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Of All Things Made in America Why are We Exporting the *Penn Central* Test?

Anthony B. Sanders*

Abstract

Developing countries enter into bilateral investment treaties ("BITs") in order to increase foreign direct investment ("FDI"). Ignoring this straightforward fact has led to a great deal of confusion in the assessment of BITs and their protection of regulatory takings. This article addresses the question of how a BIT should approach regulatory takings with the purpose of increasing FDI in mind. It explores the background of the United States Supreme Court's Penn Central test and the test's incorporation into the post-NAFTA round of U.S. BITs. Then, the article examines whether an uncertain and flexible test such as Penn Central is suitable for treaties that seek to provide foreign investors with incentives to invest in developing countries.

The article argues that Penn Central is not appropriate for BITs because it does not provide a clear rule of law that will induce a foreign investor to send its capital overseas to a developing country. This is partly due to the greater need for clarity in public law than in private law. For this distinction the article employs the work of F.A. Hayek and "rules of just conduct" versus "rules of organization of government." The article also addresses criticisms of the incentives BITs provide to foreign investors and to host governments and how those incentives counsel for clear regulatory takings rules. Whatever the merits there may be for a flexible regulatory takings rule when interpreting the Fifth Amendment's Takings Clause, those reasons do not apply to BITs. The article acknowledges that BITs may not actually succeed in increasing FDI, as the empirical evidence on the question is mixed. However, if they do, then BITs with clear regulatory takings standards will be more successful than those with vague standards, such as Penn Central. Drafters of BITs can still take into account other objectives such as environmental protection, but should do so with clear rules of law so foreign investors can plan their investments accordingly.

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INTRODUCTION

The *Penn Central* test, first enunciated in *Penn Central Transportation Co. v. New York City*¹ in 1978, was originally intended to apply to the Takings Clause of the United States Constitution in regulatory takings cases in the United States.² So how does a judicially-crafted land-use test, originally intended to apply to the United States Constitution, wind up governing expropriation claims between the citizens of Honduras and Costa Rica? How does this test grow to become the prevailing mechanism for settling regulatory takings disputes between multinational corporations and foreign governments? The answer is: through a compromise intended to allow for flexibility in investment protection and the protection of U.S. sovereignty, but resulting in uncertainty and the undermining of a growing number of foreign treaties.

Penn Central was given a new bill of health in 2002 on two fronts. The first was the Supreme Court's decision in *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*.³ There, the Court reaffirmed the *Penn Central* test as the "polestar" of a regulatory takings inquiry and the mechanism by which courts determine whether the government has committed a regulatory taking.⁴ Despite some earlier uncertainty,⁵ *Tahoe-Sierra* cemented the test as central to land-use disputes under U.S. law. The second front appeared in a less-noticed, but perhaps wider-reaching, development—a clause in the Bipartisan Trade Promotion Authority Act of 2002.⁶ There, Congress, reacting to criticism of Chapter 11 of the North American Free Trade Agreement ("NAFTA"), directed the United States Trade Representative ("USTR") to ensure that in future treaties the United States would give foreign investors no greater rights than those enjoyed under U.S. law.⁷ As the Court had made clear in *Tahoe-Sierra*, that meant one thing: use the *Penn Central* test.⁸

¹ 438 U.S. 104 (1978).

² *Id.* at 124.

³ 535 U.S. 302, 336 (2002).

⁴ *Id.* (adopting reasoning of Justice O'Connor in *Palazzolo v. Rhode Island*, 533 U.S. 606, 632 (2001) (O'Connor, J., concurring)).

⁵ See *Lucas v. S.C. Coastal Comm'n*, 505 U.S. 1003, 1030–31 (1992) (refusing to apply the *Penn Central* test to situations where the government has taken all economic use from a property owner).

⁶ See 19 U.S.C. § 3802(b)(3) (2006).

⁷ See Mark B. Baker, *No Country Left Behind: The Exporting of U.S. Legal Norms Under the Guise of Economic Integration*, 19 EMORY INT'L L. REV. 1321, 1338 (2005) (stating that Congress directed trade agreements to include investment protections at the same level of protection as those enjoyed under U.S. legal principles); Jesse Williams, Comment, *Regulating Multinational Polluters in a Post-NAFTA Trade Regime: the Lessons of Metalclad v. Mexico & the Case for a "Takings" Standard*, 8 UCLA J. INT'L L. & FOREIGN AFF. 473, 475 (2004) (stating that Senators Baucus and Grassley sponsored the amendment to the Act, limiting the scope of investor protection in future trade deals).

⁸ See *supra* notes 3–4 and accompanying text.

And use it the USTR did.⁹ This article recounts the story of *Penn Central*'s creation and the journey of the constitutional test from the Fifth Amendment to the four corners of the globe via increasingly-popular BITs.¹⁰ These treaties protect foreign investors from a host government's efforts to expropriate property without compensation.¹¹ Since the first BIT was signed in 1959, BITs have grown phenomenally, with nearly 2,200 BITs signed worldwide through the year 2002.¹² The commentary on BITs has been as caustic as it has been voluminous in recent years, with no shortage of explanation, denunciation, and pontification on their vices, virtues, and effectiveness, particularly as concerns NAFTA's Chapter 11.¹³ Many commentators see threats to sovereignty, impingements on environmental protection, and even a shadowy international "Lochnerism" in BITs.¹⁴

What is sometimes lost in the BIT debate is what BITs are actually *for*. The obvious—and correct—answer is that countries sign them to increase or secure FDI.¹⁵ Developing countries want to promote FDI because they

⁹ See *infra* Part III.C.1.

¹⁰ NAFTA's Chapter 11 was merely one of the most prominent BITs. As explained *infra*, NAFTA is neither bilateral nor purely an investment treaty, but nevertheless is correctly labeled a "BIT" for the purposes of this article.

¹¹ See Susan Rose-Ackerman & Jennifer Tobin, *Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties* 3 (Yale Law and Econ. Research Paper No. 293, 2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=557121 (describing how BITs "bind the host country to treat all foreign investors from the home country in ways that will protect their investments and that give them either parity with or advantages over domestic investors").

¹² See Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties & Their Grand Bargain*, 46 HARV. INT'L L.J. 67, 67–68 (2005).

¹³ Compare Vicki Been & Joel Beauvais, *The Global Fifth Amendment? NAFTA's Investment Protections & the Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30, 39 (2003) (arguing that if NAFTA "becomes more expansive than U.S. takings law, there will be significant costs"), and Williams, *supra* note 7, at 502 (characterizing the current trade regime as one "that accords multinational corporations safe harbor from reasonable environmental policy"), with Amy K. Anderson, *Individual Rights & Investor Protections in a Trade Regime: NAFTA & CAFTA*, 63 WASH. & LEE L. REV. 1057, 1073–74 (2006) (arguing that the criticisms of NAFTA's Chapter 11 are overblown considering the relatively few number of arbitral awards limiting governments' regulatory power).

¹⁴ See, e.g., Steve Louthan, Note, *A Brave New Lochner Era? The Constitutionality of NAFTA Chapter 11*, 34 VAND. J. TRANSNAT'L L. 1443, 1445 (2001) (stating that NAFTA's Chapter 11 is "the most significant evisceration of state police power since the Supreme Court freed the states from *Lochner*'s shackles in 1937").

¹⁵ See Deborah L. Swenson, *Why Do Developing Countries Sign BITs?*, 12 U.C. DAVIS J. INT'L L. & POL'Y 131, 154–55 (2005) (exploring what BITs are for, and concluding that they do promote foreign investment to a significant degree, and that they are, after all, signed in order to promote foreign investment).

determine that the increased investment will assist in a country's economic growth.¹⁶ Meanwhile, developed countries want to protect their citizens' investments located in other countries.¹⁷ Therefore, from either point of view, a BIT is successful if it protects FDI.

This relatively simple principle is often obscured through the raging debate over the limits that BITs may present to a host country's sovereignty. Much of the scholarship over BITs centers on the extent to which BITs protect against regulatory takings.¹⁸ In short, regulatory takings are the loss of property through governmental actions short of the outright confiscation of physical possession or title.¹⁹ Some scholars excoriate BITs that protect against regulatory takings because those BITs curtail the ability of sovereign governments to regulate perceived threats to the environment and public health and safety.²⁰ On the other hand, some recent treatments of BITs play down this danger and argue that the new U.S. Model BIT (Model BIT), which includes the *Penn Central* test, properly finds a middle ground between the interests of investors and sovereign governments.²¹ These latter scholars approve of a "balanced" approach where BITs allow for a weighing of the regulatory needs of a host government against the

¹⁶ *Id.* at 131–32 (stating that the benefits of FDI include "increased levels of investment and economic activity, worker training, [and] well-paid jobs and technology transfers that enhance the productivity of local firms").

¹⁷ There are also, of course, instances of BITs between developed nations and between developing nations. See Eric Neumayer & Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?*, in THE EFFECTS OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, & INVESTMENT FLOWS 229 (Karl P. Sauvant & Lisa E. Sachs eds., 2009) (noting the recent trend of developing nations signing BITs between themselves). Here the motivations will be more mixed. An example of the latter is NAFTA's Chapter 11 as it applies to investment between the United States and Canada. It is interesting to note that as of February 2006, "all of the NAFTA cases against the United States were filed by Canadian investors." Gilbert Gagne & Jean-Frederic Morin, *The Evolving American Policy on Investment Protection: Evidence From Recent FTAs and the 2004 Model BIT*, 9 J. INT'L ECON. L. 357, 364 (2006). This illustrates that developed countries do not fear expropriation claims coming from developing treaty partners.

¹⁸ See, e.g., Matthew C. Porterfield, *International Expropriation Rules & Federalism*, 23 STAN. ENVTL. L.J. 3, 6 (2004) (arguing that increased protections against regulatory takings are being achieved through NAFTA's Chapter 11); Been & Beauvais, *supra* note 13, at 141 (arguing that any future BITs should leave out protection for "regulatory takings").

¹⁹ See *Palazzolo v. Rhode Island*, 533 U.S. 606, 617 (2001).

²⁰ See, e.g., Been & Beauvais, *supra* note 13, at 141 (2003) (arguing that any future BITs should leave out protection for "regulatory takings").

²¹ Anderson, *supra* note 13, at 1073–74 (arguing that the criticisms of NAFTA's Chapter 11 are overblown considering the relatively few number of arbitral awards limiting governments' regulatory power); see also Marc R. Poirier, *The NAFTA Chapter 11 Expropriation Debate Through the Eyes of a Property Theorist*, 33 ENVTL. L. 851, 907–08 (2003) (stating that applying the *Penn Central* test to claims made under BITs "sounds about right").

expectations of a foreign investor.²² Arbitral panels are the actors who BITs direct to perform this balancing, as they are increasingly the method that adjudicates claims between foreign investors and sovereign governments.²³

What each of these groups misses is that BITs are “investment treaties.” They are not “environmental treaties,” “public health and safety treaties,” or even “property rights treaties.” They are intended to promote FDI, not to protect the environment, the public, or any other thing.²⁴ If governments want to place restrictions on the scope of regulatory takings protections in BITs they may do so. However, they should provide clear lines of demarcation for a BIT to successfully provide incentives for greater FDI. That is, the line between a regulatory taking and a permissible regulatory action must be as clear as possible. As this article will argue, an unclear, wavering, multi-faceted test—exactly what the *Penn Central* test is—leaves too much uncertainty in what is already a very uncertain decision: an investor sinking capital into a country whose regulatory environment and investment protections may be unfamiliar and unfriendly.

This article begins in Part I with a brief survey of BITs. This includes a discussion of what constitutes a BIT—a surprisingly tricky question—and what BITs are for. Part II leaves the international scene and recounts the genesis of the *Penn Central* decision and its famous test. Part III examines the fallout from arbitral decisions under NAFTA’s Chapter 11, and how the new Model BIT came to be, including its use of the *Penn Central* test. Part IV examines whether the *Penn Central* test actually does promote FDI, first looking at the mixed empirical evidence surrounding BITs and investment in general and then turning in detail to asserted justifications for the use of *Penn Central* in BITs. Finally, the discussion examines the trade-offs governments make in allowing for greater protection against regulatory takings in BITs, and how to set those protections against the desire to regulate when promoting FDI is an objective.

Whatever the reasons for the *Penn Central* test under the Takings Clause of the Fifth Amendment, those reasons do not transfer to supporting its use in the much more limited context of a BIT. Much of this is explained by the distinction between public and private law and the differing need for clear rules of law in each area. This article argues that public law, such as regulatory takings law, demands clearer rules than does private law. For this distinction the article turns to the work of F.A. Hayek and his distinction between “rules of just conduct” and “rules of organization of government.”²⁵ Private law answers the question of “what

²² See Poirier, *supra* note 21.

²³ See Rose-Ackerman & Tobin, *supra* note 11, at 3 (“The most important change [in the development of BITs] was treaty provisions that transferred some investor-host country disputes from local courts to international arbitration.”).

²⁴ See *infra* notes 40–53 and accompanying text.

²⁵ See *infra* Part IV.C.1.

is property?" whereas public law answers the question of whether *that* property has been taken. Whatever the merits of using flexible principles in answering the first question, those reasons do not extend to using flexible principles in answering the second question. This is especially true when the goal of the public law at issue is to provide incentives for people to invest. Such is the case with a BIT.

One point that the reader is advised to remember throughout this article is that the author is more than willing to concede that BITs may well *not* be effective in promoting FDI. Indeed, the empirical evidence on the question seems inconclusive. *If* BITs are effective, however, it is the thesis of this article that they should supply a clear rule on regulatory takings, providing potential foreign investors with greater certainty. It is not necessarily that investors look for *stronger* regulatory takings protections, but that they look for *more certain* protections that they can then use in planning their investments.

