentives to anticipate legal change, because the investor may have better information than the host government, both about the impacts of the inves-

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Insofar as OPIC and MIGA rely on the right to recover from host-country governments to help finance the coverage they provide and can recover only on the basis of the insured's substantive rights under preexisting domestic or international law, these insurers might be less likely to insure against state action not clearly proscribed by international law. As a result, the scope of OPIC and MIGA coverage might not extend beyond international law rights against expropriation—for example, to encompass a broader class of regulatory diminutions of investment value—even if there were a demand for such coverage.

388 Perry, supra note 371, at 546 (citing Central Intelligence Agency, Directorate of Intelligence, Handbook of International Economic Statistics 40 (Sept. 1994)). It may be, of course, that some of those investors who are not insured wish to be and are not voluntarily self-insuring. But even if substantial numbers of additional investors would prefer coverage, the lack of the capacity to address those needs may reflect that the projects are too risky to be efficient.

389 See Kaplow, supra note 283, at 527-32.

390 Id. at 527-29.

391 Saul Levmore, Changes, Anticipations, and Reparations, 99 Colum. L. Rev. 1657, 1663 (1999); see also Michael J. Graetz, Legal Transitions: The Case of Retroactivity in Income Tax Revision, 126 U. Pa. L. Rev. 47, 64-66 (1977) (arguing that "efficiency may demand that persons expect changes in the law").

tor's products or processes upon the environment or upon health and safety, and about regulatory trends in other jurisdictions.[392]

As a substitute for ex ante insurance, compensation requirements shift the costs of avoiding risks. When an investor chooses to buy insurance, it pays the premium. When compensation requirements take the place of insurance, the public pays. In the absence of better evidence that investors are sufficiently risk averse to pay for insurance against regulatory changes, there is little justification for asking taxpayers to provide for that insurance.[393]

D. *The Need to Attract Investment*

Proponents of treaty-based compensation requirements commonly assert that such requirements are necessary in order to encourage economically beneficial foreign direct investment (FDI) in developing countries.[394] This argument mirrors the insurance rationale discussed above: Just as foreign investors (and their home states) might want host states to provide publicly subsidized insurance against expropriation risk in the form of ex post compensation, so host-state governments may want to provide such insurance in order to attract investment. The "investment-attraction" rationale focuses on how the

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392 While not paying compensation for regulatory changes encourages investors to anticipate change, that advantage could be outweighed in some circumstances because the lack of compensation gives those benefiting from the old rule an incentive to resist change. But a rule that compensation is not required for regulatory change does not mean that compensation may not be offered if necessary to facilitate the change. See Levmore, supra note 391, at 1657-65 (encouraging legislators to use strategic and selective compensation to promote anticipatory behavior).

393 It should be acknowledged that the operation of subrogation rights under OPIC and MIGA make these programs something of a hybrid between ex ante and ex post insurance with regard to the distribution of the costs of risk mitigation. Under these programs, once the insurer pays a claim to a policyholder, the insurer then has a right to recover from the host government on the basis of the insured's rights. See supra note 387. This is similar, in some respects, to an ex post compensation requirement enforced through the third party of the insurer. Of course, policyholders do pay premiums, meaning that they bear some of the costs of risk mitigation. In addition, most of these claims against host governments are settled, suggesting that host governments may be paying out only some fraction of their potential liability under a directly enforced ex post compensation requirement. Nevertheless, it remains the case that risk-mitigation costs under these programs are not placed wholly on the investor-policyholders (as may be the case with private insurers). Rather, such costs are shared between investor-policyholders (through payment of premiums) and host-country governments that are compelled to pay OPIC or MIGA some form of ex post compensation.

394 See, e.g., Jeswald W. Salacuse, Direct Foreign Investment and the Law in Developing Countries, 15 ICSID Rev.–Foreign Investment L.J. 382, 387-88 (2000) (suggesting that "fundamental purpose[ ]" of investment treaties and other international law measures is to "reduce the risk of international investment and thereby encourage private capital flows to developing countries").

international market for FDI functions and, in particular, on the competition between developing states within this market.

The following subsections assess why developing countries might include protections against "regulatory takings" in investment or trade treaties. We are skeptical that developing countries in fact favor this strategy for attracting FDI. The history of the provisions indicates that they were demanded by the United States to protect its investors, rather than offered by developing countries to gain competitive advantage. Further, because the evidence suggests that expansion of regulatory takings doctrines is likely to have no significant marginal effect in attracting investment and imposes substantial costs upon developing countries, the claim that developing countries are insisting upon such guarantees is suspicious. But even assuming that developing countries wish to offer such protections in order to enhance their attractiveness to foreign investors, the United States should reject the inclusion of such provisions in international agreements because the costs of undertaking such reciprocal obligations are unacceptable.[395]

1. *Political Risk Assessment, Competition, and Signaling in the Market for FDI*

Investors' decisions regarding whether and where to invest overseas are significantly affected by their assessment of the "political risk" associated with particular countries, including the risk that the host-country government will expropriate or enact regulations that reduce the value of the investment. The perception that a given country presents a higher political risk can deter investment by discouraging risk-averse investors, lowering expected returns on investment,[396] and raising investors' costs of capital.[397]

Political risks in the FDI market are a subset of the risks inherent in any investment made in the context of legal and political change.[398] Governments are replaced by new governments, and both old and

[395] See infra Part V.

[396] See, e.g., Vagts, supra note 86, at 1-2 (discussing evaluation of risk in foreign investment decisions in terms of "capital asset pricing model").

[397] See generally Kirt C. Butler & Domingo Castelo Joaquin, A Note on Political Risk and the Required Return on Foreign Direct Investment, 29 J. Int'l Bus. Stud. 599 (1998) (analyzing impact of political risk on investors' required return and cost of capital and concluding that "political sources of risk increase the cost of capital when the return consequence of the political shock is positively correlated with the return on the relevant market portfolio").

[398] For discussions of the relationship between legal change and transitional relief, including compensation for loss, in the contexts of tax law, takings of property, and regulatory change, see generally Kaplow, supra note 283; see also Daniel Shaviro, When Rules Change: An Economic and Political Analysis of Transition Relief and Retroactivity 27, 81-86 (2000) (discussing parallels between takings compensation and transitional tax relief).

new governments alter laws and policies as the political context evolves over time. Governments may face particular temptations to renege on promises to investors because the government's monopoly on the legitimate use of force may permit it to defect with impunity. In addition, there is a tension between the long-term desirability of enhanced investor security and the short-term temptation to extract rents from investors. Regardless of promises made or conditions existing at the time of the initial investment, once investment costs are sunk, investors are less likely to withdraw even as governmental treatment deteriorates.[399] In international investment literature, this problem is frequently discussed in terms of the "hostage effect"[400] or the "obsolescing bargain."[401]

These risks are, to some extent, germane to all investment because in any society, new knowledge about the effects of development and new tastes for environmental and other protections lead to changes in regulations. Developing countries competing to attract FDI face particular problems in allaying investors' fears about such risks, however. First, developing countries' reliance upon, and competition for, FDI has increased dramatically in the past two decades.[402] Second, their efforts to attract FDI operate in the shadow of a long history of government expropriations between the 1930s and the 1970s.[403] Despite the more recent trend towards investor-friendly policies, governments of developing countries are particularly susceptible to market and political change, and significant deterioration in economic circumstances can lead domestic groups to pressure host governments to discriminate against foreign investors.[404] Moreover, even though there have been virtually no direct expropriations during the

399 See supra note 350 and accompanying text.

400 Thomas W. Wälde & George Ndi, Stabilizing International Investment Commitments: International Law Versus Contract Interpretation, 31 Tex. Int'l L.J. 215, 220 (1996).

401 See Stephen J. Kobrin, Testing the Bargaining Hypothesis in the Manufacturing Sector in Developing Countries, 41 Int'l Org. 609, 610-13, 633-36 (1987) (discussing findings on obsolescing bargain in natural resource sectors and finding lesser influence in manufacturing sector).

402 See Guzman, supra note 109, at 641, 669-74 (noting rise in foreign direct investment (FDI) flows to developing countries and explaining developing country accession to BITs in terms of competition for FDI); Rowat, supra note 65, at 103-04 (attributing dramatic increase in FDI flows to developing countries to developing country policy changes and to surge in debt-equity swaps); UNCTAD, supra note 90, at 1-15 (describing trends of BITs and actual effect of BITs on FDI flows); Vandevelde, supra note 78, at 386-90 (detailing historical background for increased developing-country demand for FDI).

