UK NATIONALISATION: PRACTICAL CONSIDERATIONS
An introductory guide to practical steps that investors could take to protect their position in the event of a nationalisation, written by the Baker McKenzie Dispute Resolution team in collaboration with geopolitical commentator, business advisor and co-founder of Global Torchlight, David Chmiel.

Political Situation

Certain debates are perennial in British politics – the UK’s relationship with the EU being the most obvious. Others become settled after attracting a broad consensus of cross-party support. Until recently, the question of whether parts of the UK economy should be in public or private ownership was one such matter on which political debate had largely ended. The privatisations undertaken by Conservative governments in the 1980s and 1990s were left mostly untouched by Labour administrations in the 2000s. That consensus has ended and nationalisation of assets is a matter of political debate in the UK once again.

The Labour Party said in its 2017 general election manifesto that it intended to bring key utilities back into public ownership, including private rail companies, energy supply networks, water companies and the Royal Mail. Polling data showed that such proposals were in tune with the thinking of a significant segment of the British public – at least on a conceptual level. In a series of polls conducted in 2017, between 59% and 80% of respondents agreed with the statement that water companies should be publicly owned, while between 53% and 77% felt the same about electricity and gas suppliers. Such views were not confined to one particular demographic group or even to supporters of one political party. A YouGov survey conducted in May 2017 found that at least four in ten Conservative Party supporters endorsed public ownership of utilities.
YouGov May 2017 Survey Results:
Should these industries be nationalised?

The re-emergence of this debate is not attributable to one specific event, but apparently to a range of public grievances and concerns. While the Labour Party often cites its renationalisation policies as a necessary precursor to comprehensive action on environmental issues, public support appears rooted in perceptions of declines in service, lack of long-term investment, and persistent price increases.

This debate continues to develop. In May 2019, Labour announced its detailed plan to nationalise electricity and gas transmission and distribution companies. The plan, entitled “Bringing Energy Home”, provides that the nationalisation would be effected by an Act of Parliament with a two-step process: (i) the assets are transferred into public ownership; and (ii) provision is made for compensating the former owners through a bond issuance by the Treasury.

Labour has previously stated that the compensation should relate to the book value of the companies, but in Bringing Energy Home, it explicitly stated that the level of compensation should be decided by Parliament. It states that “Parliament may seek to make deductions for compensation on the basis of: pension fund deficits; asset stripping since privatisation; stranded assets; the state of repair of assets; and state subsidies given to the energy companies since privatisation.”

Labour proposes that existing debts will be carried over into public ownership and will be repaid in full, but that these debts will be refinanced over time in order to reduce the cost.

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David Chmiel, geopolitical commentator, business advisor and co-founder of Global Torchlight comments, “What is interesting is that polling data released around the same time as Labour published its plan for the energy sector indicates that public support for renationalisation may have weakened in the intervening two years. As more detail emerges, the costs and consequences of these policies become easier to define, thereby making the debate more granular. Equally, individuals such as Conservative Environment Secretary Michael Gove have warned utilities to be more conscious of the effect that decisions on matters like executive pay can have on the ongoing renationalisation debate.”

With ongoing political volatility in the UK, there is an increasing likelihood of another general election in the near term and, with it, the possibility of the Labour Party forming the next UK Government and seeking to implement its nationalisation agenda. As such, investors in companies operating in the industries identified in the Labour manifesto in particular may wish to consider what rights and remedies would be available in the event of nationalisation of their investments and what steps can be taken at this stage in order to reduce the risk of receiving compensation below market value.
Decision making of UK public authorities can be reviewed by the UK courts by way of judicial review. Accordingly, if the legislation that permits nationalisations, or the method of nationalisation and calculation of compensation, are not made lawfully, shareholders could bring proceedings against the Government before the UK courts.

The most likely basis for challenging nationalisation is through Article 1 of Protocol 1 to the ECHR (incorporated into English law under the Human Rights Act 1998), which affords individuals and companies the right to peaceful enjoyment of their possessions. Under the Article, the UK would have the right to nationalise assets, but only insofar as this is “in the public interest and subject to the conditions provided for by law and by the general principles of international law”.

