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Law and Regulation of Secondary Trading in the European Union

MARGHERITA COLANGELO

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Creating Property Rights

Law and Regulation of Secondary Trading in the European Union

By

Margherita Colangelo

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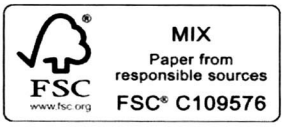

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To the memory of my grandfather
Leonardo Luigi Claps

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CHAPTER ONE

THE REGULATORY CREATION OF RIGHTS

1. *The Evolution of the Regulatory State: An Overview*

In all legal systems, intervention in the economy has always been a fundamental activity of public powers, even before their organization in the form of states.[1] Modern theories generally mark out three main types of such intervention, i.e. redistribution of income, macroeconomic stabilisation and allocation of resources:[2] each modern state carries out all of these functions in some way, depending on historical variables.[3]

The ascent of the regulatory state is often linked to the decline of its managerial role. Consensus weakened on the dirigiste state when public enterprises and nationalization policies proved unable to reach their social and economic goals. As a result the 1970s saw a new trend in economic government, including the privatization of much of the public sector and a greater emphasis on competition: generally this phenomenon sanctioned the transition from direct state intervention in the economy to its indirect control by regulation. This new approach led to a significant increase in public regulatory policies whose supposed aim is to correct different kinds of market failures such as monopoly effects, negative externalities, incomplete information and insufficient supply of public goods.[4]

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[1] See the analysis of M.S. Giannini, *Diritto pubblico dell'economia* (Bologna: Il Mulino, 1995), 20. In general on this topic, see, *ex multis*, J.E. Stiglitz et al., *The Economic Role of the State* (Oxford: Basil Blackwell, 1989).

[2] On this topic, see R.A. Musgrave, 'A Multiple Theory of Budget Determination', *FinanzArchiv N. F.* 17 (1957): 333. The Author identifies three major budget functions: "(1) the function of providing for the satisfaction of public wants; (2) the function of providing for adjustments in the distribution of income; and (3) the function of contributing to stabilization." Economists generally recognize that government activities in all three branches are intertwined and cannot be neatly compartmentalized. In this sense, see e.g. J.E. Stiglitz, *Economic of the Public Sector* (New York-London: W.W. Norton & Company, 2000, 3rd ed.), 20.

[3] See A. La Spina and G. Majone, *Lo Stato regolatore* (Bologna: Il Mulino, 2000), 15–16.

[4] On this topic, see A.I. Ogus, *Regulation. Legal Form and Economic Theory* (Oxford: Oxford University Press, 1994); see La Spina and Majone, *Lo Stato regolatore*.

Regulation is a widely debated concept, its definitions varying in intensity, degree and purpose, and even deregulation is considered as a particular interpretation and application of the same principle.[5] A brief review of some main theories on the topic shows that historically, regulation has been interpreted by welfare economists as the result of a double loss – the failure of both state and market – offering a means to find a new, more balanced settlement between public and private interests. Against this normative approach, the economic or positive approach has opposed the drawbacks of regulatory policies as they have proved to be economically inefficient, with substantial costs to the taxation system and anti-competitive distortions generated mainly by the creation of unjustified benefits.[6] As a consequence recently, regulatory policies have lost their attractiveness; the idea of deregulation has arisen, with an orientation towards liberalization, less strict and pervasive legislation and upholding the superiority of market rules.[7]

There are numerous regulatory tools available to governments. Typical of the regulatory state is the superabundance of rules and the creation of sectoral regulatory agencies/authorities. Some of the techniques used by regulatory authorities are: standards setting, product screening, rate fixing for access to some services, mandatory disclosure and prohibiting anti-competitive conduct. Quasi-market, alternative techniques include the taxation of some conducts and the creation of tradable rights. Other techniques involve the use of contractual instruments, or so-called self-regulation, set up by the recipients of public regulation themselves via the institution of associations or similar and the production of autonomous rules.[8]

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[5] In particular, two main kinds of regulation may be distinguished, i.e. economic regulation, whose aim is to correct internal imperfections in the market in order to substitute its normal functioning, and social regulation, whose aim is to remedy imperfect information of negative externalities deriving from areas such as wealth, environment, safety and consumers' interests. Deregulation arose mainly from dissatisfaction with the outcomes of economic regulation and should be interpreted as a reform of the regulatory approach. See La Spina and Majone, *Lo Stato regolatore*, 38–40, 49.

