Unbundling legal questions for the future – EC Law constraints and prospects

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1. Introduction

This is very much a “work in progress”: both the liberalisation project in the utilities sector and this paper addressing the legal issues that may be raised by questions of ownership unbundling.

2. Current position under the liberalisation Directives

2.1 Legal requirements under the EC legislation:

2.1.1 Legal, organisational & managerial separation (Arts. 10 & 15 (Elec.), Arts. 9 & 13 (Gas))

2.1.2 ‘Code of conduct’ (Art. 10(2) (Elec.), Art. 9(2) (Gas))

2.1.3 Confidentiality requirements (Art. 12 (Elec.), Art. 10 (Gas))

2.2 Basic state of play on implementation of these requirements by the Member States

3. A move to ownership unbundling?

3.1 Why might this be desirable?

- practical experience: e.g. UK Telecoms – questions of new market entry and (perceptions of) trust in the level(ish) nature of the playing field …

- see the recent Dutch proposals on unbundling in the energy sector: the Dutch government view is that the following benefits will accrue from mandating ownership unbundling of the transmission resource:

→ Improved security of supply, with independent network companies having greater focus on their core tasks and on quality, and with increased room for


2 This summary is gratefully drawn from De Brauw Blackstone Westbroek’s ‘Legal Alert – Separation of Energy Activities – Bill before Parliament’ (September 2005).
national management. The Government argues that the market for production is working efficiently and there is sufficient production capacity to ensure security of supply in that sense. It states that the combination of the previous legislative measures and the current proposals will now provide adequate security in terms of quality network provision;

→ Increased transparency, in particular regarding prices. More effective supervision will be possible by the regulator, but – importantly – without the need for heavier regulation;

→ Greater competition between commercial companies in the future. The key arguments are that there will be a level playing field, no possibility of cross-subsidisation between network and other activities and no room for unfair discrimination;

→ Splitting off network management activities will allow public shareholders in vertically integrated companies to sell their shares in the riskier commercial energy activities.

3.2 Why has this move not been made across the EC so far?

3.2.1 Outline of reasons given (by Commission) and mooted (by commentators)

3.2.2 Political problems

3.2.3 Legal restrictions … ?

This remainder of this paper will focus upon some of the legal issues to which such unbundling (and its absence) may give rise.

4. Forcing ownership unbundling through legislation

4.1 Legislation to be adopted at the EC level

4.1.1 EC competence to adopt such measures?

4.1.1(a) Treaty basis

The EC Treaty operates using a system of conferred (or attributed) competence: thus, for the EC’s legislative organs to be able to act in this field, an appropriate legal basis must be established. Here, the likely candidates are Articles 94 and 95 EC, although any element that does not relate strictly to the establishment of the internal market might be possible under Article 308 EC (implied powers to achieve EC objectives, where no specific power is clearly provided).³

³ For a recent ECJ judgment on the question of whether a measure is really aimed at achieving an
Note that this question could have been given a more straightforward and definitive answer had the Treaty Establishing a Constitution for Europe (TCE) been ratified and entered into force, due to its proposed introduction of a specific Treaty basis for the adoption of measures in the energy field.4

“Article III-2565

1. In the context of the establishment and functioning of the internal market and with regard for the need to preserve and improve the environment, Union policy on energy shall aim to:

(a) ensure the functioning of the energy market;

(b) ensure security of energy supply in the Union, and

(c) promote energy efficiency and energy saving and the development of new and renewable forms of energy.

2. Without prejudice to the application of other provisions of the Constitution, the objectives in paragraph 1 shall be achieved by measures enacted in European laws or framework laws. Such laws or framework laws shall be adopted after consultation of the Committee of the Regions and the Economic and Social Committee.

Such European laws or framework laws shall not affect a Member State’s right to determine the conditions for exploiting its energy resources, its choice between different energy sources and the general structure of its energy supply, without prejudice to Article III-234(2)(c).6

3. By way of derogation from paragraph 2, a European law or framework law of the Council shall establish the measures referred to therein when they are primarily of a fiscal nature. The Council shall act unanimously after consulting the European Parliament”.

4 Under the approach of the TCE, the energy field would have been a field of shared competence, within the meaning of the current Article 5 EC: thus, the principle of subsidiarity would have applied here too: see Article I-11 TCE, discussed in Dashwood & Johnston (2004) 41 C.M.L.Rev. 481.

5 Compare the current Article 3(1)(u) EC on “measures in the sphere of energy” and the absence of any specific section on energy in the current EC Treaty.

6 Which preserves a requirement that the Council agree unanimously when voting on “measures significantly affecting a Member State’s choice between different energy sources and the general structure of its energy supply” (see above for the full text).
4.1.1(b) Treaty constraints

(i) Article 295 EC: national systems of property rights

- “This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership”.

- does this prevent the EC from legislating so as to require Member States to secure the unbundling of transmission assets from vertically integrated utilities?

- it is dangerous to attempt to hang too much of the analysis upon this broad and vaguely phrased provision. One example of the kind of national provision that would be safeguarded by Article 295 EC would be one which prevented “common land” from passing into private ownership. Similarly, to require as a matter of EC law that ownership of a transmission asset must pass into private ownership when unbundled would also seem to be questionable. But unbundling can be required without specifying that the subsequent owner of the asset must be a private undertaking.

- Equally, maintaining such an asset in public ownership may subject the rules surrounding its future operation to other constraints (e.g. the extent to which the government-set rules satisfy the norm of Articles 3(1)(g), 10 and 81 and/or 82 EC, that Member States are obliged not to introduce or maintain certain provisions that distort the competitive process, except insofar as these are justified under EC competition law. Further constraints may be imposed by the application of general EC law: see the points raised in section 5, below.

(ii) Article 5 EC: Subsidiarity and proportionality

- even if the adoption of legislation requiring ownership unbundling is within the scope of the EC Treaty and not precluded by Article 295 EC, the questions must still be asked whether or not the EC level is the appropriate one for the adoption of such legislation. Further, the question of whether or not a requirement to unbundle ownership of transmission resources is a proportionate response to the problems raised by the absence of such unbundling must also be addressed.