Whether *Penn Central* belongs in BITs is not just a question for U.S. policymakers. The test has been incorporated into the Dominican Republic Central American Free Trade Agreement ("CAFTA"), meaning seven different countries now will adjudicate international regulatory takings expropriation claims involving each other via the *Penn Central* rubric. Furthermore, Canada's Model BIT now incorporates the *Penn Central* test, and therefore "in its future BIT negotiations, the Canadian government will paradoxically promote criteria unknown in Canadian law."²⁶ The test is increasingly popular, perhaps precisely because no one knows what it actually means.

Even so, U.S. policy will lead the way on this question. With the passage of the Bush Administration—the Administration whose USTR, with the prodding of Congress, placed the *Penn Central* test in the Model BIT—and the likely slow-down in free trade agreements that the Obama Administration brings, international scholars should pause and consider whether we need to rethink our approach to international investment protection. This reconsideration should start with the first principle of what are the incentives that promote investment. With that in focus a proper balancing of economic growth and other interests, with incentives in mind, can begin.

I. WHAT ARE BITS AND WHY ARE THEY HERE?

The briefest of definitions of a BIT is that it is an agreement between two countries where each country agrees to grant investors from the other certain protections to their investments in the foreign country.²⁷ As will be

²⁶ Gagne & Morin, *supra* note 17, at 371.

²⁷ See Salacuse & Sullivan, *supra* note 12, at 67 (The BIT is "an international legal instrument through which two countries set down rules that will govern investments by their respective nationals in the other's territory.").

seen below, this definition is exceedingly narrow, but its core—granting investors of the other certain investment protections—is common to any BIT. An increasingly popular additional requirement is that each country precommit to binding arbitration in the case of a dispute between a foreign investor and a signatory country.²⁸ If a country, often including political subdivisions of a country,²⁹ expropriates an investment of a foreign investor, then that investor may bring a claim before an arbitral panel to whose jurisdiction the host country, through the BIT, has submitted.³⁰ The investor may bring the claim without the consent of its home country and often may do so regardless of whether a domestic investor could obtain such compensation in the host country's domestic court system.³¹ This system of investor protection is, unsurprisingly, instituted in order to increase investment in a host country's economy and to increase the investment opportunities of a home country's citizens.³²

Beyond this basic outline, just what exactly is a BIT is a complicated question. Chapter 11 of NAFTA, for example, is an investor protection provision within a wider trade agreement between three different countries.³³ It therefore is not “bilateral,” nor is it strictly an “investment treaty.” The investment provisions of CAFTA are another example, this time encompassing seven states.³⁴ Some BITs, moreover, are not as explicit as others in the ability of investors to force host countries to submit to binding arbitration. Sometimes the arbitration provisions are explicit, sometimes open to question, and sometimes aspirational.³⁵ Accordingly,

²⁸ Rose-Ackerman & Tobin, *supra* note 11, at 8 (stating that arbitration provisions are “essential in giving the treaties real bite”).

²⁹ Porterfield, *supra* note 18, at 7 (describing how state and local governments may violate the protections of NAFTA's Chapter 11).

³⁰ See Michael G. Parisi, *Moving Toward Transparency? An Examination of Regulatory Takings in International Law*, 19 EMORY INT'L L. REV. 383, 399–400 (2005) (explaining the arbitral process).

³¹ Neumayer & Spess, *supra* note 17, at 230 (“Often, foreign investors are not required to first exhaust domestic legal remedies and can thus bypass or avoid national legal systems, reaching straight for international arbitration.”).

³² Rose-Ackerman & Tobin, *supra* note 11, at 3 (noting the reasons that each type of country enters into a BIT).

³³ See generally North American Free Trade Agreement, U.S.-Can.-Mex., ch. 11, Dec. 17, 1992, 32 I.L.M. 289 (1993) [hereinafter NAFTA].

³⁴ These countries are Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and the United States. See Dominican Republic-Central American Free Trade Agreement, Costa Rica-Dom. Rep.-El Sal.-Guat.-Hond.-Nicar.-U.S., Preamble, Aug. 5, 2004, 43 I.L.M. 514 (2004), available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text> [hereinafter CAFTA]. Costa Rica only fully implemented the treaty in November, 2008. See *International Briefing*, MIAMI HERALD, Nov. 12, 2008.

³⁵ Jason Webb Yackee, *Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties*, 33 BROOK. J. INT'L L. 405, 421–22 (2008) (stating that different BITs have different levels of commitment to arbitration).

BITs vary widely in the strength of their procedural protections. Additionally, BITs are the descendants of “Friendship, Navigation and Commerce” Treaties (“FNCs”) that gave some, but not all, of the same protections. Although private parties could not usually bring claims against sovereign governments under FNCs, the treaties provided a commitment to protection of cross-border investment and expressed the signatory countries’ commitment to the security of private property.³⁶

For the purposes of this article, BIT shall refer broadly to all investment protection treaties, including treaties with wider application, such as bilateral free trade agreements (“FTAs”), and multilateral treaties, such as NAFTA and CAFTA. It will not, however, refer to FNCs unless an FNC allows for private investors to bring a claim directly against a host government. The right to bring a claim without permission from one’s home government—or more simply to bring a claim at all—is what separates BITs from most other enforcement mechanisms in international law. It removes the choice of whether or not to pursue a legal remedy out of the political realm (where it would lie if the decision on whether to prosecute a claim rested with the home government)³⁷ and into the economic arena.³⁸ This is what is most distinctive and new about BITs and what gives them force in today’s globalization debate.

Additionally, in this article “BIT” will not include other possible legal arrangements where investors protect themselves against possible expropriation, or where host countries seek to increase FDI. These include contracts made directly between a foreign investor and a host government, insurance policies purchased in case of expropriation, and tax incentives

³⁶ Daniel M. Price, *Investment, Sovereignty, & Justice: Arbitration Under NAFTA Chapter Eleven: Some Observations on Chapter Eleven of NAFTA*, 23 HASTINGS INT’L & COMP. L. REV. 421, 426–27 (2000) (describing background of FNCs).

³⁷ Laurence R. Helfer & Anne-Marie Slaughter, *Why States Create International Tribunals: A Response to Professors Posner & Yoo*, 92 CAL. L. REV. 899, 936 (2005) (arguing that when private parties actually can bring their own claims before “supranational tribunals” “no ‘political filter’ exists to screen out cases that are legally meritorious but diplomatically or politically embarrassing”). Examples of tribunals where only governments may bring claims include the Dispute Settlement Body of the World Trade Organization, and the United Nation’s International Court of Justice. See Ernest A. Young, *Institutional Settlement in a Globalizing Judicial System*, 54 DUKE L.J. 1143, 1213 (2005). These two examples also point out the difference between binding jurisdiction (the WTO) and jurisdiction through consent (the ICJ). As stated above, one strength of BITs is that they generally precommit a signatory to the jurisdiction of an arbitral panel. See Rose-Ackerman & Tobin, *supra* note 11.

³⁸ Another example is, in a limited geographic and often non-economic context, the European Court of Human Rights, where an individual can bring a claim against a signatory government. See Laurence R. Helfer & Anne-Marie Slaughter, *Toward a Theory of Effective Supranational Adjudication*, 107 YALE L.J. 273, 294 (1997) (noting the crucial importance of having a private right of action against European governments in the European Court of Human Rights).

granted to companies that engage in FDI.³⁹ The instant question is how BITs may be written so as to better promote FDI, not how FDI itself can be better procured through whatever means. As stated above, it may well be that BITs are a poor method of inducing more FDI. Tax incentives or private contracts, for instance, may be preferable. However, once a country has chosen a BIT as a method to increase FDI, some types of BITs would be more successful than others in promoting FDI.

Along with the question of what *is* a BIT comes the question of what is a BIT *for*? As discussed above, the answer is obvious. However, the answer is also revealing. Again, it is generally held that developing countries enter into BITs in order to increase FDI.⁴⁰ They may have other reasons, such as cosmetically symbolizing a strong relationship between two countries, pleasing the wishes of a developed country in order to win more foreign aid, or impressing a rival developing country.⁴¹ However, increased FDI is the prime objective. For developed countries, the reasons for entering into BITs are to protect the foreign investments of domestic investors, as well as to expand their investment opportunities.⁴² Admittedly, while a mercantilist developed country might not necessarily be enthused about its citizens investing their capital abroad, once that capital is invested elsewhere the country may become worried about how secure the investments are.⁴³

³⁹ Cf. Been & Beauvais, *supra* note 13, at 109–16 (discussing the use of government-sponsored and private insurance schemes for host country expropriation of FDI).

⁴⁰ See, e.g., Parisi, *supra* note 30, at 399 (“BITs are signed between host States and the investor’s home State specifically to protect private foreign direct investment.”); Salacuse & Sullivan, *supra* note 12, at 77 (“[D]eveloping countries sign BITs to *promote* foreign investment, thereby increasing the amount of capital and associated technology that flows to their territories.” (emphasis in original)); Victor Mosoti, *Bilateral Investment Treaties & the Possibility of a Multilateral Framework on Investment at the WTO: Are Poor Economies Caught in Between?*, 26 NW. J. INT’L L. & BUS. 95, 97 (2005) (describing how developing countries “abide by the prevailing orthodoxy that FDI is a major pre-condition for their economic advancement” and enter into BITs to attract FDI); Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT’L L. & POL’Y 157, 171, 178–79 (2005) (“[T]he motivation for the developing county to conclude the agreements in most cases was to attract foreign investment.”).

⁴¹ Note, though, that if a developing country enters into a BIT because it fears more FDI is going to a rival country, then the BIT is not entered into for mere vanity purposes, but also for FDI.

⁴² See Salacuse & Sullivan, *supra* note 12, at 76 (naming the protection of investments and the facilitation of the entry of additional investments as the reasons for developed countries to enter into BITs).

⁴³ See Gagne & Morin, *supra* note 17, at 372. These incentives do not exactly apply to BITs between developed countries. There, each country is apparently willing to trade protection of its citizens’ investments with increased risk of an expropriation claim made by the citizens of the other country. *Id.* Although, this is not always true, and is sometimes mitigated against. It is telling that the investment protections in the recent FTA between the U.S. and Australia—two very developed countries—did not include a precommitment to binding arbitration. *Id.*

The claim that developing countries enter into BITs to promote FDI is quite uncontroversial. After all, they are “investment treaties,” not “property rights” treaties, “labor relations” treaties, or “security” treaties. Both friends and foes of the increasing use of BITs conclude that their purpose is to increase FDI.⁴⁴ They should not be faulted for concluding as much. A moment’s reflection demonstrates that there are other possible reasons for why BITs are entered into, but a moment’s more illustrates why they are not the actual reasons.

BITs extend to foreign investors elements of what U.S. jurisprudence recognizes as due process, equal protection, and just compensation.⁴⁵ It is plausible that countries would enter into BITs because their governments wished to extend those principles to their own citizens when abroad. In that case, countries would enter into BITs to secure protection for their own citizens in other countries in exchange for protecting those countries’ citizens. However, if this were the case, the treaties would cover “persons,” not just “investors,” and would perhaps include more substantive rights than merely “just compensation.” It might be argued that other substantive rights are covered in other treaties, such as the U.N. Universal Declaration on Human Rights and the Helsinki Accords, and that BITs are merely made to supplement these protections. However, those documents are not only directed toward protecting foreign citizens, but also domestic persons.⁴⁶ Thus, if a “global Fifth Amendment,” similar to the Universal Declaration, were entered into by developing countries it might be done for reasons other than increasing FDI. However, a BIT is a different story because it only protects foreigners.

Countries might also enter into BITs for symbolic reasons. This would be akin to the “Friendship” portion of the old treaties of “Friendship, Navigation, and Commerce.” The argument might be that whatever fluff is included in a BIT is merely a way for nations to demonstrate that they think investing in each other’s economies is important. However, this would not explain the presence of binding arbitration provisions. A treaty is not entirely symbolic if an enforcement mechanism can result in the loss of millions of dollars.⁴⁷ Arbitration provisions binding countries to a tribunal’s jurisdiction are not aspirational, unlike, arguably, “optional jurisdiction” international tribunals such as the International Court of

⁴⁴ See, e.g., Been & Beauvais, *supra* note 13, at 117–18 (discussing how developing governments seek to increase FDI).

⁴⁵ *Id.* at 40–41 (analogizing various BIT clauses to clauses in the U.S. Constitution).

⁴⁶ In other words, Mexico does not violate NAFTA’s Chapter 11 by expropriating property from Mexican citizens. It would violate the Universal Declaration on Human Rights, however, by imprisoning its own citizens without trial. See Universal Declaration on Human Rights, art. 11(1).

⁴⁷ For example, the NAFTA *Metalclad* arbitral panel originally awarded \$16,685,000.00, all of which was to be paid by the Mexican government. See *Metalclad Corp. v. United Mexican States*, Award, 40 I.L.M. 36, 54 (NAFTA ch. 11 Arb. Trib. Aug. 30, 2000).

Justice.⁴⁸ States can, and do, lose in arbitration and yet they continue to enter into BITs. A country that merely wished to affirm its friendship with another would be much better advised to sign a declaration stating as much, or a substantive treaty that imposes obligations but is not directly enforceable.

