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## ARTICLES

# Renegotiating Previous Governments' Privatization Deals: The 1997 U.K. Windfall Tax on Utilities and International Law

*Thomas W. Waelde\**

*Abba Kolo\*\**

### I. EX-POST CHANGE OF PRIVATIZATION DEALS: THE UK WINDFALLS LEVY PROJECT

Governments everywhere have the propensity to revoke deals made by their predecessors if these deals look too good to the other party.<sup>1</sup> They

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<sup>1</sup> The renegotiations (some forced-upon the foreign investors) of investment agreements in the 1970s and 80s were mostly initiated by host governments who sought to justify their actions under the principles of change in circumstances and permanent sovereignty. But the underlying factor in most cases was that the agreement had turned out to benefit the foreign investor in a manner that was never contemplated at the time the agreement was signed. For account of some of such renegotiations in the mineral industry. See WOLFGANG PETER,

usually do not revoke deals that have turned out to be dismal failures. Privatization falls under this category:<sup>2</sup> Either the price paid by purchasers/investors looks, ex post, too good -- thus providing an easy argument for revoking such deals; or it does not look too good and the purchasers/investors overpaid. Governments tend to leave these deals alone. A normal seller will rarely be able to extract a higher price for an asset sold if the assets turns out to be more profitable than expected, but governments have the sovereign power of taxation at their hand to re-make earlier deals, usually by a previous government.<sup>3</sup> General public opinion will usually be very sympathetic since "fat cats" are seen to need skinning. The ex-ante situation with its attendant uncertainty and risk, which usually explains whatever price was paid, is no longer in people's mind. The fact that there was a risk and that the risk may not have materialized is as a rule forgotten.

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ARBITRATION AND RENEGOTIATIONS OF INTERNATIONAL INVESTMENT AGREEMENTS 51-127 (Kluwer Law International, 2d ed., 1995); DANIEL YERGIN, *THE PRIZE* (Simon & Schuster 1991); Thomas W. Waelde & Abba Kolo, *Renegotiations and Contract Adaptation in the International Investment Projects: Applicable Legal Principles and Industry Practices* (1999) (unpublished paper, on file with author -- a preliminary version may be found in Volume IV of CEPMLP's Online Journal at <<http://www.cepmlp.org>>); Abba Kolo, *Between Legitimate Regulation and Taking of Foreign-Owned Property under International Law with Particular Reference to the Jurisprudence of the Iran-United States Claims Tribunal*, Ch. 4 (1994) (unpublished PhD thesis, University of Dundee) [hereinafter Kolo].

<sup>2</sup> This is exemplified by the failed renegotiations between BHP Petroleum and PetroVietnam over the Dai Hung petroleum development project. The initial estimate by the company of the total reserves (upon which the contract was based) turned out to be over optimistic. Demands by the company for renegotiations of the agreement were resisted by the Vietnamese as a result of which the company withdrew from the project. See *THE OILMAN WEEKLY*, Oct. 2, 1995, at 5; *THE OILMAN WEEKLY*, Jul. 15, 1996, at 8; *THE OILMAN WEEKLY*, Dec. 2, 1996, at 4; *THE OILMAN WEEKLY*, Feb. 2, 1997, at 5; *THE OILMAN WEEKLY*, Feb. 24, 1997, at 4; *THE OILMAN WEEKLY*, Jun. 23, 1997, at 5. A similar protracted renegotiations between Colombia and BP Oil company over the Piedemonte oil fields as a result of poor geological results from explorations carried out by the company lasted for four years before the Colombian government finally agreed to the company's demand for renegotiations. See *THE WEEKLY PETROLEUM ARGUS*, Sept. 16, 1996; *PETROLEUM ECONOMIST*, Mar. 1997, at 50; *THE WEEKLY PETROLEUM ARGUS*, Feb. 19, 1997, at 5; *THE WEEKLY PETROLEUM ARGUS*, Apr. 7, 1997, at 5; *PETROLEUM ECONOMIST*, Jan. 1998, at 6; *WEEKLY GAS INTELLIGENCE*, Jan. 16, 1998, at 2; THOMAS W. WAEDELDE & ABBA KOLO, *RENEGOTIATIONS AND CONTRACT ADAPTATION* (1999).

<sup>3</sup> It is generally accepted under international that the right to impose taxes on nationals and aliens alike (subject to treaty obligations -- such as under a double taxation agreement, a Bilateral Investment Treaty -- BIT, the EU Treaty, and NAFTA) is part of sovereignty of every state. However, such powers may also be limited by general principles of international, such as the requirement of non-discrimination and prohibition on confiscatory taxes. A. ALBRECHT, *THE TAXATION OF ALIENS UNDER INTERNATIONAL LAW*; KEES VAN RAAD, *NON-DISCRIMINATION IN INTERNATIONAL TAX LAW* 15 (Kluwer Law & Taxation Publishers, Series on International Taxation No. 6, 1986).

In the old days, right-wing governments sometimes privatized and left-wing governments often re-nationalized.<sup>4</sup> They had to pay compensation -- under national law for nationals, usually more, under international law obligations protecting foreign investment, to foreigners.<sup>5</sup> There was much debate on nationalization and compensation with Third-World radicals in the bygone days of the 1970s formulating innovative concepts of "excessive profits" to reduce compensation.<sup>6</sup> The prevailing consensus at this time, expressed in about 1,200 bilateral investment treaties<sup>7</sup> and the main modern multilateral investment treaties, such as the North-American Free Trade Agreement<sup>8</sup> and the 1994 Energy Charter

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<sup>4</sup> In Britain, for instance, the Labour Party has historically and ideologically been associated with nationalization or public ownership much more than the other political parties despite the fact that the Conservative Party have had their share of nationalizations. See C. FOSTER, *PRIVATIZATION, PUBLIC OWNERSHIP AND THE REGULATION OF NATURAL MONOPOLY* 70-86 (Blackwell Publishers, Oxford, 1992).

According to one study on nationalisation, a political party which has the concept of central state control of the economy as its core ideology is more likely to embark on nationalisation than a neo-liberal part. See Stephen J. Kobrin, *Foreign Enterprise and Forced Divestment in LDCs*, 34 INT'L ORG. 65, 65-69 (1980); ISI FOIGHEL, *NATIONALIZATION: A STUDY IN THE PROTECTION OF ALIEN PROPERTY IN INTERNATIONAL LAW* 25-28 (Stevens & Sons Ltd., 1957); Kolo, *supra* note 1, at 112-13. This is supported by history if one notes for instance, the "collectivisation" programme of the Bolsheviks after the 1917 revolution in the former Soviet Union, the Cuban nationalization in the 1960s, and Allende's nationalization of major industries in Chile in 1970. See HENRY J. STINER ET AL., *TRANSNATIONAL LEGAL PROBLEMS* 466-68 (University Casebook Series, The Foundation Press, Inc, 4th ed., 1994). However, in some cases nationalism and ethnic chauvinism have been the major motivating factors. See Kenneth J. Vandeveld, *The Political Economy of a Bilateral Investment Treaty*, 92 AM. J. INT'L L. 621, 621-23 (1998); Amy L. Chua, *The Privatisation-Nationalisation Cycle: The Link between Markets and Ethnicity in Developing Countries*, 95 COLUM. L. REV. 223, 223-37 (1995).

<sup>5</sup> Trustees of the Late Duke of Westminster's Estate v. UK, 5 EHRR 40 (1983) [hereinafter James Case]; Lithgow v. UK 8 EHRR 329 (1986); MAURICE MENDELSON, *THE UNITED KINGDOM NATIONALISATION CASES AND THE EUROPEAN CONVENTION ON HUMAN RIGHTS*, 57 BRIT. Y.B. INT'L L. 33 (1986); R. HIGGINS, *THE TAKING OF PROPERTY BY THE STATE: RECENT DEVELOPMENTS IN INTERNATIONAL LAW*, 176 RDC-Collected Courses (1982-III) 259, 359-64; J. G. MERRILLS, *THE DEVELOPMENT OF INTERNATIONAL LAW BY THE EUROPEAN COURT OF HUMAN RIGHTS* 194-96 (Manchester University Press 1988).