- see Article 5 EC:

  “The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein.

  In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed

7 For discussion, see (e.g.), Gyselen (1993) European Law Review Suppl. (Competition Law Checklist) CC55, esp. at CC58; see further Johnston and Slot, Introduction to Competition Law (Hart Publishing, Oxford: 2006 (forthcoming)), paras. 7.1-7.4 (available from the author on request in draft form).
action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.

Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty”.

- this analysis requires, at the political level, serious consideration to be given to:

→ the suitability of adopting such a measure as mandating ownership unbundling at the EC level: can the objectives not be sufficiently achieved at Member State level, and thus, due to the scale/effects, be better achieved at EC level? [Subsidiarity]

→ whether or not the goal to be achieved might not be satisfied by measures less far-reaching than ownership unbundling. [Proportionality]

- from an ex post, judicial review perspective, it should be noted that the approach that the ECJ has taken to the review of the validity of legislation on the basis of subsidiarity has been very much a “hands-off” and “light touch” one. If the legislation explains the reasons behind the need for EC level, and it is clear that the issue has been considered during the decision-making process, then the ECJ has been very unwilling to enquire into the EC legislature’s motivations and detailed reasons/evidence for deciding that EC level action was necessary. If the legislation explains the reasons behind the need for EC level, and it is clear that the issue has been considered during the decision-making process, then the ECJ has been very unwilling to enquire into the EC legislature’s motivations and detailed reasons/evidence for deciding that EC level action was necessary.8 It is worth noting that the TCE would have introduced a stronger subsidiarity regime, involving national parliaments more closely in the process of deciding whether or not EC level action would be appropriate and necessary.9

4.1.1(c) Fundamental rights (FRs) constraints

(i) EC level:

- FRs and principles developed under the European Convention for the protection of Human Rights and Fundamental Freedoms (ECHR) by the European Court of Human Rights (ECtHR) in Strasbourg:

→ Why is the ECHR and its case law relevant to EC legal position?

The ECJ has developed its jurisprudence on this question over the years (arguably largely in response to concerns expressed at

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9 See the discussion in Dashwood & Johnston (2004) 41 C.M.L.Rev. 481.
national level that the process of scrutiny and judicial review of the legislative competence of the EC did not take sufficient care in respecting FRs arguments). It has created a linkage between the ECHR and its case law, on the one hand, and the EC legal order, on the other, by the device of ‘general principles of EC law’, drawn from and inspired by the common constitutional traditions of the EC’s Member States. 10 One of the few clearly consistent elements in those traditions is the membership of the Council of Europe and its ECHR: as a result, the case law developed by the ECtHR has become an important source of inspiration for the ECJ and CFI in their development of FRs protection within the EC

→ Right to property (Art. 1, First Protocol ECHR): see Annex I for the text of this provision (and the corresponding terms of Article 17 of the EU’s Charter of Fundamental Rights).

- linkage to stranded costs issues

→ Note that the rationale underlying the fundamental rights analysis under the ECHR (mirrored in many national systems) is very similar to the basis upon which claims to recover stranded costs have been developed and subsequently analysed under EC law in the state aids field. 11

(ii) Analysis of the ECHR case law to date on the right to property: see Annex I for discussion.

(iii) National level?

- note the extensive case law (both national and before the CFI and the ECJ) on question of EC law’s respect (or otherwise) for nationally protected fundamental rights: in particular, the saga of bananas, German suppliers and the EC’s Common Market Organisation Regulation for bananas. 12

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11 See Commission Communication relating to the methodology for analysing State aid linked to stranded costs (26 July 2001), which document is available on the internet at the following web address: http://www.europa.eu.int/comm/competition/state_aid/legislation/stranded_costs/en.pdf. See further the brief article by Allibert in the Commission’s Competition Policy Newsletter, Number 3, October 2001, pp. 25-27, discussing the Decisions taken by the Commission on the applications by Austria, Spain and the Netherlands.

12 For discussion, see Everling (1996) 33 C.M.L.Rev. 401.
4.1.2 National constitutional constraints (connected to 4.1.1(c)(ii), above, and 4.2, below)

While there is no space here to go into the detailed constitutional protection of property rights in all EU Member States, it is clear that some require greater justification of any interference with property rights (and provide stronger protection against state action in this regard) than others. Further, issues relating to property rights have the propensity to raise serious questions at national level as to whether or not the EC’s respect for fundamental rights is sufficiently extensive to allow the application of EC law in situations where the national constitutional rules would have prevented any such legislation being adopted at national level. I.e., the argument is that, in joining the EU, the national government (and legislature upon ratification) could not give away powers to the EC that it did not itself hold according to the national constitution (see, e.g., the famous ‘Maastricht’ Decision of the Bundesverfassungsgericht).13

4.1.3 Resulting EC level political constraints

- Decision-making process, involvement of Member State governments (Council), lobbying of European Parliament and Commission by interest groups.

- Roles of Florence and Madrid Fora, and the new regulators’ group (ERGEG), feeding into EC rule-making?

4.2 Legislation to be adopted at the national level

4.2.1 Fundamental rights and national constitutional issues (tie-in to stranded costs questions)

Again, there is no space here to conduct a detailed examination of the FRs issues concerning the right to property that will arise in every EC Member State. However, a reasonable proxy can be provided by the analysis of the ECHR case law (above), given that all EC Member States are also signatories to the ECHR and accept the jurisdiction of the ECtHR in determining claims against the State by individuals concerning the State’s respect for the legal principles laid down by the ECHR.

4.2.2 Free movement of capital

See, e.g., the concerns of the Dutch Council of State (Raad van State) (17 June 2005) during ongoing legislative process involving the so-called “Separation Bill” (presented to the Dutch Parliament on 30 August 2005).14

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14 All quotes in this section are taken from De Brauw Blackstone Westbroek’s ‘Legal Alert – Separation of Energy Activities – Bill before Parliament’ (September 2005).
“the requirement to separate is a restriction on the free movement of capital between Member States under Article 56 of the EC Treaty. This is on the basis that, although not directly discriminating in terms of nationality, it limits investors from other Member States from combining investments in network management and production and supply and it places limitations on the ability of the present shareholders to sell shares to (foreign) private investors.15 … [P]ointing to case law of the European Court of Justice, the Council considered that the requirement could fall under a rule of reason (general interest) exception if it also conforms to the requirements of necessity and proportionality. It advised that further arguments were necessary to demonstrate why measures beyond those in the [existing legislation] were necessary”.