403 See supra note 89.

404 See Wälde & Ndi, supra note 400, at 218 ("[A] cycle of desirability (when investment is needed) and rejection (when investment is carried out and foreign control is negatively viewed) can be readily identified.").

past two decades,[405] developing countries still offer significantly less protection to private investment than developed countries. Substantive property protections are more limited, and administrative and judicial institutions are frequently less competent, transparent, and independent than their counterparts in developed countries.

The investment-attraction rationale argues that, by acceding to treaty-based expropriation protections, developing countries can lower the (perceived) risk of investing, thus reducing what might be termed the "location costs" to foreign investors and thereby attracting FDI. The competition among states for FDI provides an inducement to offer this protection against perceived risk. There are two interrelated but distinct versions of this argument, one focusing on the "real" effects of treaty-based protections on investor risk and the other focusing on "signaling" effects.

The first version contends that the host-country government, by subjecting itself to enforceable sanctions if it derogates from investor protections, materially decreases risks to foreign investors.[406] The existence of agreed legal standards and a mechanism for enforcing sanctions—backed up by the participation of the investor's home state in the overall regime—makes it less likely that host governments will violate expropriation protections. As a result, a host country is able to make its promises to treat foreign investors well significantly more credible than they would be in the absence of an international agreement.[407] The more competitive the market for FDI, the greater the impact of even a small marginal decrease in risk on a host country's attractiveness to investors.[408]

The "signaling" version of the argument focuses more narrowly on the relationship between the host country's reputation and its accession to international investment treaties. By making and adhering to investor protection commitments, especially when these require incurring visible front-end costs such as submitting to the jurisdiction of international tribunals, host countries may signal to foreign investors and capital-exporting countries that they are trustworthy.[409] Alterna-

[405] See Michael S. Minor, The Demise of Expropriation as an Instrument of LDC Policy, 1980–1992, 25 J. Int'l Bus. Stud. 177, 180 (1994) (finding, in study of expropriation trends from 1976 to 1992, that there were no recorded acts of expropriation of foreign property from 1987 onward).

[406] See Guzman, supra note 109, at 667 (describing "LDC enlightenment theory").

[407] See id. at 658-66 (discussing "dynamic inconsistency problem" faced by host countries in their attempts to make credible commitments to foreign investors).

[408] Id. at 670.

[409] See Eric A. Posner, Law and Social Norms 18-27 (2000) (using signaling model more broadly to explain social behavior); Daniel A. Farber, Rights as Signals, 31 J. Legal Stud. 83, 95-97 (2002) (arguing that constitutionalism provides efficient strategy for developing

tively, accession to an investment treaty may provide a means of communicating to foreign investors and capital-exporting states that an internal consensus has been achieved concerning liberalization of the host country's domestic policy and laws on foreign investment.[410] In addition, signaling in a competitive market can have a "snowballing" effect: As more and more countries commit themselves to a particular standard, "holdouts" are more and more likely to develop a negative reputation, making it more difficult to attract investment.[411]

2. *Are Developing Countries Seeking to Expand Regulatory Takings Protections in Order to Attract FDI?*

While the theory that jurisdictions must and will compete to attract FDI has substantial theoretical and empirical support in the literature and in common experience, the argument that developing countries are the motivating force for expansive regulatory takings protections in international investment agreements is unpersuasive for several reasons.

First, the historical impetus for the expropriation provisions did not come from the developing countries but through the BIT programs promoted by the United States and European countries. These programs were developed specifically to overcome developing countries' opposition to the Hull Formula, as expressed in the Calvo Doctrine and the CERDS resolution in the United Nations General Assembly.[412] The United States has been at the forefront of the push for investor protections[413] and consistently has refused to enter any treaty that did not contain the expropriation provisions.[414] In its efforts to promote the Hull Formula as the appropriate measure of compensation, the United States simultaneously encouraged the proliferation of the "direct or indirect expropriation" and "measures tantamount to expropriation" language of the Model BIT.[415] Although U.S. drafters and negotiators probably did not intend this lan-

and transitional states to attract investment by demonstrating commitment to rule of law). Beth Simmons argues that the signaling dynamic explains developing countries' commitment to International Monetary Fund obligations. See generally Beth A. Simmons, Money and the Law: Why Comply with the Public International Law of Money?, 25 Yale J. Int'l L. 323 (2000).

410 See infra note 435 and accompanying text.

411 See Simmons, supra note 409, at 324-25 ("[A]s more countries commit themselves to a rule, *non-commitment* sends a strong *negative* signal . . . .").

412 See supra Part II.B.1 (discussing history of treaty-based expropriation provisions).

413 See Price, supra note 7, at 9.

414 See Vandevelde, supra note 93, at 628 (noting U.S. refusal to compromise on expropriation protection and other provisions in BIT negotiations).

415 See supra Part II.B.1. It should be emphasized that we have no quarrel with the Hull Formula per se, only with the perhaps unintended side effects of its promotion.

guage to open the door to expansive "regulatory takings" claims such as those being made under NAFTA Article 1110,[416] such claims have been the direct result of the United States's promotion of the "indirect" and "tantamount to" language without qualifying text, definitions, or comments.[417]

Second, developing countries' acceptance of the U.S. language is not necessarily proof that those countries *want* the provisions. Far from embracing the United States's preferred measure of compensation, for example, developing countries have continued to oppose its proliferation. Even while acquiescing in the inclusion of the Hull Formula in bilateral treaties, developing countries have not supported efforts to make that standard part of customary international law.[418] One explanation for this anomaly is offered by Andrew Guzman. He argues that international expropriation protections are not in developing countries' best interests because they effectively increase the price to capital-importing states of attracting FDI.[419] He maintains that individual developing countries are induced to accept such provisions only by the competitive dynamic introduced by bilateral negotiations with capital-exporting states.[420] By contrast, in multilateral forums—where developing countries are in the majority and can operate as a "cartel"—they have opposed increased expropriation protections successfully.[421] Guzman's theory is buttressed by the fact that the largest developing states are relative newcomers to the BIT regime and are signatories to very few such instruments.[422] This is presumably because these countries—also the largest destination for FDI—are comparatively insulated from competitive pressures to adopt treaty-based investor protections.[423]

Of course, even if the historical impetus for the expropriation provisions that are being interpreted to provide expansive protection against regulation came from the United States and other capital-exporting countries, and even if the developing countries accepted those provisions reluctantly, it is possible that capital importers now have

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416 See supra note 106 and accompanying text.

417 See supra note 116 and accompanying text.

418 Guzman, supra note 109, at 684-87.

419 Id. at 673-74.

420 Id. at 671-74.

421 Id. at 674-78.

422 See Wälde & Dow, supra note 8, at 12 n.32.

423 The proposed Free Trade Area of the Americas, if it comes to be, will provide a further test case: Although NAFTA's Article 1110 is to be found in the current negotiating text of the treaty, Guzman's account would suggest that Latin American countries as a group may be more successful in opposing it, despite the fact that many of them already have bilateral treaties with the United States incorporating the same standard.

seen the advantages of such provisions and want them included for this reason.[424] Developing countries do, in some cases, appear to express at least tacit support for expansive expropriation protections. For example, despite the fact that Mexico was the first NAFTA party to lose a Chapter 11 dispute, Mexico has not been a vocal proponent of reform.[425] But this might also be explained by the signaling dynamic:[426] Mexico might be happy to see Article 1110's scope restricted, but it may not want to take the lead on reform for fear of sending a bad signal to foreign investors.

More importantly, developing countries are unlikely to pursue expansive treaty-based expropriation protections as a means of attracting investment because, quite simply, there is no evidence that such protections confer any competitive advantage in the market for FDI. Promoters of Chapter 11 are quick to point out that there has been a dramatic increase in FDI among the NAFTA parties in the years following the treaty's adoption. The Office of the United States Trade Representative proudly claims, for example, that in the five years after the agreement's adoption, investment from the United States to Mexico increased by forty-three percent, and the total flow of investment to Mexico reached $47 billion between 1994 and 1997.[427] But there is no evidence that the increased investment resulted from Chapter 11's investor protections, or more pointedly, from the expansion of the definition of expropriation in those protections. To name just a few elements of the panoply of factors likely to have contributed to increased FDI, NAFTA was adopted in a time of unprecedented prosperity in the United States, fostering major outflows of capital investment to many countries, not just those with which it had concluded investment treaties; NAFTA liberalized trade among the parties, creating increased rates of return for investment in manufacturing in Mexico for export to the United States; and NAFTA's adoption corresponded to a period of internal political and economic

[424] See, e.g., Dolzer, supra note 78, at 567 (explaining developing-country acceptance of expropriation protections in terms of "the special benefits that developing countries enjoy under" BITs); see also Guzman, supra note 109, at 667-68 (discussing "LDC enlightenment theory").