<sup>6</sup> See M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 403-11 (1994); see also RICHARD LILICH, *THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW* 95 (1972).

<sup>7</sup> See RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 97-117 (1995); Mohamed I. Khalil, *Treatment of Foreign Investment in Bilateral Investment Treaties*, 7 ICSID REV. FOREIGN INVESTMENT L.J. (1992); but see SORNARAJAH, *supra* note 6, at 253-60; M. SORNARAJAH, *STATE RESPONSIBILITY AND BILATERAL INVESTMENT TREATIES*, 20 J.W.T.L. 79 (1986); Andrew T. Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639 (1986).

<sup>8</sup> See generally Richard G. Dearden, *Arbitration of Expropriation Disputes between an Investor and the State Under the North American Free Trade Agreement*, 29 J.W.T. 113 (1995); Rex J. Zedalis, *Claims by Individuals in International Economic Law: NAFTA Developments*, 7 AM. REV. INT'L. ARB. 115 (1996).

Treaty, is that nationalization requires full, prompt and effective compensation.<sup>9</sup>

Notably, privatization of former public-service companies (often before and sometimes after in monopoly form) leads to a more sophisticated ball game: The value of the asset depends very much on the relevant industry regulation, since regulators can increase the value or decrease it depending on the ceiling they set for prices and other conditions of service and competition. In addition, taxes increase or lower the value of such assets, in particular if such taxes are not uniformly imposed throughout a nation, but aimed in particular at the privatized and regulated utility companies. Investment in privatized utilities therefore leads to a very particular form of political risk -- the risk that regulatory conditions change and special taxes are imposed, all measures within the sovereign powers of the state.<sup>10</sup> The normal forms of protection against political risk (investment insurance, stabilization clauses, international investment treaties and international arbitration clauses) have not yet caught up with the emergence of new forms of political risk.<sup>11</sup>

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<sup>9</sup> See Patrick M. Norton, *Back to the Future: Expropriation on the Energy Charter Treaty*, in *THE ENERGY CHARTER TREATY: AN EAST-WEST GATEWAY FOR INVESTMENT AND TRADE* 365 (Thomas W. Waelde ed., 1996); M. Sornarajah, *Compensation for Nationalization: The Provision in the Energy Charter*, in *THE ENERGY CHARTER TREATY: AN EAST-WEST GATEWAY FOR INVESTMENT AND TRADE* 386 (Thomas W. Waelde ed., 1996); Charles Leben, *Retour sur la notion de contrat d'etat et sur le droit applicable a celui-ci*, in: *Melanges offerts a Hubert Thierry*, Paris, Pedone 1998, 248.

<sup>10</sup> This is particularly so in relation to investing in the British privatization process because of the then deep-rooted Labour Party opposition of the project and their threat to renationalize some of the privatized industries with little or no compensation. It was not until 1992 when the Party softened its position on privatization by pledging to impose windfall tax on the privatized utilities instead of renationalization as previously stated. See *The Economist*, September 2, 1995, p. 24; L. Chennells, *The Windfall Tax*, 18 *Fiscal Studies* (1997) 279, 280; David Currie, *Regulating Utilities: The Labor View*, in *REGULATING UTILITIES: BROADENING THE DEBATE* (M. E. Beesley ed., 1997).

<sup>11</sup> Of the so many writings on political risk hardly any seems to have touched on this particular issue. Instead, they have concentrated on the traditional kinds of risk and how to manage them. See SORNARAJAH, *supra* note 6, at 323-37, BESANT-JONES & HYLAN, *MANAGING RISKS OF INVESTMENT IN DEVELOPING COUNTRIES* (The World Bank, Washington D.C., 1992); FARIBORZ GHADAR, STEPHEN J. KOBRIN & THEODORE H. MORAN, *MANAGING INTERNATIONAL POLITICAL RISK: STRATEGIES AND TECHNIQUES* (1983); D. Frecker, *Coping with Political Risk*, *Australian Mining & Petroleum Law Assoc. Yearbook* (1991) 507; H. Zakariya, *Political Risks of Transnational Petroleum Investment: The Mitigating Role of National and International Insurance Programmes*, 11 *NRF* (1987) 165. Most recently: Conference Proceedings of World Bank conference on infrastructure risk, September 1999. See <<http://www.worldbank.org/riskconference>>.

However, a move towards that direction could be discerned from the proposed Multilateral Agreement on Investment being negotiated by the OECD. The text of the negotiation document provides for the national and MFN treatments to investors from member states who wished to invest in any member country's privatisation programme. It follows from this that when such investments are made they shall be accorded protection against expropriation or similar measures under the Agreement. See Riyaz Datty & John.

The 1997 UK windfall tax announced by the Chancellor of the Exchequer in that year's budget speech is a case in point.<sup>12</sup> This issue is not limited purely to the contemporary UK situation, but illustrates a structural situation which can, and is likely to be repeated wherever utilities are privatized, regulated and exposed to special industry taxes.<sup>13</sup> Such actions are usually undertaken by a new government composed of parties hitherto opposed to privatization, which will be able to combine its previous opposition, and the values therein articulated with the ever present need of governments for new revenue to finance its political popularity objectives. This paper surveys shortly the possible responses by international law, mainly principles and practice of international investment protection, to situations which have recently arisen in the world privatization laboratory (the UK) and situations which are likely to arise in the many countries which currently copy the UK privatization model, once new governments come to power. The UK situation is of particular interest since in the absence of constitutional, federal or judicial constraints the prevailing concept of parliamentary supremacy means that any legal recourse can only be had from external sources of law.<sup>14</sup>

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Boscariol, *A Quick Primer on the Multilateral Agreement on Investment*, 27 INT'L. BUS. LAW. 50, 51-52.

<sup>12</sup> In his budget speech on July 2, 1997, the Chancellor of the Exchequer, Gordon Brown, announced that the "one-off" windfall tax on the privatized "utilities" was expected to raise up to £5.2 billion to fund the government's back-to-work welfare programme aimed at getting the long-term unemployed youth back to work. "Privatised utilities" was broadly defined to include all firms privatized by flotation and regulated by relevant privatization statutes. The definition included companies such as BT, BAA, and Power Gen which operate in competitive markets; Railtrack, the privatized electricity companies (excluding National Grid) and the privatized water companies. The basis of calculating the tax was the difference between a firm's flotation price and a multiple of its average profits in the four years after privatization. See *Where the Windfall Blows*, THE ECONOMIST, July 5, 1997, at 58; see Chennells, *supra* note 10.

<sup>13</sup> Perhaps no where might this be expected as in Russia and the former Communist countries of Eastern Europe where privatizations have not been transparent and allegations of corruption, fueled by the economic crisis are ripe. See *Second Thoughts about Privatizations*, PETROLEUM ECONOMIST, Mar. 1996, at 43; *Oil Industry Privatisation, Russian Style*, PETROLEUM ECONOMIST, Feb. 1996, at 3; Grigory Yavlinsky, *Russia's Phony Capitalism*, 77 FOREIGN AFFAIRS May/June 1998, at 67. Similar misgivings have been expressed elsewhere -- notably, in Latin America. See *A Very Dig Deal*, THE ECONOMIST, Dec. 6, 1997, at S9. T. Waelde and C von Hirschhausen, *Legislative Reform in the Energy Industry of Post-Soviet Societies*, in: R. Seidman, A. Seidman and T. Waelde, *Making Development Work: Legislative Reform for Good Governance*, Kluwer, London 1999.