In this way, the reason why countries enter into BITs is similar to the reason why they join the World Trade Organization (“WTO”). In either case they do so even though the treaty subjects governments to the jurisdiction of a tribunal whose judgments are binding.⁴⁹ Countries may enter the WTO in order to join the “community of nations,” but it is a high price to pay if the country does not also wish to lower its barriers to imports. Further, even if some countries do enter the WTO merely because they wish to express their alliance with other members, the case is much weaker for BITs because they are much less visible than the WTO. Additionally, BITs are not a “community” but a monadic series of agreements.

Readers are free to hypothesize additional reasons why developing countries enter into BITs, but all other reasons will fail to match the straightforward reason of “to increase FDI.” In response a reader might cite literature that argues that many developing countries do not want to sign BITs, but do so in an arms race with other developing countries, feeling that if they do not they will be left behind.⁵⁰ However, this only further proves that increasing FDI is the root reason for this behavior, however detrimental it may be.⁵¹ This view merely illustrates that developing countries sign agreements because they want FDI so badly they will sacrifice other goods to procure it.

Thus, throughout the rest of this article it is a central assumption that developing countries enter into BITs in order to increase FDI. It is therefore a truism that BITs which actually do increase FDI are successful. BITs that do not, and merely express friendship between nations, are at best paper tigers and at worst failures.

Given its obviousness, this conclusion might seem much ado about

⁴⁸ Statute of the International Court of Justice, art. 36.

⁴⁹ See General Agreement on Tariffs and Trade 1994, Uruguay Round Agreement, Understanding on Rules and Procedures Governing the Settlement of Disputes, arts. 21–22.

⁵⁰ One proponent of this view is Professor Andrew Guzman. He submits that an individual developing country is better off granting concessions, such as those found in BITs, to foreign investors, but that developing countries as a whole would be better off “forcing investors to enter contracts with host countries that cannot be enforced in an international forum.” Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT’L L. 639, 643 (1998).

⁵¹ This discussion does not mean to impute proponents of this “arms race” hypothesis with the view that developing countries do not sign BITs to increase FDI, but merely to analyze such a view.

nothing. However, keeping it in the forefront of one's mind is something missing from much of the work on BITs and regulatory takings. BITs are attacked for a myriad of reasons,⁵² but the question of how BIT expropriation provisions can best facilitate and incentivize FDI is infrequently asked in the legal literature. Instead, scholars criticize expropriation provisions on the grounds that they allow attacks on a state's ability to protect the environment or that they infringe on a nation's sovereignty.⁵³ When the underlying reason for a BIT is not kept in mind these criticisms turn BITs into nothing more than heavy-handed impositions of U.S. property rights. This is because BITs do not make sense unmoored from the goal of increasing FDI. Instead, they seem like an "economic charter of rights," akin to the Universal Declaration of Human Rights, except that they, bizarrely, only protect foreigners.

II. THE ORIGINS OF *PENN CENTRAL*'S VAGUENESS

One way in which a BIT might fail in its purpose of increasing FDI is by providing vague standards for what constitutes an expropriation. For an investor, the vaguer the standard the less certain she can be as to whether or not she will receive compensation if a host government diminishes the value of her investment through regulation. One such vague standard is the *Penn Central* test. For background on the test it is necessary to leave international law for a moment and turn to the test's origins in *Penn Central Transportation Co. v. City of New York*.⁵⁴ Following this review, this article will examine the United States' recent history with BITs, particularly that involving NAFTA, and will follow with how *Penn Central* became a part of the current Model BIT and how it may undermine the purpose of increasing FDI.

In the late 1960s the Penn Central railroad was running at a loss.⁵⁵ Unlike most other businesses that suffer from repeated annual deficits, Penn Central could not simply close its doors and walk away. As a "common carrier," the Penn Central owed the public a duty to operate and had to keep running its trains.⁵⁶ Therefore, it needed to find an influx of cash short of selling its trains at auction. It found such an opportunity in expanding the size of its prized Penn Central Station in midtown Manhattan. This would involve utilizing the airspace rights to the space above the existing Grand Terminal building to build new offices. The original plan for the building

⁵² See, e.g., Williams, *supra* note 7, at 473 (discussing lack of accounting for democratic will in NAFTA's Chapter 11).

⁵³ See, e.g., *id.*

⁵⁴ 438 U.S. 104, 124 (1978).

⁵⁵ See Gideon Kanner, *Making Laws & Sausages: A Quarter-Century Retrospective on Penn Central Transportation Co. v. City of New York*, 13 WM. & MARY BILL RTS. J. 653, 713 (2005) (describing annual deficits in excess of one million dollars).

⁵⁶ See *id.* (explaining why the company could not cease to operate).

had envisioned adding stories to its height, so the idea was inarguably in keeping with its original design.⁵⁷ The railroad hoped to turn a profit with the funds derived from leasing the new office space.

The only problem was that expanding the height of the station would run afoul of the historic designation that the City's Landmarks Preservation Commission had bestowed on the building.⁵⁸ The designation was pursuant to New York's city-wide historical preservation scheme, in which the Commission listed certain buildings and would only allow modifications to those buildings under special circumstances.⁵⁹ The railroad applied for a variance on two separate occasions, but the City denied both attempts.⁶⁰ Lacking a variance, the railroad sued, claiming that in denying the building addition the City had committed a regulatory taking.⁶¹

After victory in the trial court, but losses in the Appellate Division and New York Court of Appeals, Penn Central appealed to the United States Supreme Court.⁶² There, the railroad focused the issue on the loss of its air rights, not so much its operating deficit, arguing that in denying it permission to build additional stories the City had taken its property.⁶³ The Court, by a 6-3 margin, rejected Penn Central's argument.⁶⁴ In so doing, the Court manufactured a multi-factored test to determine when a regulatory taking occurs and concluded that Penn Central failed the test.⁶⁵ The Court enunciated that regulatory takings cases were "essentially ad hoc, factual inquiries."⁶⁶ In making these "factual inquiries" it averred that three factors "have particular significance."⁶⁷ These were "the economic impact of the regulation on the claimant . . . the extent to which the regulation has interfered with distinct investment-backed expectations" and "the character

⁵⁷ *Penn Cent.*, 438 U.S. at 115–16. The original plan intended twenty stories, and the plan at issue in *Penn Central* was for fifty-five. *Id.* The Supreme Court stated that Penn Central might have a chance to go back to the City and merely ask for a twenty-story addition. *Id.* However, the facts were such that approval of even this much more modest proposal was highly unlikely. *Id.*

⁵⁸ *Id.*

⁵⁹ *See id.* at 112 (detailing exemptions application process).

⁶⁰ *Id.* at 116–17.

⁶¹ *Id.* at 119.

⁶² *Id.* at 122.

⁶³ *Id.* at 130. Penn Central chose not to focus on the fact that it was hemorrhaging money and that the addition of office space was the only way it could turn the business around. *Id.* The reasons for this strategy, not entirely relevant to the present discussion, were because of the peculiar opinion of the New York Court of Appeals. For a detailed discussion see Kanner, *supra* note 55, at 722–37 (discussing the opinion of the Court of Appeals, and its rather unique reliance on the views of nineteenth century political philosopher Henry George).

⁶⁴ *Penn Cent.*, 438 U.S. at 138.

⁶⁵ *Id.* at 124–38.

⁶⁶ *Id.* at 124.

⁶⁷ *Id.*

of the governmental action.”⁶⁸

Faced with these factors—never before enumerated together in a Supreme Court opinion—the Court concluded that the equities were not in Penn Central’s favor.⁶⁹ The economic impact of the regulation was mitigated by the option to transfer the Terminal’s air rights to other parcels nearby.⁷⁰ The “investment-backed expectations” had been met, in spite of the Landmarks Law, because the railroad could still use the Terminal “precisely as it has been used for the past 65 years: as a railroad terminal containing office space and concessions.”⁷¹ Therefore, “the law does not interfere with what must be regarded as Penn Central’s primary expectation concerning the use of the parcel.”⁷² Finally, the “character” of the governmental action was “a comprehensive plan” that benefited “the quality of life in the city as a whole,” including the owners of the terminal themselves.⁷³ In sum, the Landmarks Law did not prevent the railroad from doing what it had been doing all along, did so in a way that it was not “singled out” so that it bore “public burdens which, in all fairness and justice, should be borne by the people as a whole,”⁷⁴ and was left with a method to mitigate its damages.

Although this method of “calculating” whether a regulatory taking has occurred has been roundly reviled, the Court could be commended for at least setting forth a path for tackling the question. It gave some substance to Justice Holmes’ question-raising explanation that a regulation will be recognized as a taking if it “goes too far” in regulating property.⁷⁵ That being said, the test itself had a somewhat mysterious genealogy.

As Gideon Kanner and others have illustrated, the three-pronged test was largely influenced by Professor Frank Michelman’s 1967 *Harvard Law Review* article *Property, Utility, and Fairness: Comments on the Ethical Foundations of “Just Compensation” Law*.⁷⁶ Michelman explored what

⁶⁸ *Id.* The Court also explained that “[a] ‘taking’ may more readily be found when the interference with property can be characterized as a physical invasion by government, than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good.” *Id.* This largely became a moot point in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982), when the Court ruled that permanent physical invasions are *per se* takings.

⁶⁹ *Penn Cent.*, 438 U.S. at 138.

⁷⁰ *Id.* at 137.

⁷¹ *Id.* at 136.

⁷² *Id.* at 134–35.

⁷³ The Court did concede that the owners may have been “more burdened than benefited by the law,” but stated that was also the case with the owners in prior cases upholding zoning legislation. *Id.* at 135.

⁷⁴ *Id.* at 123.

⁷⁵ *Penn. Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922) (“The general rule at least is that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.”).

⁷⁶ *Penn Cent.*, 438 U.S. at 128 (citing Frank I. Michelman, *Property, Utility and*

divided compensable takings from noncompensable police power actions. After conceding that reconciling the inconsistent case law seemed to be a hopeless task, he reviewed the issue from various normative perspectives, and concluded that the only standard that could consistently be applied was that a landowner should be compensated if doing so would be “fair.”⁷⁷ He explored utilitarian reasons for compensation of “takings,” as well as the more nuanced views of John Rawls, and discerned that a property owner would be more deserving of compensation if he had “some distinctly perceived, sharply crystallized, investment-backed expectation.”⁷⁸ Another reason, from utilitarian grounds, might be the stress that a property owner could sustain once he learned of the offending regulation.⁷⁹

Now, Michelman did not explicitly endorse the utilitarian approach to regulatory takings,⁸⁰ but he did take away from that approach the value of turning to “investment-backed expectations” in resolving regulatory takings disputes. That criterion suggested a manner of deciding when a police power action “goes too far.”⁸¹ The case law was so jumbled on the issue that anything beyond a “fairness” standard either left deserving landowners uncompensated or provided a windfall to landowners who were merely affected by activities better described as garden-variety police power actions. Further, not only was it a way to explain the case law, but it was the only method that could meet the objections to other possible standards. The physical takings dividing line, for example, did not work for two reasons. First, because some physical takings are *de minimis* intrusions onto a few feet of a landowner’s property causing no consternation on the part of the landowner and perhaps a large benefit on the part of the public. Second, some regulations provide little benefit to the public with huge costs on the few landowners that the regulations affect.⁸²

With Michelman’s scholarship at his disposal, Justice Brennan added some of the Court’s patchwork of precedents and weaved the confused field together into the *Penn Central* test.⁸³ To summarize, the test allows courts

Fairness: Comments on the Ethical Foundations of “Just Compensation” Law, 80 HARV. L. REV. 1165 (1967)).

⁷⁷ See Michelman, *supra* note 76, at 1221 (stating that “[w]hat we want to know, then, is whether a specific decision not to compensate is fair”).

⁷⁸ *Id.* at 1233.

⁷⁹ *Id.* at 1234 (“[T]he ‘balancing’ test is relevantly aimed at discovering not whether a measure is or is not efficient, but whether it is *so obviously* efficient as to quiet the potential outrage of persons ‘unavoidably’ sacrificed in its interest.”).

⁸⁰ *Id.* at 1218–19 (“It is not the purpose of this essay to make a case for utilitarian ethics. . . . there is no basis for concluding that the question of compensability is intelligible only when compensation is regarded as an instrument of utilitarian maximizing.”).

⁸¹ See *id.* at 1241 (arguing that declarations prohibiting use of all lands in order to preempt natural resource exploitation may have an adverse affect on productivity, but not when limited to a specific use or portion of the land).

⁸² See *id.* at 1184–90 (discussing physical invasion criterion).

⁸³ *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 128 (1978). The use of

to review a case's entire record ("ad hoc factual inquiries") for whether the regulation at issue falls on the "fair" or "unfair" side of the ledger.⁸⁴ Courts can look at the economic impact of the regulation, but can also consider other factors.⁸⁵ They are also free to examine the "character" of the regulation, and—as long as it is not a physical taking—can also specify the "character" as compensable or not.⁸⁶ Furthermore, they can look for "investment backed expectations" and divine whether the investors expected certain returns or not.⁸⁷ In short, courts are free to range just about as widely as they please in determining whether the government has taken property without providing just compensation.

Criticism of the *Penn Central* approach has been vociferous.⁸⁸ Much

Michelman's work is commented on in the following: "It has been believed—correctly, as it turns out—by specialized land-use lawyers deeply involved in this subject, that this phrase was inserted into the *Penn Central* opinion by Justice Brennan's clerk who consulted Professor Michelman's prestigious article." Kanner, *supra* note 55, at 770.

⁸⁴ *Penn Cent.*, 438 U.S. at 124.