[425] See Mann & von Moltke, supra note 10, at 10. Although initial press reports were that Mexico opposed reform, the information is too thin to be considered conclusive. Moreover, it is difficult to square this argument with the fact that Mexico litigated the *Metalclad* case as vigorously as it did, including contesting the enforcement of the award in Canadian courts. See Been, supra note 2, at 11,009 (describing *Metalclad* appeal).

[426] See supra note 411 and accompanying text (discussing "snowball" effect of signaling in competitive environment).

[427] U.S. Trade Representative, NAFTA Works: Five Years, Three Countries, One Partnership (1999), at http://www.ustr.gov/pdf/naftabro.pdf [hereinafter NAFTA Works].

liberalization in Mexico.[428] Not surprisingly, FDI in the United States and Canada also increased dramatically during this period,[429] but one would be hard pressed to argue that this was due to increased protection of foreign investors against political risk in these countries, much less to the inclusion of an expansive regulatory takings doctrine among those protections.

In fact, there is virtually no evidence that treaty-based investor protections encourage FDI. A 1998 UNCTAD study of BITs during the mid-1990s showed only a "weak" marginal increase in FDI flows between signatory countries following the adoption of a BIT.[430] However, this same study indicated that "BITs lose almost all significance" with respect to FDI trends when "other independent variables such as market growth and size, exchange rates and country risks" are taken into account.[431] Thomas Wälde and Stephen Dow sum up the empirical data as follows: "Surprisingly, in view of the existing 1500 bilateral investment treaties (BITs) and several major regional and multilateral treaties (NAFTA, Energy Charter Treaty and Mercosur Investment Protocol), there is no tangible evidence that these treaties actually significantly reduce political risk or enhance flows of private investment."[432]

The lack of any evidence of a causal link between international investment treaties and increased FDI is not surprising given the nature of the market for FDI. Even if political risk were reduced in any small measure by such agreements, a proposition for which there is no evidence, that influence likely would be dwarfed by market and other political effects. Decisions regarding location of overseas investments are likely to be determined, first and foremost, by market factors. For "efficiency-seeking" investments, those investments made overseas to capture greater profits per unit of production, the cost of inputs are

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428 See Gloria L. Sandrino, The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective, 27 Vand. J. Transnat'l L. 259, 305-07 (1994) (discussing 1989 regulations adopted by Mexico's National Foreign Investment Commission as "constitut[ing] a major shift in foreign investment policy in Mexico," replacing nationalist policies with "more open foreign investment regime").

429 See NAFTA Works, supra note 427.

430 UNCTAD, supra note 90, at 122.

431 Id. at 141.

432 Wälde & Dow, supra note 8, at 11. Ironically, there even may be some negative correlation: Large developing countries that are party to fewer international investment treaties have had much greater success in attracting FDI than smaller countries that are comparatively frequent signatories to such agreements. Id. at 12 n.32; see also UNCTAD, supra note 90, at 141 ("[T]here are many examples of countries with large FDI inflows and few, if any, BITs. Examples of countries that have concluded numerous BITs and have received modest inflows also abound.").

likely to be primary.[433] For "market-seeking" investments, those made to locate production close to overseas markets, the size of the host country and its situation relative to regional markets is likely to dominate.[434]

With specific regard to evaluation of political risk, a country's reputation is much more strongly influenced by domestic fundamentals—primarily the country's domestic policies towards foreign investment, as well as the stability and integrity of its institutions—than by formal accession to a treaty. While it is true that investment treaties can be one useful signaling device regarding the achievement of internal consensus on investment liberalization, it is the underlying liberalization that is key.[435] Treaty accession can affect a country's risk rating, but this effect is likely to be minimal compared to other political risk factors; moreover, "[m]arkets have many other ways apart from treaty accession to identify the commitment to . . . domestic policy change and corroborate . . . evidence for decrease in political risk."[436] One study of "average" foreign investors, the intended beneficiaries of an international investment treaty, found that such investors "do not have much knowledge of the treaty, do not use it in any significant way and are not particularly interested . . . in the treaty."[437] Further, to the extent that agreement to the investor protections of a BIT does provide a country with competitive advantages in the market for FDI, similarly situated countries often will respond by matching the competition, such that the competitive advantage will quickly be dissipated.

Assuming arguendo, however, that a country may gain significant competitive advantage by agreeing to an international investment treaty, it is doubtful that an expansion in expropriation provisions

433 Kenneth J. Vandevelde, The Economics of Bilateral Investment Treaties, 41 Harv. Int'l L.J. 469, 473-74 (2000).

434 Id. at 474-75; see also UNCTAD, supra note 90, at 141 (noting that "market size is especially important" in determining FDI inflows).

435 Wälde and Dow express this insight eloquently: "Treaty accession reflects internal policy changes. These policy changes, namely internal changes in legislation, institutional set-up and public perception, reduce the political risk (to the extent that the markets consider such changes reasonably stable). The treaty is then more a result of significant internal policy change than their cause." Wälde & Dow, supra note 8, at 12. Indeed, Kenneth Vandevelde reports that "[t]he rationale of the BIT negotiators has been that the BIT should not be grudgingly accepted by another state in exchange for U.S. concessions, but should reflect an already existing commitment to the protection of foreign investment." Kenneth J. Vandevelde, Reassessing the Hickenlooper Amendment, 29 Va. J. Int'l L. 115, 165 (1989).

436 Wälde & Dow, supra note 8, at 13.

437 Id. at 12. Wälde and Dow suggest that this may be, in part, because the treaties are "bureaucrats' treaties," drafted without the involvement of foreign investors and failing to answer to the specific needs of such investors. Id. at 13.

would play any significant role in this dynamic. First, the general signaling effect provided by entry into any international investment agreement, regardless of its specific contents, may account for a significant proportion of any competitive advantage gained by the entry.[438] There is little reason to think that a specific provision on expropriation has much impact. Second, the inclusion of a mechanism for international dispute resolution in an investment agreement (again, regardless of the substantive investor protections exceeding what the host-country's domestic law might provide) is likely to account for a significant proportion of any effect because of the lack of investor confidence in developing-country court systems.[439] Third, among the substantive protections provided by international investment agreements, expanding the range of government actions considered to be expropriations requiring compensation is not likely to be the most important to modern investors. Kenneth Vandevelde has argued that protections against currency exchange controls are probably significantly more important to investors than protections against expropriation.[440] The dramatic decline in direct expropriations in recent years[441] suggests that investors are less likely to be concerned with the risk of such direct expropriations. The very vagueness of international law on indirect expropriation means that the NAFTA standard is unlikely to abate investors' perception of risk and lends additional credence to the notion that capital-importing states consider its purpose to be primarily symbolic.

The uncertainty concerning the specific marginal effects on FDI of including protections against regulatory expropriations makes it unlikely that developing countries are the impetus for the expansive protections, especially given the costs of those provisions to host-country governments. As we explain in Part V, there is, of course, the direct cost of paying compensation to foreign investors on expropriation claims, as well as the cost of defending the claims. There also may be

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438 See supra notes 409-411 and accompanying text.

439 See Hope H. Camp, Jr., Dispute Resolution and U.S.-Mexico Business Transactions, 5 U.S.-Mex. L.J. 85, 89, 91 (1997) (discussing U.S. investors' perception of bias in Mexican courts); Parra, supra note 14, at 289 (noting reluctance of foreign investors to submit to jurisdiction of courts of adverse party).

440 See Vandevelde, supra note 433, at 489 (observing that protections against expropriation are less important now than two decades ago and that currently risk of currency exchange controls can be very significant to investors). A 1993 study of managers of U.S. firms in the Caribbean region (including Mexico, Central America, and northern South America) found that the managers' number-one concern was profit repatriation (or foreign-exchange risk management). Expropriation was number four. Robert J. Rolfe, David A. Ricks, Martha M. Pointer & Mark McCarthy, Determinants of FDI Incentive Preferences of MNEs, 24 J. Int'l Bus. Stud. 335, 341, 343-44 (1993).