<sup>14</sup> Although the lack of "written" constitution gives the British government a lot of flexibility in economic matters generally and in pursuing the privatisation programme in particular, nonetheless, that discretion is constrained by external laws. See Terence Daintith & Monica Sah, *Privatisation and the Economic Neutrality of the Constitution*, Pub. L. 465, 467 (1993); These are: the EU laws which take precedence over member states national laws, the European Convention on Human Rights, multilateral and bilateral treaties. See RAYMOND YOUNGS, ENGLISH, FRENCH AND GERMAN COMPARATIVE LAW 13, 16 (1998); COSMO GRAHAM & TONY PROSSER, *PRIVATISING PUBLIC PUBLIC ENTERPRISES*:

## II. THE EFFECT OF INTERNATIONAL LAW ON GOVERNMENT AND BUSINESS PRACTICE

International law does not work like normal national law because it does not rely on national judges, police and bailiffs. Instead, international law acts like a social code of rules the breach of which affects a state's reputation, makes it more difficult for such state to do normal business with other states and companies. States found in breach of international law by a consensus of the international law community and conferences, arbitration tribunals and the International Court of Justice rarely comply. Breaching states usually protest on the basis that their sovereignty is being violated and that they have been subjected to the bias of the rest-of-the-world against them. However, after agitation and excitement has worn out, there is usually an attempt by the state and its elites responsible for dealing with the world to come back into the fold. International law then becomes effective by much quieter, face-saving diplomacy and on in-depth inspection one will often find that international law is ultimately and in effect complied with.<sup>15</sup>

This is why it is important to examine the rules that may be applicable and their way of being raised, adjudicated and enforced. Unfortunately for the lay observer, these rules are rarely clear. They are usually a combination of quite open-ended standards and criteria, which will only acquire a definitive scope and meaning as they are debated and applied in the particular case. Also, international law needs a plaintiff to become effective. Usually, plaintiffs were the home states of affected investors.<sup>16</sup> Increasingly, private parties, mainly companies, have become entitled to litigate before non-national tribunals against the offending state.<sup>17</sup> This is not without risk: It requires large resources of money and executive attention. Suing a state also means getting exposed to the risk of being blacklisted and sanctioned in manifest and subcutaneous ways at the

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CONSTITUTION, THE STATE, AND REGULATION IN COMPARATIVE PERSPECTIVE (1991); A. Davis, *Windfall Tax and the Law*, THE TAX JOURNAL, Oct. 19, 1995, at 14.

<sup>15</sup> Waelde, Role of Law and Contract in International Business, CEPMLP online journal: <<http://www.cepmlp.org>>.

<sup>16</sup> See *Barcelona Traction Light and Power Company Limited (Belgium v. Spain)* 1970 I.C.J. 3 (Feb. 5); *Electronica Sicula S.p.A. (ELSI) (U.S. v. Italy)*, 1989 I.C.J. 15 (July 20); IAN BROWNLIE, *THE RULE OF LAW IN INTERNATIONAL AFFAIRS* 48 (1998); MARTIN DIXON, *TEXTBOOK ON INTERNATIONAL LAW* 53 (Blackstone Press, London, 1990); IGNAZ SEDL-HOHENVELDERN, *INTERNATIONAL ECONOMIC LAW* (1989); G. Abi-Sa'ab, *The International Law of Multinational Corporations: A Critique of American Legal Doctrine*, 2 *Annals of Int'l. Stud.* (1971) 97, 101-4.

<sup>17</sup> This is mostly brought about by recognition of such private right of action against the state in BITs a multilateral treaties and conventions such as NAFTA, the ECT and the ICSID Convention. See *AAPL v. Sri Lanka*, 30 I.L.M. 577 (1991). The ICSID Convention gives a direct right of action to the foreign investor against the host state and so also does NAFTA and the ECT. See Nassib G. Zaide, *Some Recent Decisions in ICSID Cases*, 6 *ICSID Rev.-FOREIGN INVESTMENT L. J.* (1991) 514, 515 (1991); see Zedalis, *supra* note 8, at 116, 119.

disposal of the regulating, permitting, awarding and taxing state machinery.<sup>18</sup> Consequently, international law plays a low-profile role in negotiation between a state political and bureaucratic machinery keen on avoiding political embarrassment and loss of face and affected investors worried over the state's ability to penalize private companies foolhardy enough to challenge the state. Its effect will consist in providing a set of standards in such negotiations. Although none of the affected companies mounted any legal challenge against the windfall tax as some seemed to have suggested before the announcement, nonetheless the case did raise important legal issues which merit consideration. One of such issues is what are the possible legal grounds upon which to challenge the levy?

### III. THE EUROPEAN CONVENTION ON HUMAN RIGHTS

The first legal instrument to think of in the current UK context is the European Convention on Human Rights. It allows not only foreign investors, but also British companies to raise a complaint before the Strasbourg-based European Commission and Court of Human Rights (not to be confused with the Luxembourg-based European Court of Justice, the judicial organ of the European Communities). In the absence of a UK constitution, the Convention operates so far as a quasi-constitutional constraint of last resort in the UK.<sup>19</sup> The First Protocol, Article 1 of the Convention, guarantees the "peaceful enjoyment of possessions," subject to public interest, with reference to international law and subject to regulation of property for the public interest and to "secure the payment of taxes." The Convention witnesses the strong pro-state and social philosophies prevailing after World War II. It provides wide latitude to the state for regulating property, for exercising political judgment and, as the decades of

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<sup>18</sup> During the 1975 petroleum licensing "renegotiations" between the UK government and oil companies, it was made clear to the companies that any resistance to the government's demands might jeopardize the resisting company's prospects in future licensing rounds and that warning did influence the companies attitude towards the negotiations. See PETER D. CAMERON, *PETROLEUM RIGHTS AND SOVEREIGN RIGHTS: THE CASE OF NORTH SEA OIL* (Z. Bankowski et al. eds., 1983); see Terence Daintith & Ian Gault, *Pacta Sunt Servanda and the Licensing and Taxation of North Sea Oil Production*, 8 *CAMBRIAN L. REV.* 27, 37 (1977); HIGGINS, *supra* note 5, at 351; on other similar renegotiations, see Kolo, *supra* note 1.

<sup>19</sup> For a succinct analysis of Art. 1, Additional Protocol: Luigi Condorelli, *Premier Protocole Additionel* in: Pettiti, *La Convention Europeenne des Droits de l'Homme*, Economica Paris 1992; M. Frigo *Le Limitazioni al diritto di proprieta e all'esercizio delle attivita economiche nella giurisprudenza della corte di giustizia*, 34 *Rivista di diritto internazionale privato e processuale*, 51-78 (1998) Now that the Convention has to a large been incorporated into UK law under The Human Rights Act 1998, it means most of the rights guaranteed under the Convention may be enforced in UK domestic courts. The incorporation of the Convention was one of Labour Parties election pledges. See K.D. Ewing, *The Human Rights Act and Parliamentary Democracy*, 62 *MOD. L. REV.* 79, 81-82 (1999); Jack Straw & Paul. Boateng, *Bringing Rights Home: Labour's Plans to Incorporate the ECHR into UK Law*, 1997 *EUR. HUM. RTS. L. REV.* 71.



jurisprudence saw, protects only the core of property interests against arbitrary, abusive and discriminatory state measures.<sup>20</sup> Several cases indicate that taxation is in fact covered by this provision;<sup>21</sup> however, thus far, no case has dealt with a situation involving a post-privatization special-industry tax that recoups part of the profit arising out of favorable developments in and outside the privatized industries. An analysis of extensive case law demonstrates that protection is granted against abusive measures of tax enforcement, rather than against the exercise of tax powers.<sup>22</sup> The Convention and its origin are deeply anchored in attitudes where state tax powers are considered to be at the core of sovereignty, with minimal acceptance by states of international law constraints in this field.<sup>23</sup> One would need to show an "excessive burden" or a "fundamental interference" with a financial position.<sup>24</sup>