[6] No attempt will be made here to reconstruct the several theories and debates on regulation. Suffice it to say that until the 1960's market failures, as explained by the theorems of the welfare economics based on the Pareto criterion, were considered by the prevailing regulation theory as the fundamental reasoning of public intervention. Subsequently, the beginning of the economic theory of regulation (also known as the capture theory) was marked by G.J. Stigler, 'The Theory of Economic Regulation', *The Bell Journal of Economics and Management Science* 2 (1971): 3.

[7] The term deregulation may be interpreted in different ways. Generally it can be defined as the reduction and relaxation of rules and obligations imposed by regulatory authorities and governments.

[8] See La Spina and Majone, *Lo Stato regolatore*, 66–86.

In the European context, the presence of the Union has deeply influenced the role of the states: in particular, European legislation on economic and social regulation has increased enormously, adding to national regimes and actually becoming the most important source of law. European regulation operates through widespread lawmaking and the construction of regulatory networks held up by an interrelationship between national and European agencies.[9] In the phenomenon of the Europeanization of policymaking, Member States are the principal source of demand for regulation and often act as rule-takers. In recent decades regulatory policies have been modified by different processes, such as market liberalization and integration. This has led to deregulation associated with re-regulation, implying a redistribution of regulatory power through institutions at national and local level and a consequent redefinition of policy tools. This evolution has created heterogeneous legislation following different principles in specific sectors. In parallel, there has been increasing involvement by private actors, so that new models of self-regulation and private regulation have spread.[10] In this context, regulation plays an important role in private law too.[11]

This tentative skeleton picture of the evolution of regulatory policies, in particular in the European Union, portrays the complexity of the topic, which is not easily ascribable to definite categories. The regulatory state and its modifications have determined a reorganization of the public

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[9] On the growth of regulation in the European context, see also G. Majone, 'The Rise of the Regulatory State in Europe', *West European Politics* 17 (1994): 77.

[10] See F. Cafaggi, 'Un diritto privato della regolazione? Partecipazione, coordinamento e cooperazione tra pubblico e privato nei nuovi modelli regolativi', in *L'armonizzazione del diritto privato europeo*, ed. M. Meli and M.R. Maugeri, (Milan: Giuffrè, 2004), 63. The Author explains the difference between self-regulation and private regulation: the former implies the identity of regulators and those subject to regulation, while the latter refers to the participation to the regulatory process of private actors different from those regulated, such as associations. Moreover the Author, at p. 81, warns that the idea of a sharp separation between self-regulation and regulation on the basis of the different interests protected is an exaggerated and untruthful simplification, as public regulation often considers particular interests and symmetrically auto-regulation frequently takes into account general interests.

[11] On this topic, on the growing relevance of private law tools in new regulatory policies and for an interesting analysis of the role of emerging private regulation within the regulatory and post-regulatory state, see Cafaggi, 'Un diritto privato della regolazione?', 63; Id., 'Private Regulation in European Private Law', EUI Working Paper RSCAS 31 (2009). In general on the theories of the post-regulatory state, see C. Scott, 'Regulation in the Age of Governance: The Rise of the Post-Regulatory State', in *The politics of regulation: institutions and regulatory reforms for the age of governance,* ed. J. Jordana and D. Levi-Faur (Cheltenham; Northampton: Elgar, 2004), 145, arguing that "a defining characteristic of 'post-regulatory state' thinking generally is a loosening of the sharp distinction between states and markets and between the public and the private."

sector, involving economic and social activities and entailing the development of forms of cooperation between public and private spheres: these new trends indicate the changing role of public law and its fundamental interconnection and interdependence with private law. Thus the evolution of contemporary society confirms the growing tendency for needs to be satisfied by public powers, but institutional solutions and methods of implementation have changed.[12] A new season of regulation has emerged, making use of cost-benefit and other forms of impact analysis and constructing new incentivization mechanisms typical of market approaches.[13] This study intends to analyze these tacks in the context of the regulation of some specific sectors in the EU, in particular focusing on the allocation mechanisms of scarce public resources to private actors and the related creation of rights by governments.

