

**Center for International Environmental Law * Defenders of Wildlife
Earthjustice * Friends of the Earth * Sierra Club**

October 17, 2002

Dear Member of the Congressional Oversight Group on Trade Policy:

We are writing to you in your role as a member of the Congressional Oversight Group (COG) on trade policy to share our views about the proposals for investment provisions in trade agreements that were recently presented orally by the Office of the U.S. Trade Representative (USTR).

Unfortunately, it is difficult, if not impossible, to address these proposals fully in the absence of the actual text; moreover, published reports have indicated that significant, but unspecified, changes were made in the proposal following the oral briefing. We believe, however, that the proposals, as described to us, do not accomplish the congressional mandate that trade agreements not grant foreign investors greater substantive rights than U.S. investors are afforded under U.S. law. While we recognize some potentially helpful elements in the proposals, they fail to adequately reflect U.S. law, or even international law, in many respects – including the particular Supreme Court decision, *Penn Central*, on which USTR intended to base much of the standard for expropriation.

Given these concerns, it is essential to emphasize that we believe that USTR cannot ultimately comport with the “no greater rights” congressional mandate if foreign investors are able to bring claims that would be decided by ad hoc panels that are not trained in or bound by U.S. Supreme Court precedent and that would not be subject to review by U.S. courts to ensure that they do not in fact deviate from U.S. law and grant greater rights to foreign investors. The prospects of such panels engaging in subjective balancing tests, and on the basis of those, imposing financial liability on the U.S. for regulatory actions is extremely troubling. The proposals are also seriously flawed, however, in failing to do what they purport to do – that is, reflect U.S. law.

A number of our particular concerns regarding the standards for expropriation and minimum treatment are addressed below, though we must stress that these comments do not reflect the entirety of our concerns with USTR’s proposals on investment. Based on these concerns, we respectfully request that you and the other members of the Congressional Oversight Group urge USTR to address these concerns as an essential step to ensuring that foreign investors do not in fact receive greater rights than those available to U.S. citizens under U.S. law.

Concerning expropriation, it is of serious concern to us that, in attempting to define a standard, USTR has chosen a limited, and imbalanced, set of the critical factors used by the Supreme Court in determining takings cases. The USTR proposals fail to include critical standards established in U.S. jurisprudence that preclude findings of compensable

expropriations, and leave unclear in a problematic manner some of those that it has chosen to reference. In setting out some of the indispensable factors that must bind decisions on whether an “indirect expropriation” has occurred, we believe each of the problems we identify must be addressed to ensure that the current investment proposal does not breach the ceiling of U.S. law.

- The proposals presented by USTR do not include the critical Supreme Court principle that a governmental action must permanently interfere with a property in its entirety in order to meet a threshold requirement to constitute a taking. For example, the *Penn Central* opinion clearly states that takings analysis must be based on the effect of the government action on the parcel as a whole, not its segments. *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 130-31 (1978). This standard prevents segmenting a property, whether measured in terms of area or time, as clearly articulated in the Supreme Court’s *Tahoe-Sierra* case, which rejected a taking claim arising out of a temporary moratorium on development. *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 122 S. Ct. 1465 (2002)
- The USTR’s proposal simply to list some of the factors the Supreme Court discussed in *Penn Central*, but without the essential explanations and limitations that were set forth in that case and in subsequent rulings, provides no assurance that foreign investors will not in fact be granted greater rights than U.S. investors.
- This failure to provide explanations and limitations for critical standards includes the proposed use of the “character of government action” as a factor in expropriation analysis. “Character of government action” is extraordinarily ambiguous and could easily be misapplied by tribunals that are neither trained in nor bound by U.S. precedent.

The Supreme Court’s reference to that factor in *Penn Central* reflects a clear limitation on takings claims under U.S. law that is not evident in an unexplained reference to the “character of government action.” In *Penn Central*, the Court 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 public good.” The Supreme Court thus referred to the character of government action to distinguish between a permanent invasion of land, which is more likely to give rise to a right to compensation, and normal regulatory action, for which compensation is only required in extreme circumstances that are equivalent to a permanent, compelled, physical occupation. Without a clear explanation of how the character of government action affects the analysis of a

takings claim, a tribunal applying this factor would be free to interpret it so as to afford foreign investors far greater rights than the U.S. Constitution provides.

- In addition, USTR's proposed language concerning the analysis of an investor's expectations is too vague, leaves too much to the discretion of the arbitrators, and does not indicate the deference to governmental regulatory authority that is found in U.S. jurisprudence. The proposal does not include critical limitations stating that an investor's expectations are a necessary, but not sufficient, condition for liability, that an investor's expectations must be evaluated as of the time of the investment or that an investor must expect that health, safety, and environmental regulations often change and become more strict over time. For example, it fails to include the *Concrete Pipe* Court's reiteration of the principle that those who do business in an already regulated field "cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end." 508 U.S. at 645.
- USTR's proposed definition of property rights is vague and apparently does not recognize the Supreme Court's holdings that takings claims must be based upon compensable property interests, which are defined by background principles of property and nuisance law. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1029 (1992). In addition, property for purposes of the Takings Clause does not include some things that are considered to be property for purposes of the Due Process Clause. *Corn v. City of Lauderdale Lakes*, 95 F.3d 1066, 1075 (11th Cir. 1996), cert. denied, 522 U.S. 981 (1997).