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<sup>20</sup> Thus, in *Hentrich v. France*, the court rejected the applicant's contention that the government's exercise of the right of preemption in ascendance with a general tax code was arbitrary and as such served no public interest. It held that the notion of "public interest" is necessarily extensive and that member states have a certain margin of appreciation to frame and organize their fiscal policies and make arrangements -- such as the right of preemption -- to ensure that taxes are paid. See *Hentrich v. France*, App. No. 13616/88, 18 Eur. H.R. Rep. 440, 457-60 (1994) (Court Report). See also *National & Provincial Building Soc'y, v. United Kingdom*, App. Nos. 21319/93, 21449/93 & 21675/93, 25 Eur. H.R. Rep. 127, 149 (1998) (Court Report); *GasusDosier-undFordertechnik v. Netherlands*, App. No. 15375/89, 20 Eur. H.R. Rep. 403, 426 (1995) (Court Report); *James Case*, 5 Eur. H.R. Rep. at 456; but see *Pine Valley Devs. v. Ireland*, App. No. 12742/87, 14 Eur. H.R. Rep. 319, 338-41 (1991) (Court Report). See J.G. MERRILLS, *THE DEVELOPMENT OF INTERNATIONAL LAW BY THE EUROPEAN COURT OF HUMAN RIGHTS* 140-49 (Gillian M. White ed., 1988); LUKE CLEMENTS, *EUROPEAN HUMAN RIGHTS: TAKING A CASE UNDER THE CONVENTION* 204-05 (1994); YOUNGS, *supra* note 14, at 199-200; Yves Winisdoerffer, *Margin of Appreciation and Article 1 of Protocol No. 1*, 19(1) HUM. RTS. L.J. 18 (1998); Jereon. Schokkenbroek, *The Prohibition of Discrimination in Article 14 of the Convention and the Margin of Appreciation*, *id.* at 20; Thomas W. Waelde & A. Kolo, *Multilateral Investment Treaties and Environmental Expropriation of Foreign Investment* (1999) (unpublished paper, on file with author -- to be published in INT'L & COMP. L.Q. in 2000).

<sup>21</sup> See *Wasa Liv Omsesidigt, et al v. Sweden* App. No. 13013/87, 58 Eur. Comm'n H.R. Dec. & Rep. 163, 177 (1988); decision on admissibility of Appl. No. 350 0168, C.D. 37, p. 44, and No. 5/69/71, C.D. 42, p. 137 cited by Z. NEDJATI, *HUMAN RIGHTS UNDER THE EUROPEAN CONVENTION* 217 (North-Holland Co., Amsterdam, 1978); Davis, *supra* note 14.

<sup>22</sup> *Wasa Liv Omsesidigt*, 58 Eur. Comm'n H.R. Dec. & Rep. at 177; *Gudmundsson v. Iceland*, 1960 Y.B. Eur. Comm'n on H.R. 394 (Eur. Comm'n on H.R.); ALBRECHT, *supra* note 3, at 170-75.

<sup>23</sup> CLIVE PARRY ET AL., *PARRY & GRANT ENCYCLOPEDIA OF INTERNATIONAL LAW* 389 (1986).

<sup>24</sup> *Gudmundsson*, 1960 Y.B. Eur. Conv. on H.R. at 394; *Greek Case*, 1969 Y.B. Eur. Conv. on H.R. 182-84, 512 (Eur. Comm'n H.R.); *v. Iceland*, Appl. No. 511/59, Yearbook III, p. 394, in which a law imposing a special progressive tax of between 15 to 25 percent on properties above certain value was held not to violate Article 1 of Protocol 1 because it was a measure to secure the payment of taxes or other contributions within the meaning of paragraph 2 of Article 1; the *Greek Case*, Yearbook XII, pp. 182-84, 512; Appl. No. 4338 169, C.D. 36, pp. 79, 81; Appl. No. 6202/73 *v. The Netherlands*, D.R. 1, pp. 66, 71. A. ROBERTSON, *HUMAN RIGHTS IN EUROPE* 121-24 (Manchester Univ. Press, Manchester, 2d ed., 1977).

Under such rules, one would have to show a very severe and disproportionate interference with economic assets. Although the windfall tax as announced by the government was a one-off payment, and not a tax that might drive any of the utilities to bankruptcy or closure, nevertheless it was significant in terms of the amount to be realized or paid by the affected companies. The relevant question regarding the tax is: was it proportionate to the aim sought to be achieved? In other words, was a fair balance struck between the general interest of the community and the protection of the companies individual rights. Although a government may be legitimate in initiating and pursuing a welfare program that helps people return to work, why should the privatized utilities (which are themselves employers of high number of people apart from being also tax payers that contribute in sustaining the welfare state) be targeted and made to bear what is clearly a disproportionate burden over and above that of other companies and businesses in the country. One may argue that the government could have achieved its aim in a less drastic manner by increasing general taxation or by levying a corporate tax, rather than imposing an "individual and excessive burden" on the privatized utilities.<sup>25</sup> On the other hand, one could argue that given the wide discretion states have in tax matters and the fact that the privatized utilities could have perceived the possibility of the tax should the Labor Party come to power (therefore had assumed the risk) plus the flexibility of the "reasonable proportionality" test, it is improbable that a fair balance had not been struck as required under the convention.<sup>26</sup> If the windfall levy is seen as discriminating against foreign and national investors, the ECHR institutions are more likely to take a critical look at the levy than if they were imposed with as much equality as possible and with the intention and effect to avoid protectionism and

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But in a number of cases, the court has held that where the particular individual or group was made to bear an excessive burden above that of the community or where the measure "fundamentally interfered" with the right of possession, it might amount to a violation of the Article. See the opinion of the Commission in *Agrotexim v. Greece*, App. No. 14807/89, 21 Eur. H.R. Rep. 250, 273 (1995); *National Provincial*, 25 Eur. H.R. Rep. at 172; *Hentrich*, 18 Eur. H.R. Rep. at 471.

<sup>25</sup> Richard A. Epstein, *Taxation, Regulation and Confiscation*, 20 OSGOODE HALL L.J. 433 (1982); RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* 283-305 (1985); Calvin R. Massey, *Takings and Progressive Rate Taxation*, 20 HARV. J.L. & PUB. POL'Y 85 (1996).

<sup>26</sup> The principle of proportionality which is said to be inherent in the convention requires that the measure adopted does not only pursue a legitimate objective, it must also maintain a fair balance between the demands of the general community and the requirements of the protection of the private individual's fundamental rights. This has been interpreted to mean that there must a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure depriving a person of his possession. See *The James Case*, 5 Eur. H.R. Rep. at 456; *Pine Valley*, 14 Eur. H.R. Rep. at 338-39; *Hakansson & anor. V. Sweden*, (1986) 8 EHRR 329. P. VAN DIJK ET AL., *THEORY AND PRACTICE OF THE EUROPEAN CONVENTION ON HUMAN RIGHTS* 638-43 (Kluwer, The Hague, 3d ed., 1998).

maintain a level playing field.<sup>27</sup> Similarly, while tax retroactivity has not yet been a situation before the ECHR institutions, it might well lead to a more severe judgment. Under the law of the European Community and its underlying constitutional principles, retroactive legislation is only authorized to a limited extent if legitimate expectations are protected.<sup>28</sup> While EC law does not pertain directly to the UK tax measures envisaged or to the European Convention on Human Rights, legislation with

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<sup>27</sup> Although the concept of discrimination is difficult to apply in practice, the jurisprudence of the ECHR institutions suggests that the term refers to a dissimilar treatment of like situations or similar treatment of unlike situations, a "difference in treatment that has no objective and reasonable justification." See *Van Raalte v. Netherlands*, App. No. 20060/92, 24 Eur. H.R. 503, 513 (1997) (Commission Report) (1997); *Pine Valley*, 14 Eur. H.R. Rep. at 341-42; *Fredin v. Sweden*, App. No. 12033/86, 13 Eur. H.R. Rep. 784, 797 (Court Report).

Under this rule, the windfall tax was not discriminatory against the privatized utilities vis-à-vis other private businesses as they could not be said to be within the same category; for as the court noted in the *Belgian Linguistic Case*, 6 Eur. Ct. H.R. (ser. A), at 34 (1968), Article 14 does not guarantee complete equality of treatment. It only forbids a distinction which has no objective and reasonable basis. See also *National & Provincial Bldg. Soc'y*, 25 Eur. H.R. Rep., at 127 (the Commission stated that to amount to discrimination under Article 14, "it must be established that other persons in an analogous or relevantly similar situation enjoyed preferential treatment; and that there is no reasonable or objective justification for this distinction."). Stephen Livingstone, *Article 14 and the Prevention of Discrimination in the European Convention on Human Rights* (1997), p. 25; NEDJATI, *supra* note 21, at 228-32.