441 See supra note 405.

indirect costs to the extent that vague treaty-based provisions chill efficient regulation or invite political opposition to the overall agreement.[442] The costs of expansive compensation requirements, moreover, will fall disproportionately on developing countries. Such countries are less able to pay significant compensation awards and are, in many cases, undergoing a period of much more rapid regulatory change than developed countries. As a result, an expansive regulatory takings provision is likely to be more burdensome and less desirable to developing than to developed countries. Speaking about how investment should be dealt with in a proposed free trade agreement with Chile, a Chilean trade official offered the following assessment:

> Chile is a country where probably there will be quite a lot more regulatory changes in the future. There is still a lot of work to be done in that area, and to expose ourselves to the kind of demands by U.S. investors like what has happened with NAFTA, where the investors say regulatory changes have been tantamount to indirect expropriation and have demanded huge compensation involving many millions of dollars, well that would be very difficult for Chile.[443]

All of this tends to discredit the notion that developing-country governments, which presumably are in the best position to evaluate whether treaty-based protections result in net social benefits, actively endorse expansive regulatory takings provisions. More plausibly, developing countries are persuaded, or forced, to accept these provisions, either because they believe the provisions are too vague to have much effect or because the protections are part of an overall "package" they believe they must accept to provide positive signals to capital-exporting states and foreign investors in the context of intense international competition for FDI. But if it is capital-exporting states, particularly the United States, that are pushing regulatory expropriation provisions, we have at least good reason to doubt that they are primarily intended to benefit capital importers in their quest to attract FDI.

3. *Should the United States Agree to Be Bound by Expansive Regulatory Takings Provisions If Developing Countries Want to Offer Them?*

What if developing countries do wish to offer expansive takings protections in order to attract FDI? It is tempting to respond to this

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[442] See infra Part V.A.2.

[443] James Langman & Rossella Brevetti, Bilateral Agreements: Chile Says Many Issues Still Unsettled After Latest Round of Talks on FTA with U.S., 19 Int'l Trade Rep. (BNA) 195, 195 (2002).

question by reference to the familiar debates over interjurisdictional regulatory competition, specifically whether such competition induces a "race to the bottom" with harmful social effects, or rather an efficient market equilibrium in which each jurisdiction chooses its preferred mix of regulation.[444] These issues have played a major role in discussions about tax and regulatory competition among states in the United States,[445] as well as in the negotiation of NAFTA and other international trade and investment agreements.[446]

Treaty-based expropriation protections, however, do not present squarely the normative problem of interjurisdictional competition. The question here is not whether the United States should permit or encourage developing countries to compete against one another with regard to reducing perceived risks to investors. That issue would be raised if developing countries were offering unilateral guarantees to foreign investors. Capital-importing states are certainly in a position to make such a unilateral offer by means of different tools, including domestic law reform, contracts, and formal or informal insurance. The question of whether and to what extent the United States and other developed countries should encourage competitive employment of these unilateral tools is the subject of a different article.

444 For discussion of this debate, see generally Wallace E. Oates & Robert M. Schwab, Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?, 35 J. Pub. Econ. 333 (1988); Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J. Pol. Econ. 416 (1956).

445 For analyses of tax competition among the states, see generally Peter D. Enrich, Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business, 110 Harv. L. Rev. 377 (1996); Clayton P. Gillette, Business Incentives, Interstate Competition, and the Commerce Clause, 82 Minn. L. Rev. 447 (1997); Daniel Shaviro, An Economic and Political Look at Federalism in Taxation, 90 Mich. L. Rev. 895 (1992). The role of interstate regulatory competition has been discussed most extensively in the context of environmental law. For a brief sampling of the highlights in this extensive literature, see, for example, Richard L. Revesz, Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation, 67 N.Y.U. L. Rev. 1210 (1992); Richard B. Stewart, Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy, 86 Yale L.J. 1196 (1977).

446 NAFTA's side agreement on the environment, for example, prohibits the state parties from derogating from existing levels of regulation in order to attract trade and investment. This agreement is supposed to operate to prevent the potentially harmful effects of interjurisdictional competition. See supra notes 444-445; cf. Yuquing Xing & Charles D. Kolstad, Do Law Environmental Regulations Attract Foreign Investment?, 21 Envtl. & Resource Econ. 1, 15 (2002) (finding in empirical study that weaker environmental regulations attract FDI in polluting industries but have smaller impact on less-polluting industries). For normative discussions of international tax competition, see generally Reuven S. Avi-Yonah, Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State, 113 Harv. L. Rev. 1573 (2000); Julie Roin, Competition and Evasion: Another Perspective on International Tax Competition, 89 Geo. L.J. 543 (2001).

Reciprocal treaty-based expropriation protections—as in the case of NAFTA's Chapter 11—present an altogether distinct problem. This specific means of attracting investment affects all state parties to the relevant treaty, including the United States in the case of NAFTA. Because of its economic strength coupled with its strong domestic protections for private property, the United States does not need treaty-based property protections in order to encourage FDI. The question, therefore, is whether the United States should encourage or agree to this particular tool for promoting FDI in developing countries. For the reasons detailed in the following Part, the answer to that question is "no." As we shall see, NAFTA's Chapter 11 imposes a number of potentially serious costs on the United States: In going beyond domestic legal protections for private property, it has the potential to either put domestic firms at a competitive disadvantage or ratchet up property protections for domestic firms, to affect the efficiency and distributional implications of domestic regulation, and to alter the balance of power between federal, state, and local governments, all without an open and democratic debate about whether any benefits from the provision justify such costs. As a result, the United States, far from encouraging the proliferation of treaty-based protections for regulatory expropriations, should decline to become a party to any treaty imposing such costs.

V
Conclusion: Limiting International Compensation Requirements

When the *Metalclad* award was handed down, many observers around the world blamed the United States, thinking that the tribunal simply had incorporated U.S. property norms into NAFTA. When *Loewen*, *Methanex*, and similar claims were filed against the United States, critics noted the irony of the United States complaining about the reach of doctrines it had foisted on the rest of the world. The United States, of course, bears responsibility for the vagueness of the expropriation clause it promoted.[447] But as was demonstrated in Part III, that clause threatens to take on a life of its own. Early interpretations by arbitral tribunals provide foreign investors with property protections that go beyond those afforded by the Fifth Amendment and the U.S. Supreme Court's "regulatory takings" jurisprudence. Moreover, none of the traditional rationales for compensation requirements

447 See supra notes 415-417 and accompanying text.

provide a compelling justification for NAFTA's expansion of property protections.[448]

This Part concludes our analysis by arguing that the potential costs of such an expansion counsel a much more conservative approach to international expropriation provisions. There are three major costs of compensation requirements: First, they confer a competitive advantage to foreign firms in the domestic market; second, they may deter beneficial domestic regulations or, at least very least, shift the costs of regulatory schemes; and third, they threaten to alter the balance of power between federal and state regulators and to affect the form environmental and land use law takes. The U.S. domestic political consensus does not support the assumption of these risks of an expanded international takings requirement. Accordingly, we briefly examine proposals to restrain arbitrators' interpretation of Article 1110 but conclude that the proposal most popular within the United States—tying international expropriation provisions to U.S. takings jurisprudence—is neither a realistic nor, ultimately, a desirable solution to these problems. Language that opens the door to regulatory takings claims should be abandoned in favor of expropriation provisions more narrowly drawn to embrace only international law's traditional concern with physical invasion or seizure of property, nationalization, or governmental assumption or transfer of control over property.

A. *The Costs of Expanding the Compensation Requirement*

1. *Competitive Disadvantage and the Ratchet Effect*

The first and most obvious problem with granting "supernational treatment"[449] to foreign investors in the United States is that they thereby gain a competitive advantage over domestic firms in the domestic market. Just how great an advantage is uncertain, but NAFTA litigation—whether threatened in the preregulatory phase or initiated in postregulatory challenges[450]—puts an arrow in the quiver of foreign firms that domestic firms do not have. This discrimination seems objectionable on its face: The United States provides one of the highest

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448 See supra Part IV.

449 The term is borrowed from an article by Edward Graham and appears to be adapted from the term "national treatment," which refers to the requirement that foreign investors be given treatment equal to that enjoyed by domestic investors. See Edward M. Graham, Regulatory Takings, Supernational Treatment, and the Multilateral Agreement on Investment: Issues Raised by Nongovernmental Organizations, 31 Cornell Int'l L.J. 599, 610 (1998) (describing concept of supernational treatment in context of draft negotiating text of MAI).

450 See infra notes 461-68 and accompanying text.

levels of legal protection to private property in the world[451] and constitutes the single largest importer of foreign direct investment.[452] There is, consequently, no obvious reason for the United States to confer special advantages on foreign firms in order to attract such investment.[453]

The potential unfairness to U.S. businesses of preferential treatment of foreign investors under NAFTA received considerable attention in the recent debates over authorization of the Trade Promotion Authority (TPA), or "fast-track" authority.[454] Senators Max Baucus (D-Mont.) and Chuck Grassley (R-Iowa) offered an amendment to the TPA bill clarifying that one of the President's goals in future trade agreements should be to require that "foreign investors in the United States are not accorded greater rights than United States investors in the United States."[455] The Baucus-Grassley amendment, while acknowledging that there is a serious problem with NAFTA's expropriation standard, does absolutely nothing to change NAFTA itself and therefore does not resolve the NAFTA-specific issues on which this Article focuses. Moreover, there is reason to doubt that the Baucus-Grassley language provides U.S. negotiators sufficiently specific guidance to avoid similar problems with future investment agreements.[456]

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451 See Lilley, supra note 17, at 751-53.