The Dutch Government, however, is satisfied that no problems will arise in this area:

“The Government has presented in the explanatory memorandum (29 August 2005) arguments for its position that the bill does comply with EC law. The view is that separation is not problematic as in particular:

- Independent network management and transparency are goals of the EC energy directives.

- Under the second energy directives Member States can take measures going beyond legal separation of activities.

- The requirement that network companies must not belong to a group involved in production, supply or trade does not restrict foreign investors any more than it places restrictions on Dutch-based companies. Furthermore, the requirement operates in the general interest.

- The separation proposal in fact reduces the effect of the current ban in the Electricity and Gas Acts on selling shares in network managers, as that ban has a wider effect in the context of a vertically-integrated energy company.

The Government also remarks that Article 56 EC on free movement of capital is not relevant until privatisation of the network manager comes into play, at which point the shares would come onto the commercial market; and privatisation is not proposed in the text of the bill. The Government's position is that, in practice, separation (and also privatisation) will actually remove restrictions on free movement of capital”.

15 Surprisingly, the Council does not elaborate as to whether Article 56 EC is in fact applicable: the companies concerned are not privately owned and the separation requirement is arguably covered by the freedom of Member States to regulate the ownership of companies (Article 295 EC).
5. Legal constraints and issues where ownership unbundling is not required by (EC or national) legislation

One way of looking at the matter, if there is a desire to secure ownership unbundling, is to consider how the pre-existing regulatory and general legal framework might impose constraints upon the operations of vertically integrated undertakings, to the extent that it may become more attractive to unbundle ownership of transmission.

Another important perspective concerns those other private parties that may seek to challenge the justifiability of the activities of a vertically integrated undertaking under competition law, or other trade law provisions. Here, one key consideration is whether or not these provisions may be enforced by one private party against another: to answer this where EC law is involved, an appreciation of the scope of the doctrine of direct effect is required and its operation where different types of provision are concerned.

5.1 Competition Law (EC and national systems)

5.1.1 Merger control

5.1.1(a) Prohibition of mergers involving vertically integrated undertakings

Where it is thought that allowing a merger involving such an undertaking might lead to competition difficulties, it is open to the Commission to prohibit it from being implemented under the EC Merger Control Regulation 139/2004/EC (ECMR).

5.1.1(b) Attaching conditions to approval of such mergers (including divestiture of assets)

- A good illustration of this phenomenon is the EDF/EnBW merger, in which the Commission required that EDF sell off Compagnie Nationale de Rhône (including its electricity generation assets on the Rhône river barrage system) as a condition of EDF being allowed to acquire the stake in EnBW.

- National merger control law may also relevant:

  - Particularly so where the relevant merger control thresholds for the application of the ECMR are not met, or where the Commission refers a merger down to the national merger control authorities (Article 9 ECMR);

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16 On which, see generally C.A. Jones, Private Enforcement of Antitrust Law in the EU, UK and USA (1999).
17 On this topic, see Craig & de Búrca, EU Law: Text, Cases, and Materials (3rd edn., 2003), ch. 5.
19 Case No. COMP/M.1853, EDF/EnBW (7 February 2001) (available on the internet at the following web address: http://www.europa.eu.int/comm/competition/mergers/cases/index/m37.html#m_1853 (last visited 4 October 2005)).
- this point is underlined by national merger laws that contain provisions allowing intervention on public interest grounds: while such provisions in the UK have rarely been used,\(^{20}\) where important infrastructural questions are involved in a merger this might be one of those rare occasions where such powers were called into action.\(^{21}\) Similarly, these questions may be sufficient to encourage the national authorities to request that the Commission should refer a case ‘down’ (under Article 22(3) ECMR) to the national merger control body, even where the merger’s size has ensured that it had met the thresholds for the application of the EC regime.

5.1.2 Antitrust law

The key systemic point here is that private parties may rely directly upon competition law rules before national courts, and can now (under Regulation 1/2003/EC) call upon NCAs to enforce these rules too. This fact of possible private enforcement of the competition rules against vertically integrated entities must not be forgotten in the assessment of the regulatory environment that is now in place, regardless of whether or not future legislation mandates full ownership unbundling.

To this, we must add the application of national competition law where there is no impact upon inter-Member State trade: to take the UK as an example, its national competition law is now strongly based upon the EC regime and is relatively favourable to private enforcement too. Here, again, both the OFT and private parties may seek to enforce UK competition law, whether administratively or before the national courts.\(^{22}\)

Finally, the new enforcement powers granted to the Commission by Regulation 1/2003/EC include the option for the Commission to impose structural remedies (Article 7). Recital 12 to Reg. 1/2003/EC states that “Structural remedies should only be imposed either where there is no equally effective behavioural remedy or where any equally effective behavioural remedy would be more burdensome for the undertaking concerned than the structural remedy. Changes to the structure of an undertaking as it existed before the infringement was committed would only be proportionate where there is a substantial risk of a lasting or repeated infringement that derives from the very structure of the undertaking”. Note that the imposition of any such remedies must also satisfy the EC law general legal principle of proportionality, which may operate as a relatively strong brake upon the use of structural remedies by the Commission in this area. Arguably, the force of the proportionality point is strengthened still further by the existence of the current

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\(^{20}\) Indeed, even when the formal test referred to the “public interest”, successive Secretaries of State instead took a firm and consistent policy line that this was to be interpreted as a test based solely upon competition criteria: see, e.g., Rodger [1996] ECLR 104, who criticised UK merger policy (under the previous regime of the Fair Trading Act 1973) for its failure to take into account important regional economic considerations, instead subsuming them in the overall competition-based analysis.