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.* at 124, 127. What those "expectations" are is a sticky wicket. In the case of the Penn Central railroad, for example, was it the expectations of the original investors or the current investors that was at issue? After all, the original ones had presumably long since left the picture. And if it was the original ones, were the expectations only those that the railroad actualized soon-after the station began operating (the running of the railway), or those that could have been implemented but were delayed to an indefinite point in time? Would this have been different had the fifty five extra stories been applied for in 1923, only a few years after the station's completion? Or in 1933? Or one year before the Landmark Law went into effect? All of these questions are material, especially considering that the Supreme Court has since allowed regulatory takings claims even when the regulation was instituted before the current owner obtained the property. See, e.g., *Palazzolo v. Rhode Island*, 533 U.S. 606, 630 (2001) (allowing takings claim to proceed even though claimant purchased property after challenged regulation was instituted).

⁸⁸ Instead of reviewing what has been reviewed before in countless law journals, here is an overview of the virile dislike of the opinion from some of its few friends:

It does not do justice to academic criticism of *Penn Central* to describe such criticism as a cottage industry. It is more like an industrial revolution. More than two decades ago, Carol Rose characterized regulatory takings law as a "muddle," and that characterization has acquired the status of conventional wisdom. Attacks on *Penn Central*, from every possible direction, would fill several very long footnotes. Many of the criticisms of modern doctrine are substantive, urging either that the Court has overstated or understated the extent to which regulations should be regarded as takings. We do not deal with those substantive issues in this article. For our purposes, we take the underlying substantive law, as it presently stands, as given and focus on *Penn Central* as a doctrinal tool. From that perspective, the criticisms of *Penn Central* that are relevant to our project are jurisprudential criticisms, of which there are plenty.

Gary Lawson, Katharine Ferguson & Guillermo A. Montero, "*Oh Lord, Please Don't Let Me Be Misunderstood!*": Rediscovering the *Mathews v. Eldridge* & *Penn Central*

of this has gone to the vagueness and malleableness of the test and the unpredictability that the test invites. Some theorists, however, have defended *Penn Central*'s vagueness approach. The defense basically concludes that, after all, the test is a good approximation of what is "fair." One such defender is Professor Marc. R. Poirier.⁸⁹ Rather than insisting that *Penn Central* actually gives clear guidance as to what is a regulatory taking, Professor Poirier carefully and painstakingly argues that *Penn Central* indeed is vague, but that its vagueness is what makes the test more fair.⁹⁰ His analysis is reviewed below, after this article examines the use of the *Penn Central* test in light of its incorporation into BITs. Poirier's argument, though seductive, is flawed because it fails to appreciate the public law nature of takings law. Further, even granting validity to his argument that vague regulatory takings standards should apply to the Fifth Amendment, they do not extend to supporting vague standards in BITs. His view fails to account for the goal of BITs: stability for foreign investors in inducing them to invest.

Before addressing these arguments, the narrative now turns to how the *Penn Central* test became affixed to the United States' latest round of BITs and what that means for their expropriation protections.

III. RIDING THE *PENN CENTRAL*: FROM NAFTA TO CFTA

A. National Treatment Clauses in BITs

The United States' recent BITs have typically offered three basic pillars of protection to investors: national treatment clauses, minimum standard of treatment clauses, and expropriation clauses.⁹¹ The first is roughly an equal protection clause for foreign investors.⁹² Generally, under a national treatment clause, a signatory government to a BIT may not treat an investment differently because it is foreign owned.⁹³ Because such a concept is the most obvious way to protect foreign investors and says nothing about the substance of investor protections themselves, it has proved less controversial in the implementation of BITs and in the outcomes of arbitral tribunals.⁹⁴ This level of protection, without anything

Frameworks, 81 NOTRE DAME L. REV. 1, 34–35 (2005).

⁸⁹ See Marc. R. Poirier, *The Virtue of Vagueness in Takings Doctrine*, 24 CARDOZO L. REV. 93 (2002) (arguing that the vagueness in takings doctrine is functional and entirely appropriate).

⁹⁰ *Id.*

⁹¹ See, e.g., NAFTA, *supra* note 33 (including all three forms of investor protection).

⁹² Been & Beauvais, *supra* note 13, at 40 (describing the purpose of BIT clauses).

⁹³ See Joshua Robbins, *The Emergence of Positive Obligations in Bilateral Investment Treaties*, 13 U. MIAMI INT'L & COMP. L. REV. 403, 421 (2006) (examining how national treatment clauses operate).

⁹⁴ See, e.g., Been & Beauvais, *supra* note 13, at 37 (fiercely criticizing regulatory takings clauses in BITs, but stating that national treatment clauses can protect against the "most

more, is essentially that of the Calvo Doctrine, which was influential among Latin American nations until relatively recently.⁹⁵ Under the Calvo Doctrine, a government may expropriate foreign investments without any compensation at all so long as it treats its own citizens in the same manner.⁹⁶

B. Minimum Standard of Treatment Clauses and Customary International Law

Of course, allowing governments to expropriate without compensation would do little to further the interests behind an investor protection treaty. A foreign investor could care less about equal treatment if all investments—foreign and domestic—are at risk. Therefore, diplomats have crafted the substantive protections of minimum standard of treatment clauses and expropriation clauses. Minimum standard of treatment clauses are more nebulous than national treatment clauses and have proved hard to interpret. This is because the standard they often refer to—the minimum standard of investor protection under international law—is itself nebulous and hard to interpret. As the Supreme Court itself has said: “[T]here are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state’s power to expropriate the property of aliens.”⁹⁷

Not only has the minimum standard of protection under international law proved elusive, but so has the meaning of “international law” itself as that term is used in U.S. BITs. An example of this controversy is *S.D. Myers, Inc. v. Canada Partial Award*⁹⁸ where an arbitral tribunal ruled that Canada had violated Section 1105—the NAFTA provision enforcing the minimum standard of treatment under international law—by arbitrarily banning the importation of the industrial chemicals known as PCBs.⁹⁹ The panel had already found that Canada violated Section 1102 (national treatment) and therefore found that Canada violated Section 1105 because Section 1102 itself was, after all, part of international law.¹⁰⁰

The counter to such a finding is the argument that what the NAFTA

serious risk of overreaching” by governments against foreign investors).

⁹⁵ Santiago Montt, *What International Investment Law & Latin America Can and Should Demand From Each Other: Updating the Bello/Calvo Doctrine in the BIT Generation*, 3 RES. PUBLICA ARGENTINA 75, 105 (2007) (discussing how Latin American countries upheld the Calvo Doctrine until the recent emergence of BITs).

⁹⁶ See Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT’L L. & POL’Y 157, 159 (2005) (describing the Calvo Doctrine).

⁹⁷ *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 428 (1964); but see Andreas F. Lowenfeld, *Investment Agreements & International Law*, 42 COLUM. J. TRANSNAT’L L. 123, 130 (2003) (arguing that international law is slowly coming to a consensus on expropriation issues).

⁹⁸ 40 I.L.M. 1408 (NAFTA, ch. 11 Arb. Trib., Nov. 12, 2000).

⁹⁹ *Id.* at 1439.

¹⁰⁰ *Id.*

signatories meant in stating “international law” was “customary international law,” and not just anything that might be an aspect of international law, such as treaties. Under this argument, the drafters could not have intended to incorporate by reference the various treaties on investor protection that may give greater rights to investors than customary international law itself would give.¹⁰¹ In fact, following the *S.D. Myers* award, the NAFTA parties issued Notes of Interpretation stating that that indeed was the case.¹⁰² This view led to the following language in the new Model BIT, drafted following the Bipartisan Trade Promotion Authority Act of 2002: “Each Party shall accord to covered investments treatment in accordance with *customary* international law, including fair and equitable treatment and full protection and security.”¹⁰³

As to what this “customary international law” is, Annex A of the Model BIT states that “[t]he Parties confirm their shared understanding that ‘customary international law’ generally and as specifically referenced in Article 5 [Minimum Standard of Treatment] and Annex B [Expropriation] results from a general and consistent practice of States that they follow from a sense of legal obligation.”¹⁰⁴ There is nothing surprising about this definition, as this is the textbook answer as to what customary international law means.¹⁰⁵ However, it does remind future arbitral panels that customary international law does not concern treaties. Therefore, another treaty’s existence, or even another provision of the relevant BIT, cannot be considered in determining whether a party to the BIT has expropriated an investment. This hardly clears the field for what the “minimum standard” is, but it does make clear that BITs themselves do not define the minimum standard.

C. Expropriation Clauses

Expropriation provisions, the third pillar of BIT protections, are the most controversial of all. They provide protection above and beyond even the “minimum standard of treatment” under (customary) international law.¹⁰⁶ They typically state that if a signatory, or constituent government,

¹⁰¹ See, e.g., Alireza Falsafi, *The International Minimum Standard of Treatment of Foreign Investors’ Property*, 30 SUFFOLK TRANSNAT’L L. REV. 317, 349 (2007) (explaining the *Myers* panel’s decision).

¹⁰² NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions § B (July 31, 2001) (seeking to set the record straight on the intent of the NAFTA Parties regarding the term “international law”).

¹⁰³ U.S. MODEL BILATERAL INVESTMENT TREATY, at art. 5.1 (2004), <http://www.ustr.gov/sites/default/files/U.S.%20model%20BIT.pdf> (emphasis added).

¹⁰⁴ *Id.* at Annex A.

¹⁰⁵ See JANIS NOYES, CASES & COMMENTARY ON INTERNATIONAL LAW 20–24 (3d ed. 2006) (defining “customary international law” by presenting *Filartiga v. Pena-Irala*, 630 F.2d 876 (2d Cir. 1980)).

¹⁰⁶ See *infra* note 107 and accompanying text.

expropriates an investment the government must provide some measure of monetary compensation to the investor.¹⁰⁷ As explained earlier, this protection is the driving force behind BITs.¹⁰⁸ If a government has a history of expropriating property without compensation, such as the barrage of expropriations that occurred in Third World nationalization of industries during the Cold War, then such a provision provides a level of protection to a foreign investor who might otherwise choose not to invest in the host nation.¹⁰⁹ The hope is that such protection will increase FDI.

1. NAFTA and Its Backlash: No Greater Substantive Rights

Expropriation provisions have proved especially controversial in recent years when arbitral panels have interpreted them to include regulatory takings. The text of BITs have long provided protection from regulatory takings, but since the reasons behind BITs are grounded in historical mass expropriations of physical property, regulatory takings “clauses” have not been a large concern until recently. This changed with NAFTA’s Chapter 11. Under its terms, arbitral panels have either come close to or actually found that host governments committed regulatory takings.¹¹⁰ In *Metalclad*, for example, the arbitral panel concluded that the Mexican provincial government committed a regulatory taking in arbitrarily denying a permit to run a toxic waste site.¹¹¹ Given the expansive reading of the “tantamount to expropriation” language in Article 1110 of NAFTA, it is very likely that no taking would have been found had the case been reviewed under U.S. law and the Fifth Amendment.¹¹² This gave rise to fears that if a similar claim were made against the United States or a state or local government, the United States would be forced to pay compensation for actions for which it would not have to pay if the U.S. Constitution were applied.¹¹³

With this in mind, some U.S. officials wanted to make sure that post-NAFTA BITs did not subject the United States to arbitral awards if the

¹⁰⁷ Carlos M. Correa, *Investment Protection in Bilateral & Free Trade Agreements: Implications for the Granting of Compulsory Licenses*, 26 MICH. J. INT’L L. 331, 348 (2004) (explaining the purpose of expropriation clauses).

¹⁰⁸ See *supra* Part I.

¹⁰⁹ See Vandevelde, *supra* note 96, at 166–67 (discussing expropriations of foreign investment by developing countries during the post-colonial cold war period).

¹¹⁰ See, e.g., *Ethyl Corp. v. Canada*, 38 I.L.M. 708, 730 (NAFTA ch. 11 Arb. Trib. June 24, 1998) (establishing jurisdiction); *Metalclad Corp. v. The United Mexican States*, 40 I.L.M. 36, 54 (NAFTA ch. 11 Arb. Trib. Aug. 30, 2000); *S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408, 1439, Partial Award (NAFTA, ch. 11 Arb. Trib. Nov. 12, 2000); *The Loewen Group v. United States*, 42 I.L.M. 811, 812 (NAFTA, ch. 11 Arb. Trib. June 26, 2003).

¹¹¹ *Metalclad*, 40 I.L.M. at 54.

¹¹² See generally Williams, *supra* note 7, at 473 (criticizing the expansiveness of the *Metalclad* panel’s interpretation of NAFTA’s Chapter 11).

¹¹³ See *id.*

standard for liability was stricter than that under U.S. domestic law. They believed this would lead to the perverse result of a foreign investor receiving greater protection than a domestic investor would enjoy.¹¹⁴ Indeed, many already believe that U.S. regulatory takings protections are already too strong and would presumably object to even stronger protections for foreigners.¹¹⁵

Thus, in 2002 Congress inserted explicit language into the Bipartisan Trade Promotion Authority Act, directing U.S. trade negotiators to, *inter alia*, “[E]nsur[e] that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States.”¹¹⁶ With this direction, post-NAFTA BITs (variants of the new Model BIT) have included significantly altered language in their expropriation clauses.¹¹⁷

The new Model BIT’s investor protection language differs from NAFTA’s in a significant but roundabout way. The expropriation section itself, Article 10.7, contains a very slight change. NAFTA’s section 1110 begins:

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 nondiscriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6.¹¹⁸

In contrast, the Model BIT’s Article 6.1 begins:

Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures *equivalent* to expropriation or nationalization (“expropriation”), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment

¹¹⁴ 19 U.S.C. § 3802(b)(3) (2006).