On the other hand, it might be argued that the exclusion of National Grid from payment of the tax did probably amount to discrimination against the other utilities (especially the water and electricity companies) as they were privatised along with the National Grid, unless some reasonable reason could be given for the differentiation. See *Darby v. Sweden*, App. No. 11581/85, 13 EUR. H.R. L. REV 774 (1991); see also *Clements*, *supra* note 20, at 205.

<sup>28</sup> Under this principle, it might be argued that by investing in the privatization project the shareholders of the privatized utilities had hoped (just like any other private investor) that their investment-backed expectations will not be frustrated by ex post facto regulation; the more so as the privatized utilities were already tightly regulated by the regulatory authorities and the areas of regulation include prices and tariffs they could charge customers (and there have been numerous cases of price cuts following demands by the regulators) and other social obligations, all of which affect the profits of the companies. See G. Yarrow, *Dealing with Social Obligation in the Telecoms*, in *REGULATING UTILITIES: A TIME FOR CHANGE?* 67 (S. Sayer et al. eds., 1996).

Although the principle of legitimate expectation is not expressly mentioned in EU laws nonetheless it is regarded as a general principle of EU law as well as member states'. See J. SCHWARZE, *EUROPEAN ADMINISTRATIVE LAW*, at 937-1172 (1992). In relation to Article 1 Protocol 1, the principle seems implicit from the decision of the court in *Fredin v. Sweden*, 13 Eur. H.R. Rep., at 796. On the other hand, it might be argued that by investing in the privatized utilities in which the government retained extensive regulatory power, the shareholders could be said to have known and assumed the risk of regulatory changes including possible additional taxes. Indeed, the then government did make it clear in some of the privatization prospectuses, the position of the Labour Party on the privatizations; and the regulatory regime was made part of the privatization condition. See Chennells, *supra* note 10, at 280-81; Tony Prosser, *Social Limits to Privatization*, 21 *BROOK J. INT'L. L.* 213, 221-22 (1995); Currie, *supra* note 10, at 14-15; Antony Barnett, *In the Teeth of the Windfall*, *THE OBSERVER*, June 1, 1997, at 21.

retroactive effect is seen as abhorrent to most (in particular Continental European) lawyers. A windfalls tax which is directly or indirectly retroactive, and thus imposed upon tax payers without the possibility of adjusting their behavior to tax imposition, might not fare well in a balancing test employed by the ECHR.<sup>29</sup>

Hence, the very pro-state nature of the First Protocol of the ECHR that protects property challenges the windfall tax on an uphill battle. Nevertheless, if standards such as discrimination, retroactivity, protection of legitimate expectations are applied, the balancing test may come out against the tax. Also, indications that the previous government induced investors with credible promises of stability might reinforce the "legitimate expectations" of investors to be weighed against the very explicitly recognized powers of the state to regulate and tax property. There is also the off-chance possibility that the currently prevailing philosophy of open markets requiring extensive protection of property against state interference and taxation -- as more explicitly recognized in modern investment treaties - might lead to a modernized interpretation of this rather old convention.<sup>30</sup> In that case, the breach of promises and the imposition of a tax discrimination between a particular, privatized industry and the general business taxes applicable, in other words the attempt to renegotiate a deal ex-post, after the investors have sunk their monies, could result in the balancing test under the ECHR to come out against the windfall tax. However, this outcome is unlikely. Finally, it should be noted that while the ECHR protects member state nationals (including UK companies and citizens), it does not apply to US companies or US citizens. The US purchasers of UK energy companies can not rely on the Convention because the US is not a member state.

#### IV. EUROPEAN COMMUNITY LAW

The EC quasi-constitutional rules restraining application of retroactive law are not directly applicable to UK taxation. What is applicable is directly effective EC law prohibiting discrimination between UK and EC

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<sup>29</sup> The principle of 'legal certainty' -- under which a person subject to a law is entitled to know what that law is and be able to plan his affairs in such a way as to take account of it -- is a well recognized under EU law. Hence retrospective legislation is generally frowned at, and even in the UK courts try not to give effect to such legislation. See Davis, *supra* note 14, at 15-16; M. BREALEY & M. HOSKINS, *REMEDIES IN EC LAW: LAW AND PRACTICE IN THE ENGLISH AND EC COURTS* 16 (Longman, London, 1994); BUTTERWORTH'S GUIDE TO THE EU 237 (J. Monar et al. eds., Butterworths, London, 1996); SCHWARZE, *supra* note 27, at Ch. 6; Dawn Oliver, *Retrospective Validation of Regulations: Who's with the Building Societies?*, 5 BRIT. TAX REV. 301 (1992).

<sup>30</sup> In this sense also Condorelli, *op.cit. supra*, who emphasizes the shift towards greater limitation on the power of states to intervene in property rights which has started to emerge since significant cases from 1982 onwards.

nationals (inclusive companies) under Articles 7 and 52,<sup>31</sup> state aids (Articles 92-94) of the EC Treaty.<sup>32</sup> These rules can be raised by private investors and companies before a UK court which would have to submit questions of relevant EC law to the European Court of Justice. Similarly, the European Commission would have powers to investigate breaches of EC law, with ultimate jurisdiction for the European Court of Justice in Luxembourg. There is a prohibition on tax discrimination in Article 95 of the EC Treaty, but this prohibition only applies to "products" from other member states, and not to investment by member states nationals.<sup>33</sup> The legal opinions prepared by Labor and Conservative party counsel take, predictably, two routes: The -- easy -- Labor Party position is that there is no evidence that the windfall tax would discriminate against investors from other member states (both shareholders in the privatized utilities and corporate purchasers, e.g. Lyonnaise des Eaux). Similarly, their argument is that there has not been a case where a tax on a specialized industry has been considered as a "state aids" for those parts of an industry not taxed requiring consent by the European Commission.<sup>34</sup> The Conservative Party's counsel's argument needed to be much more imaginative: They had to argue that while such cases may not have arisen, one could not exclude that the windfall tax levy would result in discrimination against EC investors forbidden under the EC Treaty; their main argument was that it was very difficult to draft a non-discriminatory tax in the first place so anything that would come out would be likely to be discriminatory in some fashion. For applying the state aids' prohibition, they suggested that not taxing a segment of the industry would in fact be the same as providing a subsidy to this industry seen increasing, in effect, its competitive position vis-à-vis its taxed competitors.<sup>35</sup>

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<sup>31</sup> Discrimination may be "manifest" or "hidden" (i.e. in law or practical effect of the law) both of which are prohibited under EU law. See Case 330/91, R. v Commissioners of Inland Revenue ex parte Commerzbank AG, STC 605 (1993); Case 80/94, Wielockx v. Inspecteur de Directe Belastingen, STC 876 (1995); Case 279/93, Finanzamt Köln-Altstadt v. Schumacker, STC 306 (1995); Commission v. French Republic, 1986 E.C.R. 273; Timothy Lyons, *Discrimination Against Individuals and Enterprises on Grounds of Nationality: Direct Taxation and the European Court of Justice*, 6 BRIT. TAX. REV. 554 (1994); SCHWARZE, *supra* note 28, at 549-626; Davis, *supra* note 14, at 15.

<sup>32</sup> THE ECONOMIST, December 7, 1996, pp. 30-31.

<sup>33</sup> See Case C-213/96, Outokumpu v. Piiritullikamari, E.C.R. I-1777 (1998) [hereinafter Outokumpu] in which the ECJ found discriminatory a customs duty charged by Finland on imported electricity because it did not give the producers the same benefit of lower duty as it did to domestic producers whose method of production was less damaging to the environment; see also Case 171/78, Commission v. Kingdom of Denmark, E.C.R. 447 (1980).