452 See UNCTAD, World Investment Report 2001: Promoting Linkages, Overview, at 1, U.N. Doc. UNCTAD/WIR/2001, at http://www.unctad.org/en/docs/wir01ove_a4.en.pdf ("The *United States* remained the world's largest FDI recipient country as inflows reached $281 billion.").

453 It might be argued that supernational treatment is conferred not to attract investment but rather because the benefits to U.S. firms are greater than the costs. This might be the case if foreign host countries were unwilling to extend unilateral protections to U.S. investors and the benefits received by U.S. overseas investors under a reciprocal international agreement were greater than the costs to U.S. firms in the domestic market. There is no empirical evidence that this is the case. Even if there were, this would raise difficult questions about redistribution that, to our knowledge, have never been addressed in the context of international investment agreements.

454 For discussion of fast-track authority, see generally Harold Hongju Koh, The Fast Track and United States Trade Policy, 18 Brook. J. Int'l L. 143 (1992); William J. Kovatch, Jr., Left Out of the Game: Fast-Track, Non-Tariff Barriers, and the Erosion of Federalism, 5 ILSA J. Int'l & Comp. L. 71 (1998); Lenin Guerra, The Use of Fast Track Authority in the Negotiations of the Free Trade Area of the Americas, Kan. J.L. & Pub. Pol'y, Spring 1999, at 172.

455 See 148 Cong. Rec. S4267 (daily ed. May 13, 2002) (discussing Andean Trade Preference Act). In advocating the amendment in the floor debates, Senator Baucus argued that "the rights of U.S. investors under U.S. law define the ceiling. Negotiators must not enter into agreements that grant foreign investors rights that breach that ceiling." Id. (statement of Sen. Baucus). The Baucus-Grassley amendment passed by an overwhelming margin. See 148 Cong. Rec. S4298 (daily ed. May 14, 2002).

456 Senator John Kerry (D-Mass.) argued, for example, that the Baucus-Grassley amendment was "little more than cosmetic change." Rossella Brevetti, Trade Policy: Sen. Kerry Signals Unhappiness with Investment Language in Trade Bill, 19 Int'l Trade Rep.

As the analysis in Part III demonstrates, maintaining a level playing field between domestic and foreign investors requires, at the very least, a complex set of limitations on the scope of protected property interests and the types of government actions subject to investor protections as well as a dramatic curtailment of the procedural advantages provided by the NAFTA ISDM.[457]

Further, unless NAFTA is amended or clarified through an interpretive statement, it is possible that domestic investors may seize on NAFTA to level the playing field "upwards" by expanding property rights rather than leveling it "down" to the existing standard of Fifth Amendment protection.[458] Property rights advocates in the United

(BNA) 891, 891 (2002) (quoting letter from Senator Kerry to colleagues). Kerry argued that this language would "still allow future chapter 11-like tribunals to rule against legitimate U.S. public health and safety laws using a standard of expropriation that goes well beyond the clear standard that the Supreme Court has established in all its expropriation cases." 148 Cong. Rec. S4268 (daily ed. May 13, 2002) (statement of Sen. Kerry). Accordingly, he offered a yet more expansive amendment establishing as a goal of future negotiations that "foreign investors are not granted greater rights than citizens of the United States possess under the United States Constitution." 148 Cong. Rec. S4504 (daily ed. May 16, 2002) (statement of Sen. Kerry). Moreover, the amendment would have mandated that future expropriation provisions not apply to measures causing a mere diminution in value or to nondiscriminatory measures protecting health and safety, the environment, or public morals. Id. The amendment went on to require that future trade agreements provide that an investor's home government approve a claim before invoking the investor-state dispute mechanism. Id. The Kerry amendment, which was strongly opposed by the Bush administration, Brevetti, supra, was tabled by a vote of fifty-five to forty-one after vigorous debate. 148 Cong. Rec. S4605 (daily ed. May 21, 2002).

457 Even assuming that U.S. negotiators were completely faithful to the amendment's no-greater-substantive-rights mandate, it is difficult to believe that they would be able to translate it into specifically tailored language. Recent attempts by the U.S. Trade Representative and the interagency working group to develop a Baucus-Grassley-compliant position on expropriation clearly demonstrate this problem. Competing proposals purporting to draw upon Fifth Amendment jurisprudence include: (1) clarification that mere diminution in value of property does not constitute an expropriation; (2) limitation of claims to "cognizable property interest"; (3) removal of Article 1110's reference to "tantamount to expropriation"; (4) provision of a regulatory "carve-out" for nondiscriminatory health-and-safety regulation; (5) decision of claims on a "case-by-case" basis; and (6) a tripartite test based on the economic impact on the investor, the existence of reasonable investment-backed expectations at stake, and the character of the government action involved. See Administration Proposes Higher Thresholds for Investor Suits, Inside U.S. Trade, Sept. 27, 2002, at 1, 18; Agencies Mull Regulatory Takings Standards, supra note 15, at 22. Achieving consensus on these proposals undoubtedly will prove difficult, and it is highly improbable that whatever language is adopted will approximate the complexity of Fifth Amendment jurisprudence. In any case, such language still would be subject to reinterpretation and expansion by independent arbitral tribunals, unless the ISDM were eliminated or significantly reformed.

458 Indeed, in the floor debates on the Baucus-Grassley amendment, Senator Baucus acknowledged that the amendment's language conceivably could be read "as a mandate to expand individual property rights in the U.S. through the back door of international negotiations," but he emphasized that "that was not what the language at issue was intended to accomplish." 148 Cong. Rec. S4267 (daily ed. May 13, 2002) (statement of Sen. Baucus).

States can be expected to use the expanded property protections afforded to foreign firms under NAFTA to gain additional leverage in their efforts to ratchet up domestic property protections.[459] While some would consider such a shift to be desirable, any expansion of domestic property rights should be subjected to public debate and scrutiny on its own merits, rather than adopted as a reaction to the (probably unintended) consequences of an international investment agreement.

2. *Chilling Efficient Regulation?*

The more common charge of Article 1110's critics is that the provision will deter beneficial social and environmental regulation because regulators may soften or abandon proposed regulatory changes (or discontinue existing regulatory programs) rather than incur the cost of defending against takings claims, and/or paying a compensation award.[460] Indeed, foreign investors already have used NAFTA claims or the threat of such claims in several instances as a "sword" in opposing regulation.

Most notably, in April 1997, Ethyl Corporation, a U.S. manufacturer of the gasoline additive MMT,[461] brought a $200 million claim against Canada, alleging that a Canadian ban on the importation of

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But even if the Baucus-Grassley language does not directly contribute to the ratcheting up of domestic property rights, NAFTA already provides the political impetus for such an effect.

459 See, e.g., Stephan, supra note 248, at 876-77 ("[E]mbracing the international law norm [on expropriation] requires countries with independent and activist judiciaries to reconsider what restraints their judges should face. For the United States, this means . . . using expropriation law as a template for determining the content of that constitutional regime."). Alternatively, public perception that NAFTA's compensation requirement is detrimental both to domestic regulation and to domestic firms may create a backlash against international investment agreements. The failure of the 1998 negotiations regarding the Multilateral Agreement on Investment is, in part, attributable to just such a dynamic: Drawing on the early lessons of the NAFTA litigation, environmental and other nongovernmental groups played a major role in scuttling the negotiations altogether. For discussion of the MAI, see supra note 12 and accompanying text.

460 See David A. Gantz, Reconciling Environmental Protection and Investor Rights Under Chapter 11 of NAFTA, 31 Envtl. L. Rep. 10,646 (2001) ("If a violation of the provisions of the applicable agreement is found, the government may be required to pay compensation, a situation that could have a chilling effect . . . ."); Wagner, supra note 52, at 467 (arguing that allowing companies to base compensation claims on economic effects of regulations chills efforts of governments to implement or maintain such regulations); Samrat Ganguly, Note, The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health, 38 Colum. J. Transnat'l L. 113, 119 (1999) ("The prospect of crushing liability claims or the chilling effect of the number and size of claims that may result under ISDMs can deter governments from legislating in the interest of the public."); Mann, supra note 2, at 16; Mann & von Moltke, supra note 10, at 6.