\(^{21}\) In the current UK regime, the Secretary of State can add to the range of relevant public interest considerations by making an Order (approved by both Houses of Parliament), while the legislature can also add to the list of public interest matters by statute.

\(^{22}\) For further discussion, see Johnston and Slot, *Introduction to Competition Law* (Hart Publishing, Oxford: 2006 (forthcoming)), ch. 6 (available from the author on request in draft form).
unbundling provisions in the various liberalisation directives (see 2.1, above): if the EC legislature has already put in place a measure of separation of activities then it will take particularly clear and compelling evidence to show that this separation (combined with the exercise of the national regulatory function, as required by the latest energy directives) is not sufficient to address the competition concerns that might be raised.

5.2.1(a) Potential abuse of dominant position by refusal of access to essential facilities (cross-subsidisation questions, etc):

(i) strong link to effective implementation and enforcement of regulatory requirements in the relevant EC Directives etc (although these clearly do not exclude the continuing applicability of the competition rules);

(ii) while recent case law on the essential facilities concept has served to restrict its potential scope of application, it seems that its applicability to transmission-style assets will be difficult to challenge (although whether any given practice amounts to an abusive refusal of access is a different question, requiring analysis of the national regulatory regime when assessing the context in which access requests are made, granted and/or denied).

5.2.1(b) Other possible avenues of challenge

E.g. discrimination on terms granted, even if the regulatory system in question outlaws such practices, it may be that such things still occur in fact – if so, reporting the perpetrator to the regulator (or indeed the NCA) may achieve results, but if not then it is still possible that the threat of a suit in a national court may be a good lever for securing non-discriminatory terms and conditions.

Again, much here will depend upon the precise national level arrangements for the application of competition law (whether EC or national) within a regulated sector: some countries have adopted a model where the NCA and the sector regulator are concurrently competent to apply the competition rules, while others may allocate such competence to one or the other. Either way, so far as EC competition law is concerned, these administrative arrangements cannot deny a private party his action in court to vindicate his directly effective EC law rights.

5.2 Free movement rules

This issue has been raised in this area by previous actions brought by the Commission – e.g. concerning a range of import-export monopolies in the fields of electricity and

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gas in the *Energy cases* decided by the ECJ in 1997. These cases established a wider range of discretion for the Member States by reliance upon Article 86(2) EC as a ground for justifying such measures that restrict trade, although the extent to which this justification provides such a capacious range of discretion has been curtailed somewhat by the extension of the liberalisation directives in the energy sector, including their provisions concerning appropriate public service provisions.

However, other issues may be of significance here as well.

5.2.1 Free movement of capital

The flipside of the arguments raised in section 4.2.2., above, is that where a national system already allows for the private ownership of assets in the regulated sectors, any restrictions upon the free disposal of shares in such assets may breach the provisions on the free movement of capital. Care must be taken in the design of any system of ‘golden shares’ or other restrictions upon the alienability of both ownership and control of such assets, to ensure that the EC law provisions are respected.

5.2.2 Free movement of goods and freedom to provide services

This point is something of a fine one, but may nevertheless be of relevance in some instances. It is drawn from an analysis of the ECJ’s approach to restrictions upon advertising in the context of the free movement of goods: cases such as *De Agostini* and *Gourmet* suggest that advertising restrictions may fall foul of Article 28 EC where their practical effect is to deprive importers of goods produced outside the host Member State of opportunities to raise public awareness of the existence of their product, so as to break into a market. The rationale behind this analysis is the subject of heated debate in the free movement field, but I do not propose to enter into that discussion here. Instead, it should be highlighted that this argument may be relevant to rules that may flank and support the maintenance of vertically integrated undertakings.

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In *Gourmet*, for example, the rules under review concerned the near total ban on advertising of alcoholic beverages, except through the national alcohol monopoly. The result of the case was to hold that such a ban was in principle a restriction under Article 28 EC, unless there was a public interest reason that justified that ban, which showed that the ban was necessary to achieve that goal and that the ban was a proportionate means of achieving that goal. On the return of the case from the ECJ to the Swedish court, the national court found the ban to be disproportionate and thus unjustifiable in its then current extent. So far as the alcohol monopoly was concerned, this was not a finding that the monopoly itself was unlawful, but a requirement to amend the advertising ban does amount to undermining the overall economic basis of the monopoly to some extent. If the logic of the combined judgments of the ECJ and the Swedish courts takes as its premise that direct imports to consumers must be allowed to be facilitated via some form of direct advertising, then although the alcohol monopoly’s sole right to sell alcohol within Swedish territory remained, the genuine exclusivity of that right was undermined by the increased likelihood of direct imports for personal use, even though a further goal of the advertising was to encourage people to go to the Systembolaget shops and request a wider range of alcohol than might otherwise have been available had no such advertising existed.

In the regulated sectors, this argument may not often stretch very far, on the basis that there is no readily available alternative distribution channel for getting the ‘product’ to the consumer. Where some degree of network competition may be available (e.g. mobile telecoms networks) then the argument may have more mileage. However, the second limb of these cases, concerning the freedom to provide services, may be more significant: the reservation by the vertically integrated undertaking of the provision of services ancillary to holding such a position may be found to restrict the freedom of other companies to provide such services, where the Member State’s licensing rules make such service competition impossible or excessively difficult. Equally, such Member State provisions may amount to a breach of Article 86(1) EC in conflicting with the competition rules. Finally, if such practices are defended by abusive behaviour by a vertically integrated undertaking with a dominant market share in (e.g.) transmission, then the antitrust provisions discussed above (in section 5.1) may come into play.

6. Conclusions

The area is a complicated one and its development is clearly still in flux. Many of the issues raised here have yet to be applied carefully to the specific question of unbundling of ownership in any detail. My aim here has been to raise a wide range of the legal issues that will be relevant to developing a sensible, robust and legally sustainable approach towards the question of ownership unbundling in this field. The resolution of the issues raised here will be dependent upon the precise nature of the

models chosen by each Member State and, possibly, by the Commission should it choose to promote ownership unbundling at the EC legislative level. However, given the sensitivities that already exist at national level in a number of Member States about the process of liberalisation to date, it may be that it is rather over-optimistic to expect the Commission to champion such a potentially controversial cause in proposed EC legislation at this stage. As a result, the other measures available under EC and national for dealing with the consequences of the persistence of vertically integrated undertakings in the regulated sectors will remain of great importance for the foreseeable future.
ANNEX I


‘Protocol 1, Article 1 – Protection of Property

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.’