<sup>34</sup> See the Joint opinion of Beloff & Singh, In the Matter of the Labour Party and the Windfall Tax, February 12, 1997, with summary in THE FINANCIAL TIMES, Feb. 13, 1997.

<sup>35</sup> Joint opinion of Barling, Flynn & Stratford, Proposed Windfall Tax, January 11, 1997, summarized in THE FINANCIAL TIMES, Jan. 13, 1997, at 5.

Both arguments do not lack imagination and some persuasion, but they are not utterly convincing. First, it would be difficult to see why the Commission services and the European Court of Justice would want to extend the state aids concept to a new situation where tax-raising, and partly re-working a privatization deal, are the main motivating forces, and not strengthening the competitive position of domestic industry vis-a-vis foreign competitors. In fact, non-UK utilities not subject to the windfall tax will benefit since their UK rivals ability to expand internationally will be curtailed by the UK tax. The UK tax, rather than helping UK utilities in European or international competition, will rather obstruct their competitive strategies abroad, and may even weaken them in domestic UK take-over games. Non-UK investors may benefit from tax credit or tax deductibility provisions at home in ways not open to purely UK-based companies and investors so that the UK tax may in fact benefit the relative competitive position, rather than negatively discriminate, against European companies. If the tax were structured so as to hit in particular hard at European investors in the UK, while benefiting UK investors (e.g. Mercury or some already earlier private and not privatized water utilities), then the argument of discrimination, and perhaps even state aids, would have some strength. But the tax seemed to have been motivated and structured not for protectionist, but primarily for revenue-raising reasons.<sup>36</sup>

## V. GATT/WTO

The Conservative Party's counsel has raised the prospect of GATT/WTO procedures -- presumably brought by the home state of a foreign utility company the UK subsidiary of which is subject to the proposed windfall tax. It is hard, though, to develop this line of attack effectively: GATT/WTO deals with trade. No indication has so far surfaced that the windfall levy did obstruct trade of, say, electricity (e.g. Electricite de France) or gas (e.g. Statoil) and imposed discriminatory taxes on such trade (forbidden under GATT and Article 95 of the EC Treaty).<sup>37</sup> It was meant to take money away from the privatized utilities and thereby reduce the value of the shares of shareholders (with the stock market already having factored in the windfall levy in the then current stock market price).<sup>38</sup> Trade was thereby not affected; to the contrary, if the UK utilities were placed in a financially weaker position, this would have made it more difficult for them to resist import competition and to build up an export position in other European countries. The GATT/WTO reference is too far-fetched.

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<sup>36</sup> THE ECONOMIST, *supra* note 12, at 38; Chennells, *supra* note 10.

<sup>37</sup> Outokumpu, *supra* note 33.

<sup>38</sup> In fact the announcement of the levy did not affect the share prices of the companies on the stock market mainly because the £5.2 billion the government expected to realize from the tax did not come as a surprise to the capital market, rather it was the list of the affected companies that was unpredicted. See THE ECONOMIST, *supra* note 12, at 58.

## VI. CUSTOMARY AND TREATY-BASED INTERNATIONAL LAW

The most potent challenge, in our view, could be based on customary and Treaty-based international law. Customary international law on nationalization and other squeezes on foreign investment were challenged in the 1970s by the Third World.<sup>39</sup> However, the collapse of Communism and the re-orientation of global economic attitudes towards open and competitive markets and liberalization of foreign investment conditions -- spearheaded very much by Great Britain -- has led to a substantial enhancement of the concepts of investment protection.<sup>40</sup> Customary international law, though, would not give a right to challenge the windfall tax to UK nationals, but exclusively to foreign investors, mainly the US and some European utilities and private investors who invested heavily in the Thatcher-led privatization of the UK utility industry, trusting that privatization, the newly established regulatory framework and economic buoyancy would lead to financial results beyond those envisaged when the price for privatization assets was set -- a high-risk investment gamble that paid off with many,<sup>41</sup> but not all UK privatization's and which has led in other privatization cases to unfavorable results. Customary international law, though, needs a proper plaintiff: Private investors can in the main not challenge a UK windfall tax directly since they have no access to the International Court of Justice (ICJ - The Hague) which acts exclusively as a court for voluntary submission of disputes between states. We understand that there may be the possibility for the US to bring a claim against the UK for a breach of international investment rules against US investors in privatized UK utilities.<sup>42</sup>

But does customary international law include a prohibition against measures such as the windfall tax?

In a first round of analysis, there would not be much strength in such claim: Customary international law protects against nationalization and confiscation without full, prompt and effective compensation.<sup>43</sup> Therefore,

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<sup>39</sup> BROWNIE, *supra* note 16, at 144-48; B. Weston, *The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth*, 75 AJIL 437 (1981); E. Arechaga, *State Responsibility for the Nationalisation of Foreign-Owned Property*, 11 N.Y.U. J. INT'L L. & POL. (1979).

<sup>40</sup> On the historical evolution of foreign investment regimes, see Thomas W. Waelde, *Requiem for New International Economic Order*, in Liber Amicorum I. Seidl-Hohenveldern (Kluwer, The Hague, 1998) 771; K. Vandevelde, *Sustainable Liberalisation and the International Investment Regime*, 19 MICH. J. INT'L. L. 373 (1978); Norton, *supra* note 9, at 383-44; SORNARAJAH, *supra* note 6, at 8-20.

<sup>41</sup> P. SAUNDERS & C. HARRIS, *PRIVATISATION AND POPULAR CAPITALISM* (Open Univ. Press, Buckingham, 1994).

<sup>42</sup> Under Article X of the US-UK Economic Cooperation Agreement of 1948, either of the contracting parties may espouse the claims of its national against the other party arising from contracts or concessions either before the ICJ or any other mutually agreed dispute settlement tribunal. See UN Treaties Series, 1948, p. 263.

<sup>43</sup> FOIGHÉL, *supra* note 4; Rudolph Dolzer, *Expropriation and Nationalisation*, 8 ENCY. PUB. INT'L L. 214 (1985); R. LILICH, *THE HUMAN RIGHTS OF ALIENS IN CONTEMPORARY*

re-nationalization of the privatized utilities would have been perfectly legal, provided full compensation was paid (although considerable difficulties would be encountered in determining the amount of compensation). But the UK government's windfall tax was a much less intrusive measure. It left proprietary title intact, and so far no evidence has surfaced indicating that such a tax would have been tantamount to expropriation. There is, however, the concept of "confiscatory taxation" and "creeping expropriation".<sup>44</sup> In essence, taxation so extensive it is equivalent to confiscation taxation which more or less taxes away the economic value of the asset at issue. This is "tantamount" to expropriation.<sup>45</sup> The idea is that a state can not circumvent the nationalization/compensation rule by depleting the economic value of an asset while merely leaving title and the formal trappings of legal ownership intact. For example, the US-Iran claims tribunal decisions have clarified that a state action -- even if formally only of a regulatory character and not a formal "taking" away of the proprietary title -- can amount to confiscation invoking the obligation to pay full compensation.<sup>46</sup>

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INTERNATIONAL LAW (Manchester Univ. Press, Manchester, 1984); L. SOHN & R. BAXTER, RECENT CODIFICATION OF THE LAW OF STATE RESPONSIBILITY TO INJURIES TO ALIENS (Sijhoff, Leyden, 1974).

<sup>44</sup> Burns Weston, "Constructive Takings" under International Law: A Modest Foray into the Problem of "Creeping Expropriation", 16 VA. J. INT'L L. 103, 106 (1975); see also HIGGINS, *supra* note 5, at 322-54; PETER MUCHLINSKI, MULTINATIONAL ENTERPRISES AND THE LAW 501-02 (1995); CYNTHIA WALLACE, LEGAL CONTROL OF THE MULTINATIONAL ENTERPRISE 259 (1982); G. C. Christie, *What Constitutes a Taking of Property Under International Law?*, 1962 BRIT. Y.B. INT'L L. 307, 307.