¹¹⁵ See, e.g., J. Peter Byrne, *Ten Arguments for the Abolition of the Regulatory Takings Doctrine*, 22 *ECOLOGY L. Q.* 89 (1995) (advocating a less expansive reading of the Fifth Amendment’s Takings Clause).

¹¹⁶ 19 U.S.C. § 3802(b)(3) (2006).

¹¹⁷ See United States-Chile Free Trade Agreement, U.S.-Chile, art. 10, annex 10-D June 6, 2003, 42 *I.L.M.* 1026 (2004), available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (applying *Penn Central* language to regulatory takings claims); United States-Singapore Free Trade Agreement, Side Letter Exchange on Expropriation (May 6, 2003), available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/singapore-fta/final-text> (follow hyperlink entitled “Exchange of Letters on Land Expropriation”) (also applying *Penn Central* language to regulatory takings claims); CAFTA, *supra* note 34 at art. 10, annex 10-C (also applying *Penn Central* language to regulatory takings claims).

¹¹⁸ NAFTA, *supra* note 33, at art. 1110 (emphasis added).

of prompt, adequate, and effective compensation; and (d) in accordance with due process of law and Article 5 [Minimum Standard of Treatment](1) through (3).¹¹⁹

Notice the only significant change is that “measures equivalent to expropriation” replaces “a measure tantamount to [expropriation].” If “equivalent to expropriation” were identical in meaning to “tantamount to expropriation,” then there would be no substantive change between the two texts. Some commentators expressed alarm after the signing of NAFTA, worrying that arbitral panels would interpret “tantamount” expansively to mean something much less than “expropriation.”¹²⁰ However, those panels that have discussed the subject have read “tantamount” in NAFTA’s Chapter 11 to mean “equivalent.”¹²¹ Thus, although “tantamount” has been a cause for great concern, and although arbitral panels might still read it expansively, those concerns have not yet been realized. To quell these fears, however, NAFTA’s “tantamount” language has been replaced by “equivalent” in the new Model BIT.

2. *The Definition of “Investment”*

To find the unarguably substantive changes in expropriation protection between NAFTA and the Model BIT, one must look to the definition of “investment,” and to the model treaty’s Annexes. First of all, the Model BIT defines what an “investment” is (that is, what is protected from a host government’s expropriation).¹²² Surprisingly, considering the concern over the expansive form of NAFTA’s takings provisions, the Model BIT’s definition of investment is arguably *more expansive* than that in NAFTA.¹²³ Its scope includes the following forms: “an enterprise,” “equity participation,” bonds and loans, derivatives, investment contracts, intellectual property rights, and some forms of licenses and permits.¹²⁴ Finally, it includes a catch-all clause including “other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.”¹²⁵

¹¹⁹ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at art. 6.1 (emphasis added).

¹²⁰ Ian A. Laird, *NAFTA Chapter 11: NAFTA Chapter 11 Meets Chicken Little*, 2 CHI. J. INT’L L. 223, 226–27 (2001) (explaining the various positions on the meaning of “tantamount to expropriation”).

¹²¹ *Pope & Talbot, Inc. v. Canada*, Interim Award, para. 104 (NAFTA, ch. 11 Arb. Trib., June 26, 2000); *S.D. Myers, Inc. v. Canada*, Partial Award, 40 I.L.M. 1408, 1440 (NAFTA, ch. 11 Arb. Trib., Nov. 12, 2000).

¹²² See *infra* note 124 and accompanying text.

¹²³ See Letter of Center for International Environmental Law (CIEL) (Feb. 27, 2003) available at http://www.ciel.org/Publications/TEPAC_Agreements_27Feb03.pdf (presenting concerns of scholars regarding the definition of “investment”).

¹²⁴ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at art. 1.

¹²⁵ *Id.*

Note that “investment” includes not only “enterprises,” equities, traditional investment contracts, and real property, but also “other tangible or intangible, movable or immovable property, and related property rights.”¹²⁶ This might include the “taking” of one use of a piece of property (a “property right”) when other uses have not been taken. This inclusion is perhaps significant because the open-ended inclusion of “property rights” might allow for the doctrine of “conceptual severance” that has been rejected in U.S. courts.¹²⁷ Allowing for conceptual severance, on its own, would allow for a greater availability of regulatory takings claims than under U.S. law. If one use of a piece of property were outlawed, the investor could demand compensation even though productive uses of other pieces remained available. This is largely academic, however, because allowing the inclusion of conceptual severance in the understanding of “investment” is at odds with the Model BIT’s other provisions discussed below.

3. Customary International Law

The Annexes are where the primary change and clarification of “expropriate” comes when compared to NAFTA.¹²⁸ The Annexes do several things. First, Annex A, discussed above, affirms that the treaty relies upon *customary* international law, not “international law” *per se*.¹²⁹ Next, Annex B flatly states that the expropriation protections of the treaty are “intended to reflect customary international law concerning the obligation of States with respect to expropriation.”¹³⁰ Under this broad assertion, even if the text of Article 6.1 were textually different from the standard of customary international law, that standard would still govern, at least insofar as the standard must be “reflect[ed].”¹³¹

Of course, as discussed above, discerning what actually is “the obligation of States with respect to expropriation” under customary international law is not for the faint of heart.¹³² Because the answer is quite murky, perhaps that murkiness should be taken into account when applying it to the Model BIT’s text. This would give arbitral panels a great deal of wriggle room in interpreting Article 6.1, but would also perhaps prevent

¹²⁶ *Id.*

¹²⁷ Matthew C. Porterfield, *International Expropriation Rules & Federalism*, 23 STAN. ENVTL. L.J. 3, 16–21 (2004) (outlining the doctrine of conceptual severance).

¹²⁸ Although classified as “Annexes” here, they have manifested themselves in other forms, such as the side letters in the United States-Singapore FTA. See United States-Singapore Free Trade Agreement, U.S.-Sing., Side Letter Exchanges on Customary International Law and Expropriation, May 6, 2003, 42 I.L.M., 1026 (2004), available at <http://www.ustr.gov/trade-agreements/free-trade-agreements/singapore-fta/final-text>

¹²⁹ See NAFTA, *supra* note 33, at sec. III.B.

¹³⁰ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at Annex B.

¹³¹ *Id.*

¹³² See *supra* note 97 and accompanying text.

them from reaching too far to one side or the other in finding or not finding expropriations.

In any case, this does not end the matter on what “expropriation” means. Even though Annex B at first states that the Model BIT’s expropriation provisions are meant to “reflect” customary international law, it goes on to further define those expropriation provisions.¹³³ The drafters could have stopped there and left it to the future arbitral tribunals to simply apply “customary international law” to claimed takings. Instead, they qualified the above-discussed definition of “investment.”¹³⁴ Annex B.2 states: “An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.”¹³⁵ This language does not rule out regulatory takings or even conceptual severance. However, it does rule out any understanding that “investment” means something other than property.¹³⁶ Such a result has been suggested in some NAFTA tribunals where a company’s market share was hinted to be an “investment” under NAFTA.¹³⁷

4. *The Model BIT’s Use of Penn Central*

The most important change lies in Annex B.3. It states: “Article 6.1 [the expropriation provision] addresses two situations. The first is direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.”¹³⁸ This “first situation” is a physical taking, recognized in the United States under *Loretto v. Teleprompter Manhattan CATV Corp.*,¹³⁹ as requiring compensation from the government. Even under customary international law, such an action is generally recognized as a taking requiring compensation.¹⁴⁰

Next comes Annex B.4. It discusses the “second situation” and is worth quoting in full:

The second situation addressed by Article 6.1 is indirect expropriation, where an action or series of actions by a Party has an

¹³³ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at Annex B.2.

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ See, e.g., *S.D. Myers, Inc. v. Canada*, Partial Award *supra* note 121 (concluding that Canada committed a regulatory taking in not allowing the claimant to enter the market of selling PCPs).

¹³⁸ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at Annex B.3.

¹³⁹ 458 U.S. 419, 441 (1982).

¹⁴⁰ See Barry Appleton, *Regulatory Takings: The International Law Perspective*, 11 N.Y.U. ENVTL. L.J. 35, 47 (2002) (“Physical takings will always require fair market compensation.”).

effect equivalent to direct expropriation without formal transfer of title or outright seizure.

(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:

(i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;

(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and

(iii) the character of the government action.

(b) Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.¹⁴¹

The three steps of Annex B.4(a) are taken directly from *Penn Central*.¹⁴² The provision tells us that when a physical taking has not occurred, we should use the *Penn Central* test; it then additionally warns us that as long as the action is nondiscriminatory, a regulatory taking will only be found in “rare circumstances.”¹⁴³

At first this language appears to rule out any successful regulatory takings claims that would not succeed under U.S. law. For one thing, Annex B does not mention the *Lucas* exception of *per se* regulatory takings where a regulation has permanently taken all economic value of property.¹⁴⁴ If an action might not constitute a regulatory taking even when 100% of the economic use has been expropriated then the law seems *prima facie* less protective than U.S. law. However, a closer reading of Annex B.4 illustrates that there might be more room for regulatory takings claims.

First, the proviso in Annex B.4(b), which states that successful

¹⁴¹ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at Annex B.4.

¹⁴² Compare U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, with *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 124 (1978).

¹⁴³ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at Annex B.4(b).

¹⁴⁴ *Lucas v. S.C. Coastal Comm’n*, 505 U.S. 1003, 1030–31 (1992) (stating that a permanent deprivation of all economic value is a *per se* taking unless the deprivation is made through background principles of common law).

regulatory takings claims will be “rare,” might actually help in making a regulatory takings claim. It does not say “extremely uncommon” or “very unlikely,” but simply “rare.”¹⁴⁵ These alternative descriptions arguably better define U.S. takings law, where a successful *Penn Central* claim is hard to come by. One study provides a hint at what that success rate might be.¹⁴⁶ Its authors took a random sampling of cases that applied *Penn Central* on the merits.¹⁴⁷ Of those cases only 13.4% concluded that the government had committed a regulatory taking.¹⁴⁸ As the authors noted, this does not mean that 13.4% of the time that an owner claims she is harmed by a land use regulation does a regulatory taking occur, as many property owners might not have the resources to bring a challenge, and many challenges may settle short of judgment.¹⁴⁹ It does, however, provide a window into how “rare” the finding of a regulatory taking can be. Whether 13.4% is less than “rare” and therefore less favorable to investors than the Model BIT’s standard, is in the eye of the interpreter. If an arbitral tribunal were to find that “rare” means something akin to 25% of all challenges, then the test of Annex B.4(b) could be more conducive to property owners than the law in the United States. Alternatively, if “rare” equals 2% then U.S. law is much stricter in comparison.

Second, although the test is drawn from *Penn Central*, it is not beholden to *Penn Central* itself. It is not a part of a larger case and its specific facts, but a provision of a treaty with no specific facts. Also, the interpretation of an international treaty is not beholden to the case law of one (and only one) of the treaty’s signatories. Things might be a bit different if the type of regulation at issue in *Penn Central* were referenced in the Model BIT’s text, but that is not the case either. *Penn Central* concerned a historic preservation law.¹⁵⁰ Annex B.4(b) only alludes to laws “designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment.”¹⁵¹ If the aim of a law were something other than “legitimate public welfare objectives, such as public health, safety, and the environment” would it not be “rare” to find a regulatory taking? Would historic preservation be such an objective? Would rent-seeking for a preferred industry?¹⁵² The Model BIT offers few

¹⁴⁵ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at Annex B.4(b).

¹⁴⁶ F. Patrick Hubbard, Shawn Deery, Sally Peace & John P. Fougere, *Do Owners Have a Fair Chance of Prevailing Under the Ad Hoc Regulatory Takings Test of Penn Central Transportation Company?*, 14 DUKE ENVTL. L. & POL’Y F. 121, 141 (2003) (reviewing 133 randomly selected cases citing *Penn Central*).

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* at 142–43 (contextualizing survey data).

¹⁵⁰ *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 116 (1978).

¹⁵¹ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at Annex B.4(b).

¹⁵² An example of “rent-seeking” might be a law requiring the use of chemical A, and not chemical B, in a certain industrial process, where it is undisputed that chemical A is not

clues for an answer.

Additionally, Annex B does not state what level of scrutiny to apply to a law in determining whether it has “legitimate public welfare objectives.”¹⁵³ This does not mean that tribunals have carte blanche review *a la* that imputed to the *Lochner* court in deciding what is in the interest of the public welfare.¹⁵⁴ That cannot seriously be imputed to its drafters. It does mean, however, that the extreme deference under U.S. law afforded legislatures in presuming that a law almost always *does* have a legitimate public welfare objective need not be present in an arbitral panel interpreting a BIT under Annex B.

The above analysis demonstrates a muddle. Keeping in mind the ambiguity of Annex B.4(b)’s “rare circumstances” provision, the provision’s uncertain connection to *Penn Central*, the uncertainty behind the meaning of “legitimate public welfare objectives,” the definition of “property,” and the directive to interpret all of these with “customary international law” in mind, the meaning of the Model BIT’s expropriation provision itself—Article 6.1—becomes quite complicated. This is in addition to deciphering the meaning of the original *Penn Central* test itself. Therefore, not only is the meaning of *Penn Central* itself exceedingly vague, but the meaning of Article 6.1—with all the cross-talk of “property,” “customary international law,” and “rare circumstances”—is even more vague. In comparison, judging whether a regulatory taking occurs under NAFTA seems relatively simple. The Model BIT’s expropriation provision fails to provide something basic to its existence: provide investors a standard to judge when they will, and will not, be protected from regulation of their investments.