Of particular importance in the context of investor claims, USTR has failed to include the Supreme Court's fundamental distinction between land and "personal property." "In the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulations might even render his property economically worthless (at least if the property's only economically productive use is sale or manufacture for sale)." *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1028 (1992).

- In considering whether a regulatory action constitutes an expropriation, the language must clearly include the standard established in Supreme Court jurisprudence that an adverse effect on economic value does not by itself constitute an expropriation, no matter how serious the adverse effect. It is extremely important to note that the *Penn Central* opinion refers to cases in which 75% and 87.5% diminution in value did not constitute a taking, and that in *Concrete Pipe* a unanimous Supreme Court used the phrase "however serious" to clarify its "long established" standard:
[O]ur cases have long established that mere diminution in the value of property, however serious, is insufficient to demonstrate a taking. *Euclid v. Ambler Realty*

Co., 272 U.S. 365, 384 (1926) (approximately 75% diminution in value);
Hadacheck v. Sebastian, 239 U.S. 394 (1915) (92.5% diminution). *Concrete Pipe
& Products v. Construction Laborers Pension Trust*, 508 U.S. 602, 645 (1993).

- The language clarifying that the exercise of regulatory powers by governments only constitutes an expropriation in “rare circumstances” needs to be strengthened to accurately reflect U.S. law. We believe that “rare circumstances” fails to adequately convey the degree to which it is unlikely that a regulatory action would be considered an expropriation under U.S. law. It would take an extreme circumstance for any of the thousands of our country’s laws and regulations to be found to constitute an expropriation. We believe that it would be more accurate to state that regulatory actions designed to protect health, environment, or the public welfare do not constitute an expropriation, except in instances equivalent to a permanent, compelled, physical occupation. As the Supreme Court unanimously stated in the *Riverside Bayview* case, land-use regulations may constitute a taking in “extreme circumstances.” *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121, 126 (1985).
- The clarification also omits the recognition by a majority of Supreme Court Justices that a regulatory action requiring the payment or expenditure of money can never be a taking in *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998), as confirmed in *Commonwealth Edison Co. v. United States*, 271 F.3d 1327 (Fed. Cir. 2001) (en banc), cert. denied (2002).

In regard to minimum, or general, treatment, we are deeply concerned that the term “fair and equitable treatment” has been included as an essential element of the standard. “Fair and equitable treatment” opens the door to outcomes in investment cases that go far beyond U.S. law. While we welcome the clarification that “fair and equitable” includes procedural due process, inclusion of one principle in a standard does not eliminate the significant potential of a broader, unbounded interpretation of the standard.

- There is no right corresponding to “fair and equitable treatment” under U.S. law. The closest thing in U.S. law is the Administrative Procedure Act (APA), which allows a court to review federal regulations to determine whether they are “arbitrary or capricious.” But the APA does not apply to many governmental actions (e.g., legislation, court decisions, actions by state, local and tribal governments, and exercises of prosecutorial discretion) that are covered under investment agreements. Moreover, the APA does not provide for monetary damages (as these investment provisions would allow); only injunctive relief is allowed.

Foreign investors have the same rights as U.S. investors under the APA to seek injunctive relief. Enshrining this equal access in a trade agreement is one thing, but granting foreign investors the right to be paid the costs of complying with a requirement that may violate the APA but does not constitute a compensable taking under the Constitution as interpreted by the Supreme Court would clearly violate the Congress' "no greater substantive rights" mandate. In other words, giving foreign investors the right to injunctive relief under the APA and takings, where an identically situated U.S. investor would be limited to injunctive relief, would violate the "no greater substantive rights" mandate. Finally, U.S. courts are bound by deference doctrines in applying the APA; there are no equivalent doctrines in treaties or other international law, to our knowledge.

- In addition, the "fair and equitable" language, if viewed as an independent standard, is extremely dangerous to good governance. It would invite an arbitral tribunal to apply its own view of what is "fair" or "equitable" unbounded by any limits in U.S. law. Those terms have no definable meaning, and they are inherently subjective. Indeed, we wonder how they can have any principled meaning when applied to countries with such different histories, cultures, and value systems as are involved in free trade agreements. The kind of second-guessing of governmental action—e.g., legislation, prosecutorial discretion, police action, court decisions, regulatory actions, zoning decisions, etc., at all levels of government—invited by this type of standard is antithetical to democracy.

Thank you for considering our concerns. Please feel free to have your staff contact us.

Sincerely,

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cc: Ambassador Robert Zoellick