<sup>45</sup> In *Revere Copper & Brass, Inc. v. U.S. Inv. Guar. Program* (1978) (Am. Arb. Assoc.), 17 I.L.M. 1321, the tax increase was not in itself found to be expropriatory but breached a stabilization clause; see also *Anaconda Co. v. Overseas Private Inv. Corp.*, 59 I.L.R. 406 (U.S., Arb. Trib. 1975) (concerning an insurance coverage dispute after the Chilean government nationalized the copper mining industry and canceled its contract with Anaconda). But in the unpublished case of *Renolds Metals Co. (Guyana) v. Guyana*, the tax increase (in the form of a bauxite levy imposing a 1,630 percent increase over existing tax levels -- i.e. an increase from \$0.68 per ton to \$11.16 per ton) was in itself found to be expropriatory even though it was one of a series of actions taken by the government against the project. See also *Kugele v. Polish State* (Upper Silesian Arb. Trib. 1932); *Corn Prod. Ref. Co. Claim*, decision of the US International Claims Commission (1951-4); J. Gillis Wetter & Stephen Schwebel, *Some Little Known Cases on Concession*, 1964 BRIT. Y.B. INT'L L. 183, 201 (discussing *Hellenic Elec. Rwy. Ltd. v. Greece* -- the Ten Lepta Charge Case of 1930 deciding "whether the tax exemption clauses contained in the convention of 1925 exempted the Company from the payment of a special charge on railway tickets imposed by a Greek law of 1929."); ALBRECHT, *supra* note 3, at 171-75; VAN RAAD, *supra* note 3, at 26-27.

<sup>46</sup> See CHARLES BROWER & JASON BRUESCHKE, THE IRAN-US CLAIMS TRIBUNAL, 369-612 (1988); GEORGE ALDRICH, THE JURISPRUDENCE OF THE IRAN-US CLAIMS TRIBUNAL, 171-276 (1966); Kolo, *supra* note 1, at Ch. 3-4. See e.g. *Starrett Hous. Corp. v. Iran*, 4 Iran-U.S. Cl. Trib. Rep. 122 (1983); *Tippets v. TAMS-AFFA Consulting Eng'r of Iran*, 6 Iran-U.S. Cl. Trib. Rep. 219 (1984); *Phelps Dodge Corp. v. Iran*, 10 Iran-U.S. Cl. Trib. Rep. 121 (1986); *Harza Eng'g Co. v. Iran*, 1 Iran-U.S. Cl. Trib. Rep. 499 (1982).



Modern views, including those of the British Judge at the International Court of Justice, Rosalyn Higgins, or the former German Chancellor's adviser and Professor at Bonn, Rudolf Dolzer, emphasize that taxation can be considered as a measure equal to nationalization if it is particularly intensive, arbitrary or discriminatory, or if agreements made with investors are then in effect ex-post and unilaterally revoked by the succeeding government.<sup>47</sup> One interesting European Court of Human Rights case is the Greek Stran Refineries case of 1994 that involved an element of a retroactive cancellation of a government contract combined with other elements of arbitrariness and government behavior against legitimate expectations, led to substantial damages.<sup>48</sup> It is here that one can not exclude that a challenge of the UK windfall tax may have some chance of success: While the windfall tax is unlikely to destroy the economic asset value altogether, there may be elements, such as the retroactive cancellation of the privatization deals of the prior government that could cause an international tribunal to modernize the conventional principles of international investment law and find for the affected investors. The argument would probably be the following: if a full-fledged nationalization requires full compensation to be acceptable, then governments can not bypass this principle by taking a part of the value by special ad-hoc taxation without paying a pro-rata, proportionate share of compensation. Also, the principle of proportionality (equally recognized in the European Convention on Human Rights,<sup>49</sup> EC law<sup>50</sup> and international law) suggests that the energy policies pursued by the UK government may be achieved

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The only case decided by the Iran-U.S. Tribunal that relates to taxation is *Too v. Greater Modesto Ins. Assoc.*, 23 Iran-U.S. Cl. Trib. Rep. 378 (1989) (holding that the internal revenue service's auctioning of the claimant's business in order to satisfy his lawful tax obligations was a legitimate exercise of the police power of the state, thus it was not confiscatory).

<sup>47</sup> See HIGGINS, *supra* note 5; Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REV. FOREIGN INVESTMENT L. J. 41, 41 (1986); Ignaz Seidl-Hohevelde, *Semantics of Wealth Deprivation and Their Legal Significance*, in FOREIGN INVESTMENT IN THE PRESENT AND A NEW INTERNATIONAL ECONOMIC ORDER 218, 238 (D. Dicke ed., 1987).

<sup>48</sup> 19 Eur. Ct. H.R. (ser. A) at 293 (1995). A parallel analogy might be drawn (based on the similar common law tradition between Britain and the United States) from the U.S. Supreme Court decision in *United States v. Winstar Corp.*, 518 U.S. 839 (1996) (where "the Federal Savings and Loan Insurance Corporation lacked the funds to liquidate all of the failing thrifts during the savings and loan crisis of the 1980's").

<sup>49</sup> See *The James Case*, *supra* note 26, at 456; *Handyside v. United Kingdom*, 24 Eur. Ct. H.R. (ser. A) (1976); ROSALYN HIGGINS, *PROBLEMS AND PROCESSES*, 235 (1994) (discussing the *Handyside Case*); VAN JIDK, *supra* note 26, at 632-35, 640-43; SCHWARZE, *supra* note 27, at 704-7.

<sup>50</sup> See Case 11/70, *Internationale Handelsgesellschaft mbH v. Einfuhr- & Vorratstelle fur Getreide & Futtermittel*, 1970 E.C.R. 1125, 1972 C.M.L.R. 255; Case 114/76, *Bela-Muhle Josef Berfmann KG v. Grows-Farm GmbH & Co. KG*, 1977 E.C.R. 1211, 2 C.M.L.R. 83 (1979); SCHWARZE, *supra* note 28, at 708-866.

<sup>51</sup> Note also the references to a "partial expropriation" in ECHR cases discussed in Condorelli, *op. Cit.* at p. 981.

in a less damaging way by changing the regulatory regime, rather than by the blunt tool of a special ad-hoc industry tax.

To sum up the position of international customary law, there is a classical view according to which taxation forms the core of sovereign powers and can not be constrained by international obligation. A modern view, however, less emphasizes the formal action of government than the economic and financial effect it has achieved. Here, taxation, particularly if depriving an investor of the economic value of his asset or if aimed at revoking a previous agreement resulting in legitimate expectations, can be seen as the equivalent of nationalization. Foreign, not national, investors could, under the sponsorship of their home governments, claim compensation equal to the value of the special tax.

A key question in this context is whether there was some sort of agreement between the government and the foreign investors. While British law tends to take a very restrictive view on the legal force of agreements with governments purporting to bind future governments (based on the notion of Parliamentary supremacy)<sup>52</sup> international lawyers are likely to give much more weight to such agreements.<sup>53</sup> There are arbitration cases before the World Bank's ICSID tribunal, where even Ministerial declarations, governmental investment prospectuses and similar promotional literature were held to have led to an agreement between government and investor.<sup>54</sup> An international tribunal would therefore scrutinize closely the promotional literature used during the British privatization campaigns to see if there was an identifiable "agreement" which would make a subsequent special industry windfall levy inconsistent.

This interpretation is not as far-fetched as it may seem on first glance: The current windfall levy was not the first case of its kind. In 1974-75, the then Labor government first intended to nationalize the largely US-owned offshore oil industry. When faced in informal consultations with the US government with reference to the International Court of Justice and international law requirements of full compensation, it decided to back-pedal and use the somewhat softer option of somewhat coercive

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<sup>52</sup> See *Rederiaktiebolaget Amphitrite v. the King (the Amphitrite Case)*, 3 K.B. 500, 503 (1921).