1(a) Introduction

In the U.K., the Human Rights Act 1998 (‘the Act’) was enacted ‘to give further effect to the rights and freedoms granted under the European Convention on Human Rights’. Among the ‘Convention Rights’ that it covers, the Act includes Article 1 of the First Protocol. Furthermore, it is clear from the wording of Article 1 of the First Protocol that legal persons may also rely upon its provisions (indeed, it is the only right in the Convention which is expressly conferred upon legal persons), provided that the company owning the property falls within the definition of a ‘victim’ of a breach of Human Rights. However, to establish whether the facts in a ‘stranded costs’ scenario do fall within Article 1 of the First Protocol, certain other elements must be considered.

32 It should be remembered that the Human Rights Act 1998 has carefully preserved Parliamentary sovereignty (see s. 4). This means that any national primary legislation can only be declared by a U.K. court to be ‘incompatible’ with the Convention Rights; this will not have the effect of making the legislation somehow void or unenforceable. However, it is also the case that the promoter of any legislation will have to make a declaration in the House of Commons that the legislation proposed is in conformity with the Convention, or (if not) to say where and why not. This forms an important part of the lobbying process in the negotiation, debate and eventual adoption of legislation by Parliament. So, despite the fact that the Human Rights law arguments which follow in this short paper will not enable a challenge to primary legislation, they may prove a powerful force in shaping the legislation before it reaches the statute book. Furthermore, the courts will be reluctant to make a declaration of incompatibility and will instead strive to interpret legislation (wherever possible) to be in compliance with Convention Rights.

33 See s. 1(1)(b) HRA 1998.

34 See s. 7(1) HRA 1998; in s. 7(7), ‘victim’ is defined as being a victim for the purposes of Article 34 ECHR, which requires the applicant to be ‘directly affected’ by the action of the public body in question. It is also worth noting that s. 7(1) allows an application to be made in anticipation that a certain course of action will make the applicant a ‘victim’ at a later date (viz: ‘if he is (or would be) a victim of the unlawful act). I am assuming here that there is no question of a shareholder trying to show victim status: in any case, it seems that the jurisprudence of the European Court of Human Rights in Strasbourg is generally not in favour of such a possibility – only in ‘exceptional circumstances’ will the Court countenance the ‘piercing of the corporate veil’ in this manner, such as where the company’s articles of association (or similar) would prevent the company from bringing an action in its own name). See, further, Agrotexim v. Greece (1996) 21 EHRR 250 (esp. at para. 66 of the judgment).
I(b) ‘Possessions’

This concept has a meaning autonomous to the Convention\(^{35}\) and has generally been construed broadly by the Court. It is clear that immovable and movable property are covered by Article 1, so, in the stranded costs situation,\(^{36}\) any investments in new plant (such as extraction or treatment facilities, or pipelines) will be protected by the Convention. Any issues of long-term contractual arrangements may prove slightly more difficult. In principle, an established interest with economic value is necessary, so that a legal right to receive a certain benefit may be sufficient, even if certain conditions must be satisfied; however, ‘mere expectations’ will not be sufficiently certain to qualify as ‘possessions’ under Article 1.\(^{37}\) An accrued claim for negligence, which was later removed by retrospective legislation, was held to be a ‘possession’ under Article 1\(^{38}\) and given that contractual rights have been held to fall within ‘possessions’,\(^{39}\) I would submit that such long-term contractual arrangements should also be so treated. Thus, it would appear that the likely subject matter of any stranded costs claim would count as a ‘possession’ under Article 1 of the First Protocol.\(^{40}\)

I(c) Which type of infringement?

It is important to identify precisely which type of infringement of the right to peaceful enjoyment of one’s possessions is in issue, because the analysis of how any such infringement may be justified is dependent upon the nature and extent of the infringement involved. Typically, the Strasbourg Court has begun by analysing whether the alleged infringement amounts to a deprivation or a control of the use of possessions; only if neither of these is satisfied does it go on to examine the more general rule concerning freedom from interference.

I(c)(i) Deprivation

The main test for ‘deprivation’ of property is the extinction of the owner’s rights in the property, usually by means of a legal transfer of those rights to another by operation of law or the exercise of a legal power to do so. It seems unlikely that such

\(^{35}\) See, e.g., Gasus Dösier-und Fördertechnik v. Netherlands (1995) 20 EHRR 403, para. 53. Thus, just because domestic law does not see a particular right as ‘property’ does not exclude the possibility that Article of the First Protocol may be applicable.


\(^{39}\) A, B and Company v. Germany (1978) 14 DR 146, at 168 (ECommHR).

\(^{40}\) Of course, without fuller factual details of any precise stranded costs claim, this conclusion must remain a provisional one.
a situation would arise in the context of stranded costs cases, unless the view were
taken that the only way to promote competition would be to force current incumbents
to transfer certain companies or assets to new market entrants. Such a move would be
a state act and would no doubt be laid down in the relevant legal framework (thus
satisfying the basic conditions for such a deprivation). However, even in this
hypothetical situation, the typical method would be to force the sale of such assets,
thus ensuring some form of compensation for the incumbent operator. The adequacy
of the compensation that such a method might provide falls to be considered below,
under the proportionality and compensation headings.

The Court has been prepared to countenance the possibility of a *de facto*
depredation: the substance of the matter will be examined to ascertain whether, in
spite of formal legal ownership or possession remaining with the applicant, the
practical consequence of the interference has been one of deprivation. However, the
Court has been extremely wary of finding *de facto* deprivation in the cases: only in
exceptional circumstances will it be made out, such as where coins had been
confiscated and held by police, without bringing charges against their owner. When
courts and government recognised the unlawfulness of the police action and that the
original owners had remained owners throughout the confiscation period, and yet
attempts to recover the coins failed in the national courts, the Strasbourg Court did
find there to have been a *de facto* expropriation. It is unlikely that such extreme
circumstances would obtain in the stranded costs scenario.