461 MMT, or methylcyclopentadienyl manganese tricarbonyl, is "a highly toxic organometallic compound used primarily to increase the octane levels of unleaded gasoline," and

MMT violated Article 1110 and several other Chapter 11 disciplines.[462] Canada settled the claim before the NAFTA tribunal reached the merits, agreeing to rescind the ban, issue a public statement conceding that the government had no evidence that MMT causes harm, and pay Ethyl approximately $13 million.[463]

Similarly, in 1994, R.J. Reynolds and other U.S. tobacco companies threatened a Chapter 11 claim for "hundreds of millions of dollars" against the Canadian government if Canada adopted plain-packaging legislation to discourage teen smoking.[464] The tobacco lobby argued that the plain-packaging requirement would expropriate the value of their trademarks.[465] The NAFTA issue was made moot when the Canadian Supreme Court struck down the regulation as violative of constitutional free speech requirements,[466] but recent events make clear that the tobacco industry continues to see the threat of NAFTA litigation under Article 1110 as a useful lobbying tool. In 2001, Philip Morris used similar tactics to oppose a proposed ban on the use of the words "light" and "mild" on cigarette packaging in Canada:[467] The company argued that the terms are an integral part of

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was used in Canadian gasoline until 1997. Statement of Defence, Ethyl Corp. v. Canada, paras. 29, 31 (Nov. 27, 1997), http://www.dfait-maeci.gc.ca/tna-nac/documents/ethyl4.pdf.

462 Statement of Claim, Ethyl Corp. v. Canada paras. 19-27 (Oct. 2, 1997), http://www.dfait-maeci.gc.ca/tna-nac/documents/ethyl3.pdf. The claim also alleges violation of Article 1102's "National Treatment" requirement and Article 1106's restriction on "Performance Standards." Id. paras. 28-50.

463 Wagner, supra note 52, at 495; see also Order Amending the Schedule to the Manganese-Based Fuel Additives Act, 132 C. Gaz. pt. 2, at 2265 (1998) (rescinding the ban); Government of Canada Statement on MMT (July 20, 1998), at http://www.ethyl.com/products/pa/mmt/gov_ca_stmt.html (stating that there is no conclusive scientific evidence that MMT produces health risk). The U.S. Environmental Protection Agency is currently reviewing studies on the potential harms associated with MMT. See Comments on the Gasoline Additive MMT (methylcyclopentadienyl manganese tricarbonyl), at http://www.epa.gov/otaq/regs/fuels/additive/mmt_cmts.htm (Mar. 6, 2003).

464 Schneiderman, supra note 16, at 525; Shawn McCarthy, Plain-Pack Smokes Scheme Postponed, Toronto Star, June 14, 1994, at A10.

465 See Allen Z. Hertz, Shaping the Trident: Intellectual Property Under NAFTA, Investment Protection Agreements and at the World Trade Organization, 23 Can.-U.S. L.J. 261, 302-03 & n.190 (1997) (citing legal opinion prepared for R.J. Reynolds President Jules Katz, formerly chief U.S. negotiator of NAFTA, delivered to House of Commons Standing Committee on Health); Schneiderman, supra note 16, at 502, 523-35 (discussing debates regarding relevance of NAFTA to tobacco regulation in Canada).

466 RJR-MacDonald Inc. v. Canada, [1995] 127 D.L.R. (4th) 1, 2 (Can.).

467 Notice of the proposed change to the Tobacco Act was published on December 1, 2001. 135 C. Gaz. pt. 1, at 4299-4303 (2001), available at http://canada.gc.ca/gazette/part1/ascII/g1-13548_e.txt. The notice referred to scientific data showing that patterns of consumer use of light cigarettes make them just as harmful as normal cigarettes, despite consumers' belief that they are healthier. Id.

their registered trademarks and that the ban would violate Article 1110 by expropriating these trademarks and associated goodwill.[468]

Most recently, a task force established by several major American pesticide manufacturers threatened to bring a Chapter 11 claim in response to a proposed ban on the use of twenty-eight pesticides within the province of Quebec; Quebec's Environment Minister, André Boisclair, has refused to back down on the regulations for now.[469] Whether and to what extent such tactics will be effective in the future will depend on how NAFTA tribunals address future expropriation claims. At present, however, the uncertainty over how far NAFTA can be pushed to provide protection for property owners, together with federal, state and local regulators' unfamiliarity with NAFTA and its ISDM procedures, and regulators' concerns both about the expense of defending against NAFTA claims and about their potential liability for compensation awards, make NAFTA a useful threat for those who oppose environmental and land use regulation.

As we discussed in Part IV.A, there are reasons to be skeptical that NAFTA's expanded compensation requirements will deter *inefficient* environmental regulation by forcing government decisionmakers to internalize the costs of the regulation. Environmentalists' concern that NAFTA will chill *efficient* regulation accordingly may be misplaced. Ultimately, we need more empirical data about how compensation requirements affect government behavior to discern whether such requirements sufficiently align financial incentives with political incentives to deter inefficient regulation, or whether they provide too much deterrence (or deterrence that is arbitrary or skewed).[470] Those concerned about the role NAFTA may play in chilling desirable regulations, however, have the benefit of the status quo on their side: Because international compensation requirements were construed fairly narrowly prior to NAFTA, caution requires that those arguing for a more expansive compensation requirement bear the burden of proof both that the requirement will deter inefficient regulation effectively and that it will not overdeter efficient regulation.

Further, even if we could be sure that compensation requirements did not deter efficient regulation—that is, if government actors

468 Submission by Philip Morris International, Inc. in Response to the National Center for Standards and Certification Information Foreign Trade Notification No. G/TBT/N/CAN/22, at 6-8, http://www.essentialaction.org/tobacco/pmresponsetonoi.pdf (last visited Mar. 6, 2003).

469 Kevin Dougherty, Boisclair Stands Firm, Montreal Gazette, July 6, 2002, at A8.

470 Concerns that a compensation requirement might skew regulators' cost-benefit calculations by unduly focusing on the costs of regulatory actions are discussed supra Part IV.A.3.

were completely insensitive to the assessment of compensation awards—the assessment of awards against the government clearly would shift the costs of regulation and thereby redistribute wealth. Under NAFTA's expanded regulatory takings standards, taxpayers generally could be expected to pay more (and foreign property owners to pay less) for the government's regulatory actions than they would under the Fifth Amendment of the Constitution. NAFTA's expanded compensation requirements accordingly would shift significantly the preexisting balance between foreign investors' property rights and the host government's regulatory prerogatives. Some would champion such a redistribution of wealth (or as they would view it, a correction of an earlier redistribution of wealth). But again, the issue is whether such a redistribution should be done through international investment agreements rather than through domestic law.[471]

3. *Altering the Balance of Power Between Federal, State, and Local Governments*

Regulatory takings claims under NAFTA often will seek compensation for the effects of regulations adopted by state or local governments. But, as noted above, any award rendered in NAFTA arbitrations is against a signatory party—the federal government.[472] If forced to pay compensation because a state or local regulation was held to violate NAFTA, the U.S. federal government might respond in several different ways.[473] First, it could attempt to make the responsible state or locality repay the cost of the award to the federal government, either by suing the state or local government for contribution or indemnification or by deducting the amount it was forced to pay from grants or other funds it would otherwise make available to the state or locality.[474] Second, the federal government could attempt to avoid future liability for similar regulations by trying to persuade the state or locality to change those regulations. It could, for example, condition future funding for the state or locality upon its agreement to rescind or modify the regulation.[475] Failing that, the federal government

[471] We have already shown in Part IV that there is no compelling rationale for introducing international compensation requirements for regulations that diminish property values.

[472] Supra note 288 and accompanying text.

[473] For a more detailed exploration of these options, see Been, supra note 2, at 11,012-15.

[474] Id. at 11,012-14.

[475] Id. at 11,014-15.

could preempt, or conditionally preempt, the state or locality's regulation.[476]

Each of these strategies could decrease, and change, state and local governments' traditional control over environmental and land use regulation.[477] Preemption obviously reduces the ability of state and local regulators to experiment with their own systems of regulation. Passing the costs of any award back to state and local governments also may make those governments less willing to regulate environmental or land use matters, to the extent that monetary liability deters regulation.[478] Or state and local governments may alter the nature of their regulatory processes by asserting federal mandates (rather than state or local law) as the basis for their refusal to permit development (at least where cooperative federalism programs enable them to do so), or by strategically placing their permitting process last in the sequence of federal/state/local reviews.[479] Further, because individual permitting decisions that have an administrative or judicial character will be more susceptible to charges of discrimination against foreign investors than broader regulatory programs that are more legislative in character, state and local governments may respond to NAFTA by moving away from flexible, discretionary regulatory systems toward more comprehensive command-and-control schemes.[480]

Detailed analysis of whether any of those shifts is appropriate is beyond the scope of this Article. For our purposes, it is sufficient to note that the balance of power among federal, state, and local governments in the United States is finely tuned, and hotly contested, and that one of the costs of expanding regulatory takings protections under NAFTA very well might be increased centralization of land use and environmental decisionmaking at the federal level. As with the potential shift in the balance between private property rights and regulatory prerogatives discussed above, some might argue that such a change would be desirable. But here, yet again, the question is whether such change should be accomplished, if at all, as a secondary consequence of international agreements. This brings us to a fourth

[476] Id. at 11,015.