IV. DOES THE INCLUSION OF THE *PENN CENTRAL* TEST IN A BIT HELP PROMOTE FDI?

A. The Empirical Debate Over BITs’ Promotion of FDI

The question this article is concerned with is not whether BITs are

better for the environment or human health than chemical B, but where chemical A is manufactured by a politically-connected corporation, whereas chemical B is not. If a foreign investor could show that the only reason for the regulation was favoritism toward the producer of chemical A, and thus was not a legitimate public welfare objective, would it be easier to establish a regulatory taking? The text of B.4(b) seems to point in that direction. *Id.* Of course, this might all be moot because such favoritism would likely not survive the protection of a national treatment clause. One could imagine, however, a scenario where the producers of both chemicals were foreign. Then, only a substantive protection—above and beyond a national treatment clause—would allow for a finding of a regulatory taking.

¹⁵³ *Id.*

¹⁵⁴ See *Lochner v. New York*, 198 U.S. 45 (1905); see generally David E. Bernstein, *Lochner’s Legacy’s Legacy*, 82 TEX. L. REV. 1 (2003) (examining the recent historical characterization of *Lochner*).

“good.” The question is rather, given that BITs are entered into to promote FDI, does the inclusion of the *Penn Central* test further that goal? As stated earlier, some legal treatments of BITs have sought to address why BITs are “good” without keeping in mind why we have BITs in the first place.¹⁵⁵ How BITs may hinder objectives such as domestic environmental legislation is an interesting issue, but a thorough treatment of the issue would weigh the impact on environmental legislation, health and safety laws, etc., against the possible benefits that BITs, in the form of additional FDI, bring to a host country.¹⁵⁶

The ideal way to consider whether the *Penn Central* test furthers FDI would be to compare the flow of FDI into countries that have signed a BIT with the United States that includes a version of the *Penn Central* test with the flow of FDI into similar countries in the same time period that also have a BIT with the United States which does not include the test. For good measure, a control group of countries that lack BITs with the United States altogether would also be used. Unsurprisingly, such figures do not exist, or are at least extremely hard to find. This is because the new Model BIT (the version that includes *Penn Central*) has only been around a few years and few countries have entered into BITs incorporating it. In addition, only U.S. FDI could be considered in examining the flow of FDI into those countries because the Model BIT would not govern FDI from other countries. Only considering FDI from U.S. investors, however, makes the data more susceptible to local variances than considering worldwide FDI.¹⁵⁷ Moreover, such a small sample size of “similar countries” during the same time period would be hard to find.

A great deal of data exists on BITs more generally and their relationship to FDI. Here the results are varied. Economists either conclude that BITs are marginally beneficial at best or that they provide for substantial returns on FDI. It is not the purpose of this article, nor the expertise of the author, to evaluate the merits of the statistical analysis in these empirical studies. Some findings in the literature, however, can assist the instant project.

For example, three major studies on the relationship between BITs and FDI alternatively claim that the results are inconclusive or that BITs are marginally beneficial for increased FDI.¹⁵⁸ One study concluded that there

¹⁵⁵ See *supra* notes 40–52 and accompanying text (discussing lack of perspective in remembering that BITs are entered into specifically to promote FDI).

¹⁵⁶ Some articles on the subject do address that question to a limited extent. See, e.g., Been & Beauvais, *supra* note 13, at 116–17 (arguing that developing countries can better increase FDI through other strategies).

¹⁵⁷ Such local variances might include a large immigrant population from the host country living in the United States, thus familiar with the host country’s economy and investing more FDI than would otherwise occur with an inadequate expropriation treaty. With worldwide FDI such variances would more likely even out.

¹⁵⁸ See Rose-Ackerman & Tobin, *supra* note 11 (results inconclusive); Neumayer &

is not enough data to come to a conclusion.¹⁵⁹ Another concluded that BITs might actually inhibit FDI to a small degree.¹⁶⁰ However, a third concluded that when a larger sample was examined, BIT signings correlated with increased FDI. Importantly, the study found that BITs that included explicit language submitting host countries to the jurisdiction of arbitral tribunals witnesses increased FDI.¹⁶¹ The conclusion was that the stronger the language committing a country to arbitration, the more likely that the BIT would increase FDI in the country.¹⁶²

Intuitively this finding makes sense. BITs seek to provide some measure of assurance to investors that there will be an additional recourse (additional to other existing ones, such as insurance) to turn to in the case of expropriation. As stated earlier, private enforcement through an arbitral tribunal is what removes the relief promised through a BIT from the always precarious political field, and—because the tribunal need not be located in the host country nor composed of its citizens—away from the whims of the host country’s legal system.¹⁶³ The more enforceable this important part of the BIT, the more likely it is that the BIT will convince investors that it will protect them, thus promoting FDI.

Similar reasoning should apply to other provisions of BITs. All other things being equal, the stricter the protections of a BIT on what the government can do to investors the more likely investors will invest. The weaker the protections, the less likely investors will invest. This much seems fairly non-controversial. More complicated is when the language in a BIT is not “strict” or “weak” but ambiguous. Ambiguity brings discretion—whether to grant deference to the host government, whether to use drafting history and statements made by the negotiators, what public policies to promote, how similar provisions have been interpreted, etc. A prospective investor must consider some or all of these in predicting whether a BIT provides enough protection that it makes a difference in whether to invest in a host country. On balance, the more that must go into the investor’s consideration, the more uncertain the answer. This might not mean that an investor thinks a BIT does not protect its investment. After all, an ambiguous expropriation provision is presumably better to the investor than none at all. However, it does mean that an investor will be

Spess, *supra* note 17 (results show increase in FDI, particularly with strong binding arbitration clauses); Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Investment? Only a Bit—and They Could Bite*, in *THE EFFECTS OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, & INVESTMENT FLOWS* 374–75 (Karl P. Sauvant and Lisa E. Sachs eds., 2009) (arguing that BITs might actually slightly inhibit FDI).

¹⁵⁹ See Rose-Ackerman & Tobin, *supra* note 11, at 31.

¹⁶⁰ Hallward-Driemeier, *supra* note 158, at 374–75.

¹⁶¹ Eric Neumayer & Laura Spess, *supra* note 17, at 226.

¹⁶² *Id.*

¹⁶³ See *supra* note 37.

less sure of what protection is there.

B. A Defense of Vagueness

As explained above, the *Penn Central* test as it exists in the Model BIT is a “model” of ambiguity. It is a test originally drafted by a U.S. court, taken partly from prior U.S. case law and partly from utilitarian theory, grafted into international treaties that make no mention of its genealogy, and intended to reflect “customary international law,” something itself so ambiguous that treaties must turn around and look to mechanisms such as *Penn Central* to give it effect. The entire circular enterprise merely adds more and more layers of vagueness to the provision’s meaning. When faced with the Model BIT, it is hard to imagine that an investor would think: “I know when this treaty will, and will not, protect me against a regulatory taking.”

Before proceeding to a possible remedy of the Model BIT’s regulatory takings language, it is necessary to address those who defend it precisely because it is vague. The most thorough defense of the *Penn Central* test’s inclusion in BITs comes from Professor Marc R. Poirier. In two articles, first on vagueness in regulatory takings in Fifth Amendment jurisprudence¹⁶⁴ and later applying that analysis to regulatory takings in the international arena,¹⁶⁵ Poirier argues (1) property is an evolving construct, and so creating a “one size fits all” approach to regulatory takings doctrine is inappropriate;¹⁶⁶ and (2) when takings law is applied across national boundaries through BITs, the differences in conceptions of property become even more profound and we should be even more weary of bright-line tests in evaluating regulatory takings.¹⁶⁷

Poirier’s conception of property as an evolving concept is well recognized and hard to find fault with. Technological change, for example, gives us new forms of property that are difficult to pigeonhole into the old forms.¹⁶⁸ For example, how does a flight-path over another’s field fit within the former property regime that recognized one’s property as extending up to the sky? Who “owns” a virtual character in an online gaming program: the software developer or the game player? As long as there have been changes in society, technological or cultural, there have

¹⁶⁴ Poirier, *supra* note 88.

¹⁶⁵ Poirier, *supra* note 20.

¹⁶⁶ Poirier, *supra* note 88, at 101 (“The article explores the sources of vagueness in takings doctrine, and argues that they can be understood in part as a consequence of the socially constructed nature of property.”).

¹⁶⁷ Poirier, *supra* note 20, at 860 (“When we understand regulatory takings doctrine as part of a process of transition management for property rules, we can see why it ought to remain substantively vaguer and procedurally slower and more transparent than foreign investors or other property owners would like.”).

¹⁶⁸ See Poirier, *supra* note 88, at 176–78 (discussing the new forms of property that sprung out of new social practices).

been needs for property rights to adapt. Poirier thinks that when takings law is applied to property, it is best to leave the definition of a “taking” vague because it allows for the parties involved—the landowner, the authorities, the environmentalists, etc.—to have a conversation on what is the right course of action.¹⁶⁹ A clear takings line in the sand does not allow for this conversation to develop. Further, without vague takings law the conception of property may remain stagnant because such a conversation needs to go forward in order for property to evolve.¹⁷⁰ Further, Poirier assumes that these changes and conversations arise out of the democratic process.¹⁷¹

Poirier’s assumption that the democratic process shapes property largely ignores the common law process as a method for adapting property, but for good reason.¹⁷² In the common law process, courts adjudicate claims involving novel conceptions of property and, over the course of time, arrive at new rules for how to fit the new modes or uses of property alongside the old ones.¹⁷³ Poirier does discuss this process, and the process of social change outside the law, but does not make it central to how the understanding of property changes.¹⁷⁴

Poirier largely leaves the common law process out as a method for evaluating new conceptions of property because he is not really talking about what common law judges adjudicate: private law. Takings doctrine, of course, is a concern of *public* law, of how the state is administered, both internally—how the government governs itself—and externally—how the government relates to private parties. Generally, when concerned with what constitutes a taking, courts examine the relevant private law (in the United States, usually state law) to determine what *is* property, but then examine the Fifth Amendment—a form of public law—to determine if the government, in its relation to the private party, took that property.¹⁷⁵ In

¹⁶⁹ *Id.* at 132–33 (describing the need to repeatedly “renegotiate” property regimes).

¹⁷⁰ *Id.* at 178.

¹⁷¹ See Poirier, *supra* note 88, at 180 (discussing wide agreement among scholars that the democratic process lends legitimacy to changes in property rights).

¹⁷² Poirier does briefly discuss “Burkean” considerations, but does not elaborate on these. By this it seems he means a degree of reverence for existing institutions, a central tenet of the English political thinker Edmund Burke. Poirier argues that his approach holds some appeal to those of this ilk as “[e]ven a certain kind of Burkean conservatism expresses faith in social democratic process.” *Id.* at 181.

¹⁷³ See Todd J. Zywicki & Anthony B. Sanders, *Posner, Hayek & the Economic Analysis of Law*, 93 IOWA L. REV. 559, 599–600 (2008) (describing the spontaneous order process of law arising out of social interaction).

¹⁷⁴ Poirier does rightly point out that many property theorists do not do this at all. See Poirier, *supra* note 88, at 165 (“An entire generation of policy prescribers—typically, although not always, grounded in law and economics—seems to have simply forgotten about informal practice, either as an alternative to formal regulation, or as the substrate within which baseline norms take root and achieve legitimacy.”).

¹⁷⁵ See, e.g., *Pruneyard Shopping Ctr. v. Robins*, 447 U.S. 74, 84 (1980) (stating that the

recommending vagueness in takings law, Poirier calls for vagueness in the second determination, not the first.¹⁷⁶ Poirier primarily discusses how the state will regulate “property” and how in promulgating regulations, especially environmental regulations, the new rules should emerge from a conversation between interested parties that are not restricted by a clear regulatory takings standard.¹⁷⁷ Poirier does discuss how the definition of property changes, but as it relates to the state, largely leaving out mere relations between individuals.¹⁷⁸ Whether or not something is “property” is not his concern. His concern is whether the state has to provide compensation when it regulates that “property.”¹⁷⁹

C. Spontaneous Order and the Private Law/Public Law Distinction

1. *Rules of Just Conduct vs. Rules of Organization of Government*

Contrary to Poirier, it may be that the first question—what is property—demands a vague (or at least vaguer) answer, and that the second question—was the property taken—demands a clear (or at least clearer) answer. For an exploration of this distinction a useful source is F.A. Hayek’s trilogy *Law, Legislation and Liberty*.¹⁸⁰ Hayek, trained both in law and economics, came later in life to see private law as, ideally, a body of rules that come into being spontaneously.¹⁸¹ That is, they arise not because judges or legislators create them with a purpose in mind, but because the rules have already come to be accepted and relied on in society.¹⁸² Although not intentionally created, they are tools that people use to peaceably interact with each other.¹⁸³ Hayek termed this a “spontaneous

United States, unlike the States themselves, does not possess the residual authority to define property). *But see* Roderick E. Walston, *The Constitution & Property: Due Process, Regulatory Takings, & Judicial Takings*, 2001 UTAH L. REV. 379, 404–05 (arguing that in light of *Lucas v. S. C. Coastal Council*, 505 U.S. 1003 (1992), the Court has implied that state common law defines property, but that state legislative enactments are not as relevant).

¹⁷⁶ See, e.g., Poirier, *supra* note 88, at 178 (discussing the change in property rights resulting from the ability of airplanes to fly over one’s land as utilizing takings and nuisance law).