<sup>53</sup> R. W. Benthall, *The Acquisition of Natural Resources Interests by the State in the United Kingdom and in International Law*, 5 J. ENERGY NAT. RESOURCES & ENVTL. L. 49, 55 (Dec. Supp. 1986).

<sup>54</sup> See *S. Pac. Properties (Middle East) Ltd. v. Egypt*, 1991 (16) Y.B. COM. ARB. 16 (Int'l Council Com. Arb. 1991) (an unpublished case postponing judgment until a court ordered expert can assess the valuation of the properties and potential damages), *amended by S. Pac. Properties (Middle East) Ltd. v. Egypt*, Case ARB/84/3 ICSID (W. Bank 1992), 8 ICSID REV. FOREIGN INVESTMENT L.J. 328 (1993) (awarding claimants the sum of US \$27,661,000); see also Georges Delaume, *The Pyramids Stand—The Pharaohs Can Rest in Peace*, 8 ICSID REV. FOREIGN INVESTMENT L. J. 231 (1993) (discussing *S. Pac. Properties (Middle East) Ltd. v. Egypt*).

renegotiations (sale of participation to the then established British National Oil Company) and institution of a new tax -- the Petroleum Revenue Tax (PRT).<sup>55</sup> While there is not much analysis and little historical record available so far, it does seem that US representations based on international law concepts induced the British government to institute a less intrusive measure than was originally planned. But there is not only customary international law, arguable in intergovernmental diplomatic discussions and before the International Court of Justice, to rely on. All learned commentators so far have ignored that Britain signed in 1994 -- with 48 other countries and the European Communities -- the Energy Charter Treaty in Lisbon. This Treaty includes the so far most comprehensive, far-reaching and innovative regime for protecting foreign investment in the energy sector.<sup>56</sup> The Treaty was -- for US energy investors in the UK very regrettably -- not signed by the US, but by the EC countries. EC-originating investment in the UK energy sector (*i.e.* not water or telecommunications) is therefore protected under this Treaty. We consider that there is nothing in UK law which would keep a UK government from committing itself -- validly under international law -- to assume the investment guarantees of the Energy Charter Treaty in favor of foreign investors. If this view is accepted -- and the judges would not be H.M. judges, but international arbitrators in an independent setting -- then the Treaty would be fully applicable to the windfall tax on energy companies owned by foreign investors.

#### VII. WHAT IS THE PROTECTION AFFORDED BY THE 1994 ENERGY CHARTER TREATY?

Not surprising given the sovereignty-focus of most governments, taxation (on capital and income presumably covering the windfall tax) is largely -- but not fully -- excluded from the Treaty's scope (Article 21) -- except for an explicit reference to "confiscatory taxation" (Articles 21-13). It would be up to the arbitrators to determine at which level of intensity and scope a tax becomes "confiscatory." The windfall levy did not seem to take away the full economic value of the assets at issue; however, its character of being, at least in intent and target, retroactive, its special-industry character intended to effectively ex-post re-determine unilaterally the sales price of UK privatization's and, possibly, its contravention of -- possible -- promises made by H.M. government during the privatization campaigns does lend itself to argument that such tax would be tantamount to expropriation,<sup>57</sup> in particular with the view in mind that full-scale

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<sup>55</sup> CAMERON, *supra* note 18, at 98-99, 116-37; HIGGINS, *supra* note 5, at 349-52; Bentham *supra* note 53; Daintith & Gault, *supra* note 18, at 36-37.

<sup>56</sup> See Waelde, *supra* note 9.

<sup>57</sup> Kyle D. Logue, *Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment*, 94 MICH. L. REV. 1129 (1996); Jim Rossi, *The Irony of*

nationalization requires full-fledged compensation and that such rule should not be undermined by the circuitous tax route. There are, naturally, arguments to the contrary, namely that investors who bought UK energy shares knew -- or should have known -- that the UK government could not commit its successors and that the vociferous opposition of the then opposition Labor Party constituted a political risk that might materialize in the future.<sup>58</sup>

A second argument (apparent now that the windfalls tax is known) is that the tax is actually not a "tax on capital/income," but rather on value appreciation. If this is so, then other provisions of the ECT (Article 10), in particular compliance of commitments entered with investors and non-discrimination are applicable.<sup>59</sup> While it seems harder to make a case for non-discrimination, it seems easier to make a case that in essence a commitment -- the sale at a specific price -- is breached and changed retroactively.<sup>60</sup>

Whatever the legal merits of this argument -- likely to be advocated by opponents of the tax and to be criticized by its supporters -- the fact is that the Energy Charter Treaty provides (Article 26) for a direct right of aggrieved foreign (member state) investors to litigate against the defendant government before an international arbitration tribunal, where traditional notions of Parliamentary supremacy are likely to have less weight than the values of international trade and commerce, namely sanctity of property and contract.<sup>61</sup>

#### VIII. CONCLUSION: MANAGING THE POST-PRIVATIZATION POLITICAL RISK

Our discussion has identified the considerable political risk faced by a foreign investor when buying into privatization when and if the privatized assets turn out to be profitable. It is easy to construct the "excess profit" notion when the risk that was present during the privatization process is ignored and when only subsequent developments, and not the risk nor failures in other cases of such investment are taken into account. Behind investment into privatization is often a quite narrow perspective -- fueled by the promoters and advisers of such deals -- which downplays the

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*Deregulatory Takings*, 77 TEX. L.REV. 297 (1998) (book review); *contrast with* Saul Levmore, *The Case for Retroactive Taxation*, 22 J. LEGAL. STUD. 265 (1993).

<sup>58</sup> *Where the Windfall Blows*, THE ECONOMIST, July 5, 1997, at 58 ("Nobody doubted that a windfall tax on the 'excess' profits of the privatized utilities, to pay for a welfare-to-work programme, would be the centerpiece of Labour's first budget. The only questions were how much it would raise and which companies would pay it."); Currie, *supra* note 10; Chennells, *supra* note 10.

<sup>59</sup> Paasivirta, in Waelde, *supra* note 9, at 349-64.

<sup>60</sup> See The Greek Stran Refineries Case, *supra* note 48.

<sup>61</sup> Paulsson, in Waelde, *supra* note 4, at 422; Thomas W. Waelde, *Investment Arbitration Under the Energy Charter Treaty from Dispute Settlement to Treaty Implementation*, 12 ARB. INT'L. 429 (1997).

considerable political risk. In modern energy privatization, the risk is in subsequent changes of regulatory regimes and in the use of taxation to re-define unilaterally the original deal. Traditional international law is not equipped to deal with these risks since its focus was exclusively the issue of nationalization and compensation. But modern concepts of international law have evolved to cover under the quite open-ended concept of "creeping expropriation" many more economic assets against a much more diverse form of state intervention. These concepts are likely to evolve further, in particular as indicated by the innovative direct investor-state arbitration (without prior arbitration agreement) of the 1994 Energy Charter Treaty.

But whatever the status of the still -- and as a rule belatedly -- evolving international law,<sup>62</sup> privatization investors would do well to pay more attention to methods of managing such risk. Some are legal: obtaining clear legal guarantees, enforceable before international tribunals, against unilateral future changes of deals made by governments; shifting the burden of regulatory and special-tax risk on local partners who may be more suitable for assuming such risk (ideally a state company -- but its halcyon days have gone). The UK windfall tax will undoubtedly contribute to new methods of political risk management aimed at dealing with this particular and possibly in the future not unpopular device of partially re-writing the terms of privatization. A particular device would be the extensive use of "stabilization" clauses and specific investment agreements, subject to international arbitration, to secure a foreign investor against subsequent abrogation of its rights -- simultaneously a method whereby a current can impose a lasting commitment on its successor,<sup>63</sup> a thought that is quite inconsistent with the traditional UK notion of "Parliamentary Supremacy." One wonders if the 1994 Energy Charter Treaty was not a device for many governments to create a lasting international commitment binding its successors, even if not always agreeable to its international business deals.

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<sup>62</sup> Datty & Boscariol, *supra* note 11.

<sup>63</sup> Thomas W. Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 TEX. INT'L. L.J. 215 (1996).