[477] Id. at 11,015-16.

[478] See supra Part IV.A. If the federal government passes the costs back to state and local governments, one of our objections to the internalization rationale would be addressed. Indeed, because the federal government could pass the costs of an award back to the state or locality by deducting the amount of the award from grants the federal government otherwise would have provided, the federal government can target the actual decisionmaker more directly than takings claims brought in U.S. courts now do.

[479] Been, supra note 2, at 11,016.

[480] Id.

problem with expanded regulatory takings protections under NAFTA: the questionable democratic legitimacy of this policy choice.

4. *Democratic Legitimacy*

Defenders of Chapter 11 point out that NAFTA was freely entered into by the United States and the other two parties.[481] If NAFTA's compensation requirement has costs, they might contend, then presumably the democratically elected signatory governments judged that these costs were outweighed by the requirement's benefits.

This argument is problematic, however, because there was virtually no public awareness of or debate concerning the potential impact of NAFTA's investor protections. While NAFTA generated considerable debate regarding the potential for job flight to Mexico and an environmental "race to the bottom," the specifics of Chapter 11 were negotiated and approved without significant public comment.[482] There is substantial evidence that a better informed Congress and public would not have supported the expansion of compensation requirements or the extension of preferential property rights to foreigners. The passage of the Baucus-Grassley amendment, discussed above,[483] supports this conclusion. In addition, the outcome of the public debate over property protections during the 1990s suggests that the majority of American voters oppose the expansion of property compensation requirements for domestic property owners.[484] During the period from 1990 to 1997, numerous bills were introduced in Congress to expand compensation requirements for federal actions dimin-

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481 See, e.g., Price, supra note 7, at 7.

482 See Pub. Citizen & Friends of the Earth, NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy iii, 1 (Sept. 2001), http://www.publiccitizen.org/documents/ACF186.PDF ("[M]any members of Congress who voted in favor of NAFTA had no idea that these investor provisions were a central element of its contents."); Mann & von Moltke, supra note 10, at 3 & n.7. As is well known, NAFTA was enacted under "fast-track" negotiating authority, whereby the Congress authorizes the President to negotiate agreements and confines itself to a thumbs-up or thumbs-down vote on overall agreements at their conclusion. See Koh, supra note 454, at 152-56 (discussing fast-track procedures and use of fast-track authority in negotiating NAFTA). Fast-track authority shifts power from the Congress to the President and focuses congressional debate over particular issues on the period of prenegotiation authorization, rather than postnegotiation approval of the overall "package" agreement. Id. at 161-71. Fast track may, as a result, have diminished the likelihood, if not the possibility, of open debate on the potential effects of Chapter 11.

483 See supra notes 455-456 and accompanying text.

484 For perspectives on the property rights movement in the 1980s and 1990s, see generally Land Rights: The 1990s' Property Rights Rebellion (Bruce Yandle ed., 1995); Let the People Judge: Wise Use and the Private Property Rights Movement (John D. Echeverria & Raymond B. Eby eds., 1995).

ishing the value of private property, all of which were defeated.[485] A wave of property rights bills were introduced in state legislatures across the country, with somewhat greater success. Between 1991 and the end of 1997, more than 250 property rights bills were considered by state legislatures.[486] Thirty-nine became law, but only four of those actually expanded compensation requirements.[487]

The rejection of expanded compensation requirements in Congress and the vast majority of state legislatures provides strong support for the proposition that the U.S. electorate does not favor a generalized expansion of property protections even for domestic property owners. NAFTA's Chapter 11 nevertheless apparently has achieved such an extension for foreign firms and threatens to give political impetus to efforts to "ratchet up" domestic property protections as well.

It is possible that NAFTA's drafters and negotiators anticipated the expansive use of Chapter 11 to challenge environmental and social regulation but deliberately avoided airing this fact in the debate leading up to the agreement's adoption. If so, property protections that would not have been favored by the Congress or the U.S. electorate were smuggled in through the back door of NAFTA by deliberate avoidance of informed debate—which is hardly the sign of a well-functioning democratic process. More likely, U.S. negotiators simply

485 For accounts of the various federal bills, see John D. Echeverria, The Politics of Property Rights, 50 Okla. L. Rev. 351, 358-60 (1997); Robert Meltz, Property Rights Legislation: Analysis and Update, SB 14 A.L.I.-A.B.A. 551 (1996); Frank I. Michelman, A Skeptical View of "Property Rights" Legislation, 6 Fordham Envtl. L.J. 409 (1995). See generally Carol M. Rose, A Dozen Propositions on Private Property, Public Rights, and the New Takings Legislation, 53 Wash. & Lee L. Rev. 265 (1996). The high point of this legislative push was the Private Property Protection Act of 1995, which, as amended and passed by the House of Representatives, would have required the federal government to compensate property owners for any federal action under six statutes that reduced property values by twenty percent or more. The bill was introduced as part of the 1994 Republican "Contract with America" and passed in the House, but died in the Senate. See Echeverria, supra, at 359-60.

486 For discussion of the state takings legislation, see id. at 361-62; David A. Thomas, The Illusory Restraints and Empty Promises of New Property Protection Laws, 28 Urb. Law. 223, 244-46 (1996); Carl P. Marcellino, Note, The Evolution of State Takings Legislation and the Proposals Considered During the 1997-98 Legislative Session, 2 N.Y.U. J. Legis. & Pub. Pol'y 143, 156-61 (1998). See generally Mark W. Cordes, Leapfrogging the Constitution: The Rise of State Takings Legislation, 24 Ecology L.Q. 187 (1997); David Coursen, Property Rights Legislation: A Survey of Federal and State Assessment and Compensation Measures, 26 Envtl. L. Rep. 10,239 (1996); Kirk Emerson & Charles R. Wise, Statutory Approaches to Regulatory Takings: State Property Rights Legislation Issues and Implications for Public Administration, 57 Pub. Admin. Rev. 411 (1997).

487 See, e.g., Cordes, supra note 486, at 190-91 (indicating that assessment statutes are most common type of property rights legislation and that only four states have enacted legislation requiring compensation).

did not expect Chapter 11 to generate significant claims against the United States and did not anticipate that foreign investors would seek an expansive interpretation of Article 1110 through regulatory takings claims.[488] This mistaken expansion of property rights has gained some permanence, however, because amending an international agreement is so much more difficult than amending domestic legislation.[489] In either case, there are strong grounds for reform of Chapter 11 and proposed future investment agreements so as better to reflect the U.S. domestic consensus against expansion of property rights.

B. A Conservative Approach to International Expropriation Provisions

NAFTA's expansion of property rights and compensation requirements is surrounded by uncertainty. While several rationales for compensation requirements have been offered, our analysis shows that none of them provides a convincing justification. The clearest cost of expanded property protections under NAFTA is the competitive advantage given to foreign firms in the U.S. market. The concern that NAFTA will deter local, state, and national governments from enacting efficient regulations where there is a risk of a NAFTA expropriation claim is much less clear, but it gives reason for caution. Even if the requirements provide no deterrence, they shift the balance between private property rights and public regulatory prerogatives in a problematically undemocratic fashion. They also may alter inappropriately the allocation of authority for environment and land use regulation.

In the face of such uncertainty, the prudent course is to proceed with caution. In U.S. jurisprudence, we generally presume that regulations adopted by democratically accountable legislators "adjust[ ]

488 Daniel Price points out that most of the BITs that preceded NAFTA were concluded with developing countries with very little investment in the United States, thus limiting the likelihood that claims would be brought against the United States. Price, supra note 7, at 7.