¹⁷⁷ *Id.* at 103 (“[T]hese assorted benefits from vagueness in regulatory takings doctrine are likely to accrue only if the citizens affected by regulatory takings have faith in societal dialogue and come to view themselves as participants.”).

¹⁷⁸ See *supra* notes 175–76.

¹⁷⁹ See Poirier, *supra* note 88, at 185 (analyzing evolutionary change in property rights in the context of how takings and due process protect those unfairly affected by the change, not regarding how the “property” changes without relation to the government).

¹⁸⁰ This discussion will primarily draw upon the first work of the trilogy, F.A. HAYEK, 1 LAW, LEGISLATION & LIBERTY: RULES & ORDER (1973).

¹⁸¹ See Zywicki & Sanders, *supra* note 172, at 599–600 (describing the spontaneous process through which Hayek argued law arises).

¹⁸² *Id.*

¹⁸³ *Id.*

order.”¹⁸⁴ In Adam Ferguson’s famous formulation, these rules “are the result of human action, but not the execution of any human design.”¹⁸⁵ For Hayek, the English common law is an example of such a spontaneous order: it arose through a multitude of individual decisions by individual courts that merely enforced the law accepted by their surrounding communities.¹⁸⁶ The law provided for greater certainty concerning where the lines fell between people’s property, and in providing this greater certainty people could use those lines to interact with each other to trade and plan for the future.¹⁸⁷ However, they evolved over time when new circumstances arose, reflecting how the larger society adapted and incorporated these new circumstances, such as recognizing new forms of property.¹⁸⁸ Hayek termed these legal tools that individuals used in relating with each other “rules of just conduct.”¹⁸⁹

Very different from these “rules of just conduct” are what Hayek termed “rules of organization of government.”¹⁹⁰ Hayek was by no means an anarchist and recognized that there were legitimate functions for the government to perform. In performing these functions the government needs rules. Some of these rules are as simple as the line-items in the budget,¹⁹¹ while others are broader, defining how the government relates to its citizens. Hayek expressed dismay at how in the modern world, and especially in socialist countries, public law was replacing private law, making much of human behavior a matter of an individual’s relationship with the state and not with other individuals.¹⁹²

A review of Hayek’s ideas on public law demonstrate that he held the rules for the administration of government should be clear in their application. This is because public law “is not law in the sense of rules defining what kind of conduct is generally right, but consists of directions concerning what particular officers or agencies of government are required to do.”¹⁹³ Conversely, this would also include rules on what officers or

¹⁸⁴ HAYEK, *supra* note 179, at 38 (outlining the characteristics of a spontaneous order).

¹⁸⁵ ADAM FERGUSON, AN ESSAY ON THE HISTORY OF CIVIL SCIENCE, §.2 at 122 (Duncan Forbes, ed. 1966) (originally published 1767).

¹⁸⁶ See HAYEK, *supra* note 179, at 84–85 (describing how English common law retained the ancient understanding of law as the law of the custom of the community).

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 65–66 (describing how law evolves, and lawyers’ role in the evolution).

¹⁸⁹ *Id.* at 131–32; see also Zywicki & Sanders, *supra* note 172, at 600 (discussing how law changes in society, but more slowly than other institutions in society, such as the economy, technology, and social mores).

¹⁹⁰ *Id.* (contrasting the two forms of rules).

¹⁹¹ In fact, Hayek remarked “most of a budget, so far as it concerns expenditure, will not contain any rules at all.” HAYEK, *supra* note 179, at 136.

¹⁹² Hayek placed criminal law under the rubric of private law as it generally conforms to the background “rules of just conduct” held by society, and did not belong under the rules of organization of government. See *id.* at 132.

¹⁹³ *Id.* at 133.

agencies of government are required not to do, such as not to diminish property value by regulation. For private actors to have some measure of certainty about when the government will inhibit them from acting (or force them *to* act) they need relatively clear rules on what the government can do and what it cannot.

The need for certainty in an individual's relationship with the government may well be greater than in his relationship with private actors. This is because an individual is generally in less of a position, to put it mildly, to negotiate terms with the government than with another party.¹⁹⁴ When parties are relatively equal in size and resources this is assuredly true, and when one is more powerful than another, such as with an individual and a large corporation, then at least both are generally subject to market forces.¹⁹⁵ Governments, on the other hand, are predominately not subject to market forces, and generally have little input from their citizens, as opposed to a small cadre of lobbyists, as to the specifics of a proposed law.¹⁹⁶ These considerations bring us to the conclusion that there is a greater need for clarity in public law, including regulatory takings standards, than in private law. The clearer the "rules for the organization of government," the better private actors may plan their behavior without having to guess how the government will treat them. Again, although clarity is to be valued in the private law, its application may be negotiated by the affected parties. An example from public law is the expectation of how the Fifth Amendment inhibits the issuance of a new environmental regulation. In this regard, the *Lucas* standard—whatever faults it may have—gives clearer guidance than *Penn Central*. The first clearly commands the government to pay compensation when it deprives a property owner of all of a property's economic value; the second gives some hazy guidance on when a taking might otherwise occur.

2. *The Rule of Law*

Scholars of this area may at this point ask why we are not discussing a fundamental concept: the Rule of Law. The classical understanding of this concept, for Hayek as much as for anyone, is that the rule of law requires

¹⁹⁴ Think of the vast difference in negotiations between a person negotiating with another private party as to the specifics of a contract, and a person lobbying the legislature or an agency as to the specifics of a bill or regulation. Further, bilateral monopoly may often apply in the case of the former instance, but nothing approaching that level of equality applies in the latter.

¹⁹⁵ The author wishes to clarify that he is not aware whether Hayek specifically discussed how individuals can negotiate with each other within vaguer rules than they can with the government. However, this conclusion is compelled by Hayek's other words on the public-private law distinction. See HAYEK, *supra* note 179, at 132.

¹⁹⁶ See generally JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT* 283 (1962) (discussing the public choice approach to governmental action and the incentives of governmental actors when faced with special interest pressure groups).

predictable legal rules that parties can look to in planning their activities.¹⁹⁷ The reason why this discussion avoids the “Rule of Law,” and the extensive literature on the subject in the regulatory takings field, is because this analysis seeks to demonstrate that *even if* the value of the rule of law is not jealously guarded otherwise, it must be in the context of BITs and regulatory takings. Conflicts over regulatory takings seem to always result in a face-off between the supposed sanctity of the rule of law and the supposed need for regulation. Indeed, Poirier sets up his defense of vagueness as an alternative to “those subscribing to a classical liberal theory of property” who believe that “the system works only when individual property owners know *ex ante* just what they own and what the rules are for use and exclusion.”¹⁹⁸ The present analysis need not jump into this interminable debate. This is because even if one thinks the Fifth Amendment should be interpreted to allow a great degree of regulation, and that the “Rule of Law” is overrated, one should still value a clear takings rule as opposed to a vague takings rule when the need for incentives—such as those for FDI—are taken into account. This is especially the case with BITs where the very reason for a treaty’s existence is to produce incentives. Even if the rule of law is not to be valued, it should be apparent that one of its components—certainty in the future application of legal rules—will provide greater incentives to parties to act.

3. *The Distinction Between What Is Property and What Is a Taking*

Returning to Hayek’s private law/public law distinction, someone in Poirier’s camp may see this Hayekian critique as beside the point. At root Poirier calls for a vague regulatory takings doctrine because it allows for the government to negotiate with interested parties on what property rights the owners should have.¹⁹⁹ After that the Fifth Amendment should check the government only if there is a great injustice, such as a large amount of investment in property accompanied by very justifiably settled expectations. Indeed, Poirier does not call for the abolition of a regulatory takings doctrine as do some other property theorists.²⁰⁰ Poirier may recognize the desire for certainty in dealing with the government, and in the distinction between private and public law. However, he argues that there is a countervailing interest in the government examining new conditions and not being constrained in the exercise of its police power in meeting the supposed challenges the new conditions pose.²⁰¹ He generally provides

¹⁹⁷ See F.A. HAYEK, THE CONSTITUTION OF LIBERTY 156–57 (1960) (arguing that the predictability of legal rules is a central tenet of the Rule of Law).

¹⁹⁸ Poirier, *supra* note 88, at 97–98.

¹⁹⁹ *Id.* at 190–91.

²⁰⁰ See *id.* at 178 (“Takings Doctrine serves as one of a number of safety valves that facilitate negotiation and compromise.”).

²⁰¹ *Id.*

environmental examples, such as new scientific understandings of the benefits of wetlands, and the hazards attendant to building on eroding coastal islands.²⁰² At the same time there is still the need for a regulatory takings doctrine, but if we are to have one it should be vague. Poirier hears concerns such as Hayek's regarding certainty, but believes that they are outweighed by the need to enable regulation.²⁰³

Poirier's concerns lose power when one parses out that it is public law he is talking about, not private law. If private law, through a spontaneous process, regulates the relations between private parties when new conceptions of property arise, then there is much less of a need for government having freedom to examine those new conceptions when it regulates the private parties. If government regulators do not define what property is then they do not need room to define it. They merely need room to regulate that "property." The "conversation" that Poirier advocates can go on between the private parties, either through the market or in the courts. Governmental regulation of private parties, such as banning construction on privately owned wetlands or imposing building moratoriums on eroding coastal islands, must still be examined in the public law context. However, this examination is *after* (conceptually, not necessarily chronologically) the private law has determined what the "property" is. This regulatory examination should then involve clear (which is not the same as stringent) standards of what the government can do to the now-defined property. To argue that this examination should be vague is really just to argue that the government should have more power to regulate private property. The underlying point is that there is no need for vagueness, *a la Penn Central*, to give the government that power.

If protection of the environment is really Poirier's goal, why not a permissive, yet clear takings rule? If Poirier wants to retain a residual protection against governmental overreaching, a rational-basis standard such as that used in the equal protection context can accomplish that end.²⁰⁴ Poirier's argument anticipates that rules of property will be made by political actors through deliberative democracy.²⁰⁵ Hayek's conception of private law removes this concern. Private parties have a "conversation" regarding the scope of property in their multitude of interactions in civil society. The concern that remains—clarity in the law—can then be served

²⁰² See *id.* at 170 (providing examples of when the understanding of property should change).

²⁰³ Another reason Poirier gives for vagueness is that concepts such as "property" and "regulatory takings" are "essentially contested concepts" that we should allow our democratic society to discuss. *Id.* at 134–37. He does not address why this cannot occur through the common law process, and not through legislatures and agencies.

²⁰⁴ See, e.g., *Romer v. Evans*, 517 U.S. 620, 635 (1996) (applying deferential rational basis test, but nevertheless concluding that law banning local governments from extending protection to homosexuals unconstitutional).

²⁰⁵ See Poirier, *supra* notes 173–75 and accompanying text.

with a clear rule in regulatory takings—at least clearer than the *Penn Central* test. Civil society (that is, society outside of the regulators) defines property; the government then regulates that property under whatever clear(er) takings standards the government chooses to set.

Now, many readers will consider the above perhaps pertinent to the English common law of the Eighteenth Century, but naïve in today's statutory era, and indeed beside the point to civil law countries whose property rules are embodied in legislation. To some degree this is a valid criticism, and, indeed, Hayek recognized the blurring of the lines between public and private law, especially in Continental European jurisprudence.²⁰⁶ However, the distinction is still germane for two reasons. First, even when property rules are legislatively determined, when private parties are negotiating who owns what—even if a statute, instead of the common law, determines the “shape” of the property—negotiation, in individual cases and market-wide, may still facilitate compromise on the scope of property rights. Second, although civil law systems rely on legislation to define property rights, that legislation often merely codifies existing law. Bruno Leoni, a thinker very close to Hayek in his view of the common law process, defended the traditional Justinian Code by pointing out that the Code sought to express in legislation what was already followed in society.²⁰⁷ A similar case can be made for much (although not all) of the Uniform Commercial Code and other “codifications.”²⁰⁸

D. Why BITs Are Not, and Should Not Be, the Fifth Amendment

Poirier applies his vagueness ideas to BITs in a follow-up piece, *The NAFTA Chapter 11 Expropriation Debate Through the Eyes of a Property Theorist*.²⁰⁹ There he makes a similar argument, but with a new twist. Along with the arguments for a vague takings doctrine outlined above, he further points out that different countries have, of course, different conceptions of property and different traditions (different forms of “nomos”

²⁰⁶ HAYEK, *supra* note 179, at 133–34 (lamenting the loss of the distinction).

²⁰⁷ See BRUNO LEONI, *FREEDOM & THE LAW* 139 (1961) (explaining the codification process of the Justinian *Corpus Juris*). Leoni states “[A] strict connection between the ideal of the *Corpus Juris* as a written law and the common or unwritten law actually embodied in it was strikingly evidenced by the content of the *Corpus*. Indeed, the central and more lasting part of it, the so-called *Pandectae* or *Digesta*, consisted entirely of statements of the old Roman jurists relating to the unwritten law.” *Id.*

²⁰⁸ See, e.g., Homer Kripke, *Law & Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact*, 133 U. PA. L. REV. 929, 972 n.154 (1985) (“The UCC, however, merely codified and simplified prior commercial practice—it does not alter the nature of credit transactions.”). But see Gunther A. Weiss, *The Enchantment of Codification in the Common-Law World*, 25 YALE J. INT’L L. 435, 466–67 (2000) (arguing that codification always changes the substance of law to at least some degree, even when legislatures merely seek legislation to reflect existing law).