Thus, I will assume that ‘deprivation of property’ is unlikely to be a plausible
scenario and will focus upon less extreme forms of interference in what follows.

1(c)(ii) Control of use

The distinction between ‘deprivation’ and ‘control of use’ infringements can often be
an untidy one, but is important due to the different approaches taken to the issues of
proportionality and compensation under these two headings. Use of property may be
controlled either by imposing positive requirements upon individuals to act in a
particular way with regard to their property (such as requiring the planting of trees to
promote environmental protection) or by restricting the activities of individuals
(such as planning controls and environmental orders).

An example of particular relevance to the stranded costs situation is that of the
economic regulation of the professions, which was found by the European
Commission on Human Rights to be a control of the use of possessions. Similarly,
the revocation of licences which affect business interests\(^{45}\) may also amount to a sufficient interference by control of use: e.g., the revocation of a licence to sell alcoholic beverages in a restaurant\(^{46}\) or the revocation of a licence to extract gravel.\(^{47}\) It may be argued that these situations are analogous (or at least sufficiently similar in nature and outcome) to be applied to the stranded costs scenario, where (for example) the use of plant in which investments had been made under different regulatory assumptions is now rendered highly uneconomic, because of levels of price and/or conduct regulation that will be introduced. I would tentatively submit, therefore, that the stranded costs fact scenario would be most likely to amount to an interference with possessions in the form of a control of their use, imposed by the state in the form of legal provisions.

1(c)(iii) Interference with peaceful enjoyment

However, even if the foregoing analysis is not persuasive (and thus the stranded costs scenario would amount neither to a deprivation of possessions nor to a control of their use), it is still possible that the act in question may be held to be an interference with the peaceful enjoyment of possessions. This is often seen as ‘a kind of ‘catch-all’ category for any kind of interference which is hard to pin down’.\(^{48}\) The leading case\(^{49}\) here concerns the subjection of properties to expropriation permits for many years. These permits permitted proceedings for expropriation at a later date, without depriving the owners of their property or their use thereof. The property was never in fact expropriated and the Court held there to have been no deprivation, nor control of the use of the property; nevertheless, the existence of the permits ‘in practice significantly reduced the possibility of [the] exercise’ of their property rights and amounted to an interference with the substance of their ownership of their land.\(^{50}\) While some of the cases which have been decided under this heading of interference could arguably have been held to fall within the deprivation or control of use categories, it is likely that the fact scenarios raised by a stranded costs situation would be caught by this residual provision (even if the above analysis on control of use proves unpersuasive).

1(c)(iv) Tentative conclusion

Thus, it seems that such actions require justification if they are to be lawful under the Convention and, therefore, U.K. law as embodied in the Human Rights Act 1998. It is to the question of justification to which we must now turn.

1(d) Justifiability of infringement and questions of compensation

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\(^{45}\) Provided that the licence-holder had a reasonable and legitimate expectation as to its lasting nature: see Gudmunsson v. Iceland (1996) 21 EHRR CD 89.


\(^{50}\) Ibid., at para. 60.
In all situations where an infringement by means of some interference with possessions has been shown, the state must show that this interference was justifiable to escape a finding that its conduct has been unlawful. There are separate elements to be considered here, but it should not be forgotten that there is an essential link between how the public interest is defined and the shape of the proportionality argument that follows. Indeed, the question of compensation is definitely a part of that proportionality analysis, but given its centrality to the stranded costs scenario, it will be highlighted separately in what follows.

1(d)(i) Public interest/General interest

Any justification for an infringement upon the right to the peaceful enjoyment of possessions must state the grounds upon which that interference is to be made. While it is unclear whether or not the different wording used in Article 1 of the First Protocol is intended to produce different consequences for the different grounds of claim, and given that the Court has not yet ruled on whether the difference in wording has any substantive consequences, it is submitted that this is unlikely to be of any practical significance, given the Court’s rather permissive attitude towards claimed grounds of public/general interest justification. The Court has tended to be deferential to the Member States’ definitions and explanations of why a certain restriction was necessary: for example, leasehold enfranchisement legislation in the U.K. was held to be a policy calculated to enhance social justice within the community and therefore was ‘properly described as being “in the public interest”’.53

On the case law as it stands, therefore, it seems highly likely that the type of public/general interest ground that would be relied upon by the state in a stranded costs scenario (such as benefiting overall social welfare by the introduction of competition) would be difficult and perhaps impossible to characterise as not being acceptable under the Convention. However, the ground of public interest may be legitimate, but it must still be analysed whether or not the means chosen to fulfil that ground were proportionate to the benefit to be gained.

1(d)(ii) Proportionality

Although there is no express reference to a proportionality test in the wording of Article 1 of the First Protocol, it is clear from the Strasbourg Court’s jurisprudence that such a requirement is inherent in that Article. Proportionality is a general principle of the Convention and requires there to be a ‘reasonable relationship of

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51 I have assumed throughout that any interference will be laid down by statute or secondary legislation and will thus meet the criterion of being ‘conditions provided by law’ which is necessary for any justifiable infringement of Convention Rights. This basis in law must be accessible, sufficiently certain and must provide protection against arbitrary abuses. Thus, it is not only a requirement to be able to point to a positive legal provision empowering the body in question to take the action of which the applicant complains; there is also an element of the ‘Rule of Law’ about this requirement.

52 I.e. ‘public interest’ with regard to deprivation and ‘general interest’ with regard to control of use. While there is no specific language concerning this issue in relation to the more general ground of interference with peaceful enjoyment of possessions, the Court has required a ‘legitimate aim’ to be shown in its operation of the ‘fair balance’ test (see the text, infra, at section 1(d)(ii) ff.): here, too, the Court has shown great deference to the Member States’ public interest choices (see, e.g., Fredin v. Sweden (No. 1) (1991) 13 EHRR 784, at para. 51).

proportionality between the means employed and the aim sought to be realised'. In the context of Article 1 of the First Protocol, the Court has developed a requirement that a ‘fair balance’ must be struck ‘between the demands of the general interest of the community and the requirements of the protection of the individual’s fundamental rights’. This approach is followed by the Court in all cases of infringement of Article 1 of the First Protocol, whether concerning deprivation, control of use or more general interference with the enjoyment of possessions.