489 Of course, it can be argued that in the domestic context legislators or officials of the executive branch similarly fail to pay attention to or anticipate the consequences of legislation or fail appropriately to reflect the electorate's views on a particular domestic matter. Riders to appropriations bills, commonly not subject to open debate and not commanding majority support, are one prominent example of this phenomenon. See generally Sandra Beth Zellmer, Sacrificing Legislative Integrity at the Altar of Appropriations Riders: A Constitutional Crisis, 21 Harv. Envtl. L. Rev. 457 (1997). However, while domestic "political process failures" may be remedied, it is much harder to correct international treaty provisions that have been adopted without significant debate or anticipation of negative consequences. Once adopted, an international agreement may be amended only by unanimous consent of all state parties; unanimous consent is also required to issue an "interpretive statement" that explains but does not alter the language of the agreement.

the benefits and burdens of economic life"[490] appropriately. Judges intervene to require compensation for such regulations only in exceptional cases. In the sphere of international investment agreements interpreted by arbitrators, the burden of proof should, likewise, be on those advocating an expansion of compensation requirements.[491] In the absence of compelling evidence either that the prospect of international expropriation claims does not deter efficient regulation, or that the overall benefits of having treaty-based compensation requirements both outweigh their costs and are appropriately distributed adherence to the status quo is the best course.

For the United States, adherence to the status quo would mean, at a minimum, that international investment agreements should not expand property compensation requirements beyond what is required by the Fifth Amendment. But directly tying investor protections to existing U.S. takings doctrines is an inadequate response to the problems raised by this Article for two reasons. First, tying investor protections to U.S. takings doctrine—as the Baucus-Grassley amendment attempts to do—is virtually impossible from a practical standpoint. Any attempt to translate the exceptionally complex,[492] and notoriously fact-bound,[493] body of U.S. jurisprudence into intelligible treaty provisions would be a fool's errand.[494] Even seemingly clear rules such as "compensation is required only for regulations that destroy one hundred percent of the value of the property" are in fact fraught with difficult line-drawing questions that U.S. courts have not been able to resolve, most notably the "conceptual severance" issue discussed above.[495] Moreover, as we have shown, U.S. takings jurisprudence is inextricably intertwined both with definitions of what constitutes property[496] and with procedural limitations designed to sharpen the courts' ability to discern the impact a challenged regulation has on the property.[497] Finally, whatever language ultimately might be adopted to link investor protections to U.S. takings law presumably still would have to be interpreted by some international adjudicatory body and would not be subject to review by the U.S. Supreme Court. Given the fact-bound nature of takings claims and

[490] Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978).

[491] It bears mentioning here that international courts and tribunals historically have given greater deference to state action than have the U.S. courts. Stanley, supra note 120, at 386-87.

[492] See supra notes 143-144 and accompanying text.

[493] See supra note 135 and accompanying text.

[494] See supra note 457.

[495] See supra notes 156-164 and accompanying text.

[496] See supra Part III.A.

[497] See supra Part III.C.

the paucity of clear limitations imposed by takings jurisprudence, there is little reason to believe that such an international adjudicatory body would be able to mirror U.S. jurisprudence.

Second, even if it were possible to tie international compensation requirements to U.S. takings jurisprudence, this would not be a desirable solution from an international standpoint. Most importantly, any effort simply to equate NAFTA's Chapter 11 with the Fifth Amendment would ignore differences between domestic and international contexts that render the reasons for affording regulatory takings protections within any given country inapplicable in the context of international investment agreements. As we argued in Part IV, the reasons commonly advanced for requiring compensation for diminutions in value resulting from a government's exercise of its regulatory authority become exceptionally problematic on an international level. In addition, while tying international expropriation provisions to the Fifth Amendment hypothetically would resolve the specific problem of supernational treatment for foreign investors in the United States and would leave property rights in the United States unchanged, it would not address the situations of the United States's treaty partners. At a minimum, they certainly would face the redistributive consequences of such a provision that we discuss above. Insofar as developing countries are comparatively impoverished, are undergoing a period of accelerated regulatory change, and are less able to bear the costs of international takings claims,[498] their domestic regulatory programs are likely to be especially vulnerable to overdeterrence of efficient regulation. Further, the normative consequences of redistribution from the citizens of such countries to foreign firms would be particularly troublesome.

Part IV's analysis of rationales for compensation requirements calls into question whether any international compensation requirement, even one limited to nationalization and other traditional forms of expropriations, is justified. Given our skepticism about whether any such requirement is necessary or beneficial, we believe that any international compensation provision should be narrowly drawn so as not to require compensation except where there is a clear international consensus that a particular government activity demands compensation. "Indirect expropriations" and "measures tantamount to expropriation" should not require compensation because there is little clarity or consensus in international law about how to define such actions.[499] Further, such language is notoriously susceptible to expan-

[498] See, e.g., supra Part IV.D.2.
[499] See supra Part II.B.2.

sive interpretation and threatens to capture efficient nondiscriminatory land use and environmental regulation.

Our analysis suggests, therefore, that the United States should seek to limit treaty-based expropriation clauses to the traditional concerns of international law: direct nationalization, physical invasion or seizure of property, and "creeping expropriation" or "constructive takings" involving transfer of control of the property to the government or a third party rather than mere diminution in the property's value.[500] It may be, given the analysis in Part IV, that even this more conservative requirement is unjustified. But rather than arguing against all compensation requirements, we limit ourselves here to arguing against expanding compensation requirements beyond the existing customary international law consensus to embrace regulatory takings claims based primarily on diminution in value. While this consensus certainly is not above scrutiny, it deserves some deference insofar as it represents a comparatively longstanding international norm. Moreover, claims based on the traditional concerns of the international law of expropriation are likely to have significantly lower social costs, from the standpoint of redistribution of rights or deterrence of regulation, than regulatory takings claims of the type we have seen under NAFTA.

It may be necessary to complement this substantive restriction on the scope of international takings provisions with procedural and institutional reform. Serious analysis of the alternatives to the ISDM and

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[500] Some would argue that customary international law requires compensation for nondiscriminatory regulatory actions that substantially or sufficiently diminish value, even without any transfer of control. E.g., Price, supra note 7, at 5-6; see also Beauvais, supra note 2, at 280-81 (arguing that NAFTA tribunals appear to rely primarily on degree of diminution of value in deciding expropriation claims). There is, however, no consensus on this issue. See supra Part II.B.2 (discussing uncertainty of international doctrine regarding indirect expropriation). On the contrary, virtually all of the international precedent on expropriations involving regulation in the absence of direct nationalization or physical invasion have concerned governmental assumption of control of the property in question. See, e.g., Aldrich, supra note 129, at 587-603 (cataloguing acts giving rise to expropriation liability as including "nationalization," state "appointment of managers or supervisors," "de facto nationalization," "physical seizure of property," "retention of goods," and prevention of export/repatriation of foreign equipment); Christie, supra note 114, at 332 (acknowledging that international law does not provide answer to question as to whether rent controls applied over long period so as to deprive owner of adequate return constitute expropriation); Weston, supra note 114, at 131-73 (describing past precedent characterized by forced sales (sometimes induced by state-sponsored boycotts) and governmental assumption of "supervisory control" of foreign property). Again, regulations with a protectionist or discriminatory purpose that result in a diminution of value of the investment should be addressed under nondiscrimination provisions, rather than under the rubric of expropriation.

For discussion of alternative approaches to limiting the expropriation provision, see Beauvais, supra note 2, at 287-92.

its component procedures is well beyond the scope of this Article, but we recognize that even a more narrowly drawn expropriation provision may be subject to expansive interpretation by international adjudicators. To the extent that the decisionmakers responsible for dispute settlement under international investment agreements are not procedurally, institutionally, and politically constrained, even facially conservative investor protections may be broadened through dynamic interpretation over time. We are, as a result, sympathetic to arguments for procedural and institutional reform,[501] though we do not endorse any particular proposal here.

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This Article calls for a fundamental reappraisal of the assumptions underlying international compensation requirements for regulatory takings. Before the U.S. seeks to extend its model international expropriation provision to the FTAA and perhaps to the OECD or WTO as well, we must take stock both of how this provision relates to our own constitutional property protections and of the likely benefits and costs of such a policy. NAFTA's Article 1110 and similar provisions do not merely "internationalize" the Takings Clause of the Fifth Amendment of the U.S. Constitution, but rather extend the scope of potential regulatory takings claims in significant respects. Even to the extent that Article 1110 and similar provisions could be tailored to track U.S. takings jurisprudence and judicial procedure, such an approach would not answer the broader questions this Article has raised about international expropriation provisions. Arguments for compensation requirements that are dubious in the U.S. domestic context become altogether untenable when translated into the international sphere. We should, therefore, proceed with great caution in opening the door to regulatory expropriation claims; the United States, in particular, should lead the return to a more conservative approach to international compensation requirements. That approach should require compensation only in those circumstances in which there is clear and longstanding international consensus that compensation is necessary and in which encroachment on bona fide nondiscriminatory social and environmental regulation is least likely. A global "regulatory takings" doctrine is neither necessary nor beneficial, and the potential costs of such a doctrine at home and abroad are too great to be ignored.

501 See id. at 292-95 (advocating procedural and institutional reform).