²⁰⁹ Poirier, *supra* note 20.

as he terms it) in how the countries' governments can regulate property.²¹⁰ Further, different countries, and, even more so, different localities have different environmental and other regulatory needs.²¹¹ For example, a wetlands regulation might be greatly needed in one region due to the past decimation of wetlands, but not in another region which is undeveloped and where economic growth is of greater need. In the face of this diversity of local laws and conditions stand BITs which generally have the same application to all signatory countries. Not only do they have unvarying application, but they are interpreted by arbitrators who are often not from the host country, and therefore not necessarily familiar with the country and locality's laws, customs, and conditions.²¹² This estrangement between the governing law—the BIT—and the arbitrators on the one side, and the local laws and conditions on the other, calls for vagueness in the BIT, argues Poirier, so that the local needs and understandings can be properly considered by the arbitrators in assessing whether the regulation in question constitutes expropriation.²¹³

The following discusses two reactions to Poirier's application of vagueness to BITs. First, different countries assuredly do sometimes have quite different understandings of property. Hayek recognized that a rule of law in one community might not work in another because the rule will have to relate to other different rules not present in the first community.²¹⁴ For example, the rule of adverse possession may be set into the fabric of Anglo-Saxon law, and therefore be workable in that system, but foreign to another legal system where it would not function properly if integrated into that system's property rules.²¹⁵ However, Poirier makes the issue more complicated than necessary in his more basic point that BITs should include vague standards that allow flexibility to properly take into consideration

²¹⁰ *Id.* at 875 (“A *nomos* represents both a community of like-minded individuals sharing a way of life, and the world view that facilitates and expresses that way of life.”).

²¹¹ *Id.* at 875–76 (discussing how local property norms arise out of the customs of the relevant community).

²¹² *Id.* at 876–78 (discussing the culture of foreign investors and international arbitrators).

²¹³ *Id.* at 907 (arguing that tribunals should “determine the difficult conflicts case by case, on an all-things-considered basis”). For reasons discussed below, contrary to Poirier, vagueness is not more relevant to BITs than to the Fifth Amendment. In fact the opposite is true. However, Poirier does have a point regarding the use of foreign arbitrators. These arbitrators, as they commonly are used in BIT regimes, are often not native to the country involved and therefore often do not have full understandings of the host country's property rights system. The reason for using “international” arbitrators, and arbitrators at all instead of a signatory country's domestic court system, is to protect the foreign investor from a “home field advantage.” It is not in the scope of this article to assess the merits of either side of this argument, but the author notes that both have currency.

²¹⁴ See Zywicki & Sanders, *supra* note 172, at 576 (contrasting the concept of fiduciary duty in the United States and Russia).

²¹⁵ See *id.* (discussing why the concept of fiduciary duty might work in societies placing a high value on trust, but not in others).

local laws and conditions.²¹⁶ The country's civil society and legal system determines what property "is," and then the BIT protects the foreign investor's investment (the "property"). This is complicated because BITs define what an investment is in some detail, such as with the Model BIT described above,²¹⁷ but the contours of property are still largely up to the host country. For instance, the Model BIT defines "property" to include "an enterprise." "Enterprise" is not defined, however, and so the arbitrators may consult the host country's legal system to determine its meaning.²¹⁸

Second, for regulations that may effectively expropriate a foreign investor's property, but that the host country contends are too important to require paying the investor compensation, there is a very important objection not present in the Fifth Amendment context. Poirier argues that BITs may be, in the abstract, a good idea because foreign investors are in need of some protection, just as domestic property owners are.²¹⁹ However, he also argues that a vague test is appropriate to allow flexibility in the host country's regulatory regime.²²⁰ In fact, he assesses the incorporation of the *Penn Central* test in the new Model BIT and concludes that the rule it produces "sounds about right."²²¹ What this misses is something quite basic, but something that must continually be repeated: BITs are entered into to promote investment.

The Fifth Amendment arguably *is* about fairness, which is why Poirier thinks some regulatory taking doctrine is worth having.²²² BITs have little to do with fairness. As discussed earlier, they are not environmental treaties or any other type of treaties. If BITs, *qua* BITs, do not promote foreign direct investment, then they are not worth entering into even if they are "fair." Having a vague expropriation test may in some theoretical way balance the regulatory needs of the government with those of foreign investment and thus make "a normative statement,"²²³ but it does not perform the practical task of satisfying the needs of foreign investors. If a foreign investor confronts a vague takings test—such as the Model BIT version of *Penn Central*—it will not greatly assist her in assessing the risk of investing in the host country. There will still be great uncertainty as to whether the investor will be protected from regulations that may diminish

²¹⁶ See Poirier, *supra* note 20, at 907.

²¹⁷ See *supra*, Part III.C.2.

²¹⁸ This could, admittedly, be a problem if the arbitrators solely focus on international economic understanding of the terms, or the understanding of a foreign legal jurisdiction.

²¹⁹ Poirier, *supra* note 20, at 907 ("[M]aking a normative statement through legal standards against the most invasive forms of government interference with private property is important not only to international norms but to domestic property norms as well.")

²²⁰ *Id.*

²²¹ *Id.* at 907–08 (approving the use of the *Penn Central* test in BITs).

²²² Poirier, *supra* note 88, at 191.

²²³ Poirier, *supra* note 20, at 907.

the value of her investment.²²⁴

In fact, it might even be better for an investor to invest in a country where the takings protection is low, but clear, than one where the takings protection is largely unquantifiable. A way to illustrate this is to leave investment for a moment and look at two examples involving taxation. In the first example, Company A settles in a jurisdiction that taxes profits at a 30% rate. With this knowledge in mind, Company A can plan its business for the next year expecting that if it is able to make a profit it will have to relinquish 30% of it. It may consider this too high and therefore structure its operations so as to not earn much of a profit. It may instead consider 30% a relatively good deal, and turn a tidy, but taxed, profit. With either choice it knows the rules it is working under. In the second example, Company B settles in a jurisdiction that taxes “whatever is fair and equitable” from corporate profits. This varies from year to year, so Company B may sometimes only lose 10% or 20% in taxes, but in other years may be socked with 40% or higher. Even if the average over time is low, Company B cannot know *ex ante* the rate in any one year, and therefore cannot effectively plan for its future. Its directors can only consider whether to invest or take a larger profit based on probabilities about the law, not on what the government has told it will be the law. This is on top of the initial uncertainty of whether the company can even make a profit in the jurisdiction in the first place.

The conundrum of Company B is the antithesis of certainty in the law, and, indeed, of the rule of law: Company B cannot plan its future because it does not know the rules. Company A, however, even though it may not like the rules all that much, can assess what is expected of it and then move forward knowing what the rules are.

With a version of the *Penn Central* test protecting a foreign investor, the investor is in much the same position as Company B. The investor does not know what protections it may have if the host government regulates its investment so as to diminish its value, and therefore is uncertain about whether or not to invest. It might be that it would win a regulatory takings claim, but it very well might lose in arbitration and thus lose much of its investment. A flat “no claims for regulatory takings” rule might even look attractive in this environment, because then an investor will know there is a high risk in investing in areas subject to regulation. Relevant examples in such a regime might be potentially environmentally harmful activities, such as the toxic waste storage at issue in the *Metalclad* award.²²⁵ A host

²²⁴ There are two levels of uncertainty here, of course. The first is whether the host country will issue regulations that diminish the value of the investment. The second is if such regulations are issued, whether the BIT will make the investor whole.

²²⁵ *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36, 54 (NAFTA ch. 11 Arb. Trib. Aug. 30, 2000) (awarding damages for not permitting the investor to use its investment for waste storage).

country could lose out in FDI if foreign investors chose not to invest in such industries because of a “no claims will be paid” rule, but investors might instead merely divert their FDI to ventures less subject to the swings of regulation.²²⁶

A response to the above justification of clear regulatory takings rules in BITs is that perhaps BITs *are* only concerned with increasing FDI, but they *should* also be concerned with environmental protection, public health, and the like. Therefore, a better BIT would recognize these goals and give a host government deference in enacting regulations. Such a course is already present in the Model BIT where it only allows for compensation in the context of such regulations in “rare circumstances.”²²⁷ Although well meaning, this objection brings us right back to the vagueness principle. If the intention of the treaty’s drafters is to promote FDI then giving such deference to the host government effectively neuters this purpose. Now, it may be that regulatory takings protections in BITs have no impact on whether foreign investors decide to invest or not.²²⁸ It may be that those protections do indeed induce more FDI. In either case, however, crafting regulatory takings protections in vague terms serves no purpose. If the regulatory takings protections have no purpose then why have them in the first place? If they do have an impact then they should actually induce investors to invest, not keep them guessing as to how strong those protections are.

This does *not* mean that BITs cannot balance regulatory takings protections with regulatory goals such as environmental protection. It merely means that this should not be done with a vacuous test such as *Penn Central*. Another means of balancing the two objectives would be to provide a clear (or at least “reasonably” clear) line at which a police power action becomes a regulatory taking. One example raised here for the sake of discussion, but not necessarily endorsed, is to state in a BIT that a compensable regulatory taking occurs when a governmental action reduces the value of an investment by 90%.²²⁹ In this scenario, if a regulation, such as a ban on the use of an industrial chemical, reduces the value of a plot of land by 50%, no compensation is required. If that plot of land were so tied to that chemical, however, so that any other use of the land would be worth only ten cents or less on the dollar as compared to a greater amount with

²²⁶ This assumes that BITs would still protect foreign investors through clear national treatment clauses, and expropriation clauses protecting them from physical takings. The uncertainty alleviated through the enforcement of these protections sets a baseline of protection that a hazy regulatory takings test might not add very much to.

²²⁷ U.S. MODEL BILATERAL INVESTMENT TREATY, *supra* note 103, at Annex B.4(b).

²²⁸ See *supra*, Part IV.A.

²²⁹ Such a percentage cap has been a common proposal in state legislatures. See Carl. P. Marcellino, Note, *The Evolution of State Takings Legislation & The Proposals Considered During the 1997-98 Legislative Session*, 2 NYU J. LEGIS. & PUB. POL’Y 143, 154-56 (1998) (reviewing proposed legislation ranging from 20% to 50% takings caps).

that chemical in use, then a regulatory taking would have occurred and the host government would be responsible for the value of the loss. This would be a spin on the *Lucas* rule, but with a hard-and-fast number.

It may be argued that such a rule would create odd regulatory planning where a government could—with impunity from a BIT's expropriation clause—carefully regulate right up to the edge of a taking. For example, a local government could regulate away 89% of a foreign investor's value in a business, making sure it left the investor just enough that it could not sue under the BIT. A protection against this, however, would be the relevant BIT's national treatment clause. If the local government really were regulating right up to 89% of the foreign investor's interest, then unless there are a number of domestic investors with the same loss the foreign investor could that argue its status as a foreign investor is driving the regulation. Further, given that in most instances there would, relatively, not be that many foreign investments covered by a particular BIT in one local jurisdiction, and they may not even be widely known as "foreign" investments, the practice of regulating right up to the "89% line" would not be often utilized.

Opponents of regulatory takings protections might also argue that even a 90% rule (or 50%, or whatever the number may be) does not allow for important environmental, or other, regulations that are unforeseeable at the time the BIT is enacted. The government, goes this objection, should have the flexibility to implement such a regulation if it proves necessary for the furtherance of important goals. However, a 90% rule *does* allow for governments to implement regulations that reduce an investment's value by 90%. It merely requires the government to pay for the investor's loss. The setting of the line at 90% is the act of balancing the police power with the promotion of FDI. If a host government is to have unfettered ability to regulate without worry, as long as it adheres to principles of national treatment, then there is less incentive for a foreign investor to invest in the host country. If BITs do actually promote FDI, and if FDI is to be valued, then the host government must relinquish some of its power to regulate without providing compensation. To argue, as some scholars do,²³⁰ that a compensation requirement is harsh because many affected entities, such as local governments in developing countries, do not have the funds to pay for such regulatory takings claims, is to argue (again, assuming that BIT regulatory takings provisions actually promote FDI) that those countries must choose between those regulations and more FDI. This indeed might be the case. Perhaps the country should make the choice not to adopt the BIT. However, to argue that we can split the baby by means of a vague standard such as the *Penn Central* test ignores the incentives that an effective BIT should send to prospective foreign investors.

²³⁰ See, e.g., Been & Beauvais, *supra* note 13, at 38.

CONCLUSION

It may be that BIT regulatory takings protections in actual fact do not increase FDI. This is a very real possibility, and the empirical evidence is mixed on BITs' effectiveness. However, once a country chooses to use a BIT to increase FDI certain forms of BITs will work better than others. The above discussion has demonstrated that a clear rule on regulatory takings gives potential foreign investors a benchmark by which they can assess whether to invest. A hazy rule, such as that in *Penn Central*, as embodied in the new Model BIT, adds uncertainty to an already uncertain investment decision and is much less likely to increase FDI. Arguments centered on the Fifth Amendment and the need for property to evolve do not take into account that BITs are nothing more than methods of promoting FDI. As attractive as these arguments may be in the context of regulatory takings generally, they do not assist in creating BITs that provide incentives to invest.

Countries engaged in BIT negotiations should examine the use of the *Penn Central* test and ask: If increasing FDI is the goal, does *Penn Central* give foreign investors an incentive to invest in a host country, or does it equivocate between investment protection and the police power to such an extent that no one can be sure what it means and whether it protects them? If the latter is the correct answer, then a new standard must be developed. This new standard need not necessarily sacrifice a host country's ability to regulate. It must balance the scope of non-compensable regulation with providing incentives for FDI prior to drafting the standard itself. It should not make this balancing the standard itself. That simply punts the balancing decision to arbitrators who then must interpret an open-ended and unpredictable test such as *Penn Central*.