It is important to note that the intensity of the proportionality test applied will vary according to the severity of the infringement in question. ‘Deprivation of property is inherently more serious than a control of its use’, thus suggesting that it will be more difficult to argue that the action of a public body in depriving a company of its property is a proportionate way to achieve the public interest goal at issue. In any application of the idea of fair balance, however, it is clear that two elements will be key: first, is there any entitlement for the property owner to compensation for the interference suffered? Second, is there any procedure open to the applicant to challenge the measure that has caused the interference with his possessions? In the stranded costs situation, a good example of the procedural element is provided by Article 24 of Directive 96/92/EC, under which Member States were allowed to develop plans to compensate incumbent companies for stranded costs. These plans were then to be submitted to the Commission of the European Communities within a certain period of time for their examination in accordance with the EC’s State aid rules. Equally, the absence of any such procedure may well lead to a finding that the interference is a disproportionate one that fails to respect the balance to be struck between the competing interests at stake. Given that the key element in the stranded costs scenario will be a company’s claim to be entitled to compensation, this element will now be examined in more detail.

1(d)(iii) Compensation

It would appear that there is no absolute right under the Convention to receive compensation in return for an interference with the right to the peaceful enjoyment of one’s possessions. Rather, the availability and extent of any compensation falls to be considered as part of the overall analysis of the proportionality of the interfering measure. However, it is also accurate to state that the more serious the infringement of the right to peaceful enjoyment of one’s possessions, the stronger the presumption that at least some compensation must be paid for the ‘fair balance’ of interests to be respected.

- deprivation of possessions:

57 See n. 5, supra.
58 See Sporrong and Lönnroth, n. 18, supra for a good example, although here it was the combination of the failure to provide any means of compensation with the lack of any opportunity to challenge the measures which seemed to tip the balance overall. This illustrates the interlinked nature of the proportionality analysis in such cases, covering many different and yet connected issues.
Only in ‘exceptional circumstances’ will the taking of property without justification be justifiable; otherwise, the protection afforded by Article 1 of the First Protocol ‘would be largely illusory and ineffective’. 59 However, while compensation should normally be an amount ‘reasonably related to [the] value’ of the property taken, there is no ‘guarantee [of] a right of full compensation in all circumstances, since legitimate objectives of public interest, such as pursued in measures of economic reform …., may call for less than reimbursement of the full market value …. ‘60 This seems to imply that there is a proportional relationship between the nature and extent of the public interest, on the one hand, and the individual burden to be borne, on the other. That is to say that ‘the greater the public gain to be achieved by the legitimate aim, the greater the financial burden the property owner can be expected to bear. To this extent the state enjoys a wide margin of appreciation in calculating compensation terms’. 61

Overall, the defendant States have not been successful in arguing that their case falls within the ‘exceptional circumstances’ needed to escape the need to provide compensation. 62 However, there are examples where the Court has been rather deferential to the terms upon which compensation has been calculated.63

- control of use:

By contrast, States have been far more successful in justifying a failure to pay compensation in cases involving the control of the use of the applicant’s property. 64 The European Commission on Human Rights has gone so far as to say that, as a rule, control of use does not contain a right to compensation. However, as has been discussed briefly above, the dividing line between deprivation and control of use cases is a fine one and the Court’s characterisation of various State measures has been uncertain enough to suggest that this statement is perhaps both too bold in nature and too broad in scope. The flip side of this leniency is that where some compensation has been paid in control of use cases, the Commission often seemed to treat this as conclusive proof that there has been no violation of Article 1 of the First Protocol. 65 There has been a reluctance on the part of the Court to countenance compensation where the applicant was involved in a commercial venture containing an element of

59 Lithgow v. U.K., n. 10, supra; see esp. paras. 80-83.
60 Ibid.
63 See Lithgow v. U.K., n. 10, supra, where the calculation of the compensation paid to a company which was to be nationalised was made on the basis of the value of its shares at a point before the announcement of the nationalisation plan, rather than on the basis of company assets held at the date of nationalisation. The Court acknowledged that such a broad public interest issue as nationalisation legislation involved the consideration of a very wide range of competing interests, which the Member State and its national authorities were best placed to assess. Overall, the Court found that adequate reasons did exist for the compensation criteria chosen and, as a result, held the U.K. to be within its margin of appreciation and thus found no violation of the Convention.
64 E.g., James v. U.K., n. 10, supra, saw the Court find no breach of the Convention by the U.K.’s leasehold reforms which allowed some tenants to purchase the property which they were renting, with its consequent impact upon the value of the property owned by the applicant.
risk, especially where the applicant was aware of the general factual circumstances
that led to the eventual control on its use of the property.66

- general observations:

However, given the existence of case law both under the control of use heading and
the more general category of ‘interference’, I would submit that it would be inaccurate
to conclude that this apparently more permissive approach means that the prospects of
raising a human rights argument in support of a claim for compensation for stranded
costs as a result of legislation designed to increase competition in a particular sector.
Nevertheless, it should be stressed that full, market-value compensation is not even
necessarily required in relation to deprivation cases, so it would be foolish to expect
anything but a similar (if not, indeed, even more lenient) assessment under the other
categories of interference.