While these principles give Member States a wide margin of appreciation as to what constitutes “in the public interest” so as to allow for nationalisation, these principles also provide a right to reasonable compensation for affected parties. Previous case law provides that:

- Compensation must be of an amount reasonably related to the value of the property.
- Compensation does not necessarily entail the full market value of the property if the legitimate objective of the public interest justifies less than full reimbursement.

The valuation method for calculating compensation must be “manifestly reasonable”, although in practice the European Court of Human Rights (“ECtHR”) has granted national authorities wide discretion in this area and will generally respect their approach unless it is “manifestly without reasonable foundation”.

In practice, a claim under the ECHR may be pursued in different ways in the UK courts, either by challenging the primary legislation that gives the Government the power to nationalise the relevant industries, or by challenging the application of that legislation by relevant public bodies, as follows.

- Public authorities must not act in a manner that is incompatible with a right under the ECHR. Accordingly, if the method of nationalisation and calculation of compensation provides for any discretion by a public authority, and that discretion is not exercised in accordance with the ECHR, the shareholder(s) could bring proceedings against the Government. Typically, this will not lead directly to compensation but an order requiring the public authority to take the decision again in accordance with the ECHR.
- There may also be grounds for challenging the exercise of a public authority’s discretion under domestic law more generally, on the basis that the decision is illegal or irrational (i.e. “so unreasonable that no reasonable authority could ever have come to it”). As above, the remedy in such circumstances where a public authority has made a wrongful decision in respect of nationalisation or compensation is likely to be an order quashing the decision.

In addition, under section 3 of the Human Rights Act 1998, legislation must be read and given effect to in a manner that is compatible with the ECHR. As such, courts in the UK will interpret any legislation giving effect to nationalisation so far as possible in order to provide adequate compensation rights in accordance with the ECHR. However, this will only be possible where there is sufficient ambiguity in the legislation. If not, then the UK courts will only be able to make a declaration that the relevant legislation is not compatible with the ECHR and this will not affect the validity of the legislation (though there would be political pressure to amend the legislation accordingly).

It is worth noting that the UK’s membership of the ECHR is entirely independent of its EU membership, so the UK will remain bound by the ECHR and subject to the rulings of the ECtHR after Brexit.
The most promising route to claim redress for nationalisation of assets is under an investment protection treaty, whether a bilateral investment treaty or a multilateral investment treaty, if applicable.

An investment protection treaty is an agreement made between states, containing reciprocal undertakings for the promotion and protection of investments made by nationals and companies of each of the states in the territory of the other states. As investment protection treaties are individually negotiated treaties, their terms vary and the precise wording of particular provisions will affect their interpretation in any dispute. Nevertheless, most treaties typically include broad guarantees of treatment for foreign investors in accordance with international law. The host state will typically promise "fair and equitable treatment" and "full protection and security" for investments, and promise not to engage in "arbitrary" or "discriminatory" decision-making. Typical treaties also establish clear limits on the expropriation of foreign investments (and measures having equivalent effect). Such provisions typically only permit expropriation where it is carried out:

- In the public interest;
- Following due process of law; and
- In a non-discriminatory manner; and
- In return for just compensation (at market or fair value).

Investment protection treaties provide foreign investors with a private right of action: the right to submit an investment dispute with a host government directly to international arbitration (generally referred to as Investor-State arbitration).

The ability to use a treaty to seek compensation or other redress in the event of a nationalisation of assets is dependent on whether the relevant investor is an “Investor” under a treaty between the UK and another State (or States). As such, this option will only be open to parties where there is a relevant treaty.
Practical Steps

1. Contractual Protections

Where investments are held indirectly through contractual arrangements, such as bonds issued by utility companies, then investors should consider what contractual protections may be built into the documentation. For example, Thames Water has recently included nationalisation as an event of default under its bonds, to ensure that lenders are paid back immediately in the event of a nationalisation. Whilst it is possible that a Labour government could change the law to make such provisions unenforceable, such steps nonetheless provide an additional level of protection.