A particularly apposite example for the purposes of stranded costs scenarios is
provided by the case of Stran Greek Refineries,67 which concerned measures taken by
the new democratic government of Greece to overturn a contract made for the
construction of a crude oil refinery by the applicants. The government argued that the
termination of the contract was necessary to avoid prejudice to the national economy
and the applicant claimed that he should be compensated for expenditure incurred in
preparing to carry out the contract. The national courts later held that an arbitral
award (which had declared that the applicants were entitled to some compensation for
the termination of the contract) was rendered void by the legislation that had
terminated the contract. While the national court’s preliminary judgment favoured the
applicant, the Strasbourg Court held that this amounted to a mere hope that they
would receive confirmation of their claim once the full investigation had been carried
out. However, the arbitral award was final and binding and established the State’s
liability up to a maximum amount, thus amounting to a ‘possession’ within Article 1
of the First Protocol. The Court then ruled that the effect of the legislation nullifying
the arbitral award was to interfere with68 the applicant’s property right and accepted
that the ground relied upon by the Greek State was a valid one in the public interest.
However, its failure to provide (or indeed to accept that the arbitrators had obliged it
to provide) compensation for the termination of the contract ‘upset, to the detriment of
the applicants, the balance that must be struck between the protection of the right of
property and the requirements of public interest.’

However, this outcome should be carefully contrasted with the result of the
Lithgow case in the Strasbourg Court,69 which illustrates clearly the need to examine
the facts of each individual case very carefully on its own merits. Drawing general
conclusions on the assessment of the proportionality and compensation criteria may
well prove a dangerous exercise, so caution should be exercised.

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68 Rather than to deprive the applicants of their property, although it is of course highly arguable that
deprivation was in fact precisely what the effect of the legislation had been (see, e.g., Clayton &
69 See the summary in n. 32, supra.
Two final points should be made in this brief survey of the possible availability of compensation for interference with property rights in stranded costs situations. First, it should be noted that the position under the wording of Article 1 of the First Protocol differs from that which obtains in many Commonwealth constitutions and in the U.S.A., where the constitutional provisions themselves provide for the possibility of expropriation only if full compensation is paid. Issues of control of use of property are more complicated: originally, the U.S. courts considered that ‘regulatory control’ of property attracted only the protection of the due process clause of the Constitution and not that of the ‘takings’ clause (which required the payment of full compensation). However, the Mahon case\(^{70}\) acknowledged that some statutes that regulate land use can amount to a taking of land within the U.S. Constitution and it seems that the Privy Council has decided appeals from Commonwealth Constitutions on similar issues in a similar manner. While providing some leeway within which to find that measures short of deprivation may entitle an applicant to compensation, it appears that the practical results of all these cases may well be rather similar and show a tendency on the part of the courts not to overturn the assessment of public authorities as to the necessity of certain actions in the public interest, even if they impinge to some extent upon private property rights.

The second point to note is the nature of the ‘margin of appreciation’ doctrine in the law of the ECHR. Many of the cases discussed above turn on the amount of scope given to the Member State by the Strasbourg Court under the doctrine of the margin of appreciation. This doctrine is predicated upon the idea that a supranational court such as the European Court of Human Rights is not best placed to make complex analyses and balances of multiple competing interests that are at stake at a national level. Thus, in assessing whether or not a Member State has breached the Convention (and thus its international law obligations), it may often defer to that State’s own assessment of the proper balance to be struck within that State’s own territory. However, under the Human Rights Act 1998, our national courts are now charged with the responsibility of hearing cases on whether or not public bodies in the U.K. have complied with their obligations under the Convention. It has been argued\(^{71}\) that the application of the margin of appreciation doctrine by the national courts would be a far less appropriate tool for ensuring the application of Convention Rights in the U.K.: after all, national courts cannot argue so easily that they are unaware of the social situation which obtains in their own society. It is thus possible that national courts may look less deferentially upon decisions taken by public authorities in the U.K. with regard to compensation for interference with property rights and may, indeed, require compensation to be made more frequently and to a greater extent. However, this argument should be treated with some caution, given the record of the Privy Council to date in deciding cases on appeal from the various Commonwealth Constitutions in the area of property rights: it appears that the Privy Council has taken an approach relatively favourable to government interference with property rights in the public interest.\(^{72}\)

\(^{70}\) \textit{Pennsylvania Coal v. Mahon} (1922) 260 US 393, \textit{per} Holmes J.


Nevertheless, even by making this argument in favour of compensation, the Human Rights angle can often put significant pressure on those involved in developing legislation, given the often negative overtones of coverage of the issue if the government is seen to be ignoring the very Human Rights which it did so much to incorporate within our legal system.


‘Article 17 – Right to Property

1. Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law in so far as is necessary for the general interest.

...’

While it should be noted that this Charter was expressly excluded from having legal force when it was adopted, it is also important to recognise that its position and possible legal status was a key point in discussions in the Convention led by Valéry Giscard-D’Estaing on the Future of the European Union and remains a contentious issue in the current Intergovernmental negotiations over the final text of the new E.U. Constitution. It is possible, therefore, that the provisions of the Charter may yet become binding European Union law in the relatively near future. With that in mind, it is valuable to note the great similarity of Article 17 of the Charter with the provisions discussed above in the European Convention on Human Rights. Equally, one important difference is the Charter’s explicit reference to the need for ‘fair compensation being paid in good time for their loss’, with regard to ‘deprivation’ of property. However, no such reference is made in relation to the regulation of the ‘use of property’ in the third sentence of Article 17. Whether or not this difference is significant is difficult to say at this stage, although a number of reasons could be suggested for the different wording.\(^73\) In the light of the case law of the Strasbourg Court discussed above, it is likely that this wording was intended to reflect the flexibility of that case law with regard to questions of proportionality and compensation, although this is perhaps a somewhat speculative suggestion.

\(^73\) One possible explanation is the desire to retain the established EC case law concerning the ‘abusive’ use of intellectual property rights. Article 17(2) of the Charter provides that IP rights shall be protected (and, indeed, the current Article 295 EC provides that ‘[t]his Treaty shall in no way prejudice the rules in Member States governing the system of property ownership’); however, the Court of Justice in Luxembourg has developed a doctrine which distinguishes between the existence of an IP right and its exercise. Thus, for example, a dominant company cannot reply upon national IP rights to act in a manner ‘abusive’ under Article 82 EC (see, e.g., Case 102/77 Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH [1978] ECR 1139, at para. 16). If compensation were to be required for control of use in the Charter, it is possible that this case law (which, while often challenged by various critics, has been an important tool in the opening up of the single market) would be difficult to sustain.