Depending on the type of investment, investors may also want to consider appropriate termination rights or shorter contractual terms, which may also provide some protection in allowing an investor to exit an investment either in the event of a nationalisation or where there is a materially increased risk of a nationalisation.

2. Structuring Investment within the terms of an investment protection treaty

The fact that a potential investor is not a citizen or company based in a State with an investment protection treaty with the UK is not necessarily fatal to a treaty claim if the investment in the UK is structured appropriately. If potential investors are considering making an investment into a sector at risk of nationalisation, it is therefore important to give full consideration to the appropriate structure for the investment in order to maximise the chance of being able to rely on treaty protections.

It is also possible to restructure existing investments in order to take advantage of treaty protections. However, this is unlikely to be effective if the restructuring takes place after a dispute has arisen with the UK or after the UK has formally announced a policy of nationalisation. As such, investors need to plan ahead and carry out any restructuring in advance of nationalisation policies being implemented.

Any restructuring, whether by a potential investor or an existing investor, will require careful legal consideration in order to ensure that the investor and the investment both fall within the protections of the relevant treaty. Each treaty is different, and whilst some allow any company incorporated in a State to qualify as an “investor”, others require more substantive links with the State.

3. Valuation

Investors can take steps now to have their investments independently valued at market value, in order to provide a benchmark value. In the event compensation is below the benchmark value, then this may provide good evidence that compensation is below market value.

Investors may also wish to consider whether there are any steps that can be taken into account to improve the value of their investments as Labour provide more information as to the proposed method of valuing compensation. It may be that a particular form of valuation gives rise to particular incentives for investors to take steps that would improve the valuation from that perspective. For example, investors may want to consider shareholder rights plans (or “poison pills”), and whether there are any defence tactics or disincentives that could discourage nationalisation, or that may allow for more favourable terms to be applied.

4. Government engagement

As indicated above, the power and means to effect nationalisation, and potentially the method of valuation, are likely to be implemented by way of legislation. The Government should therefore publish Green and White Papers in relation to its proposals in due course, which outline more detail on its proposals. It is therefore worth considering engaging with relevant industry groups and other affected parties in order to coordinate a lobbying effort, or responding to any Government consultation, to encourage the Government to take industry concerns into account. Raising these arguments during the decision-making process may also assist with any formal legal challenge at a later stage.

David Chmiel says, “Many current investors in UK utilities are foreign companies, sovereign wealth funds or overseas public pension funds. Any efforts to nationalise UK assets, particularly at anything less than full market value, could have significant political and economic consequences beyond the boundaries of the UK. Foreign investors may wish to engage with their own governments, even at this preliminary stage, to determine what efforts are being made to transmit views and concerns through diplomatic channels. Equally, some interest groups in countries whose pension and sovereign wealth funds are invested in the UK utilities sector have used the re-emergence of the nationalisation debate to increase scrutiny of these funds’ investment strategies and so foreign investors will need to prepare for likely increased media attention on the whole sector.”

Monitoring the ongoing debate

If anything is certain at this stage, it is that the current fractured and volatile nature of UK politics will likely persist into the foreseeable future. In combination with mitigating the risks associated with nationalisation, investors will also want to pay close attention to the evolution of the political debate itself. In particular, it will be important to consider whether the apparent weakening of support for nationalisation in recent months is indicative of a broader trend as details emerge of just how Labour proposes to pursue this policy.

Equally, the prospects of a coalition government emerging from the next general election cannot be discounted. Given that polling data suggests that nationalisation of certain sectors finds support outside of the Labour Party, it will be important to see how other parties respond to Labour’s proposals and, in particular, if smaller political parties that might hold the balance of power in any future parliament indicate that they are prepared to support nationalisation legislation and, if so, on what terms.

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