2. *Government Largess and the New Property Theory*

Issues connected with the consequences of regulatory policies and the relationship between public power and private operators are objects of study for private and public law and for the economic analysis of law. In the 1960s the "new property" theory highlighted the role of the state as the main distributor of wealth. Reich distinguishes several types of government intervention in support of wealth (money, benefits, services, contracts, franchises and licenses), all sharing one characteristic: "they are steadily taking the place of traditional forms of wealth – forms which are held as private property".[14] Among the different forms of government-created wealth, Reich identifies some obvious forms which involve direct payment: this is the case of incomes and benefits which are accorded to a large number of people, such as social security benefits, unemployment compensation and so on, or to economic sectors in need of subsidies (e.g. agriculture). Many services dispensed by the government are a source of wealth too (e.g. insurance for homebuilders and savings banks, postal services for periodicals and newspapers). Moreover, many people are employed by the state, as many businesses take advantage of

[12] On this topic, see G. Napolitano, *Pubblico e privato nel diritto amministrativo* (Milan: Giuffrè, 2003).

[13] See G. Napolitano and M. Abrescia, *Analisi economica del diritto pubblico* (Bologna: Il Mulino, 2009), 85.

[14] C. Reich, 'The New Property', *Yale Law Journal* 73 (1964): 733.

government contracts. Other forms, which are indirectly valuable, are occupational licenses -which can be required to engage in some jobs – and franchises, which are partial monopolies created and handed out by government (e.g. taxi licenses). Finally, a very large part of the resources used by private businesses and individuals is publicly owned (e.g. public lands valuable for mining, sources of energy, the radio-television spectrum, routes of travel and commerce).

These forms of wealth – a profession, a job, a right to receive income, to carry out an activity or to use public resources – represent for an individual the basis of social status.[15] Rights resulting from government largess constitute a new type of rights akin to property rights, but stemming from regulatory activities intended to safeguard public interests or wealth, they cannot fall into the traditional category of property and should be named as "the new property". In Reich's view, status created by government largess should be treated like property, governed and preserved by a system of regulation.[16]

Government largess has given rise to a new system of law, whose analysis necessarily involves at least three perspectives: the rights of holders of largess; the power of government over largess; the procedure by which holder's rights and governmental power are adjusted.[17] Reich stresses that the growing dependence of a large number of people on government largess is not matched by a clear definition of the limits of public power. As Stigler affirms, "with its power to prohibit or compel, to take or give money, the state can and does selectively help or hurt a vast number of industries". [18]

There are four main policies providing benefits for industries: direct subsidy; control over entry by new rivals; imposition of protective tariffs; and price-fixing.[19] One of these policies is the licensing of occupations, which constitutes an effective barrier to entry, as practicing without a license is a criminal offence. There are three main rationales based on public welfare arguments which are generally advanced to justify the licensing of certain occupations: lack of information or misinformation;

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[15] Reich, 'The New Property', 739. See also Id., 'Individual Rights and Social Welfare: The Emerging Legal Issues', *Yale Law Journal* 74 (1965): 1245.

[16] Reich, 'The New Property', p. 785.

[17] Ibid.

[18] Stigler, 'The Theory of Economic Regulation', 3. On the points of contact between Reich and Stigler, see R.H. Nelson, 'Private Rights to Government Actions: How Modern Property Rights Evolve', *University of Illinois Law Review* (1986): 361.

[19] Stigler, 'The Theory of Economic Regulation', 4–6.

society's knowing better than the individual what is best for him; social costs being higher than private costs.[20] Besides the hypothesis that occupations may be licensed in the public interest, an alternative assertion is that they are licensed in the interest of the practitioners themselves.[21]

The growth of government power based on the dispensing of wealth must be evaluated considering that it revolves around the gratuity principle and necessarily implies discriminatory measures: in Reich's view, this leads to a vicious circle, because when one sector of the economy is subsidized, others are forced to seek comparable participation and feel disadvantaged. Reich compares the main features of government largess to the general outlines of the feudal system: people turning over wealth and rights to government, which reallocates them as largess, leads to a merging of public and private. Holding a status is both the basis for benefiting from government largess and a consequence of receiving it, so that the new wealth is not readily transferable. In this system sovereign power is shared with large private interests and the lines of private property are blurred. In Reich's opinion, government largess is only "one small corner of a far vaster problem" which unites many other new forms of wealth requiring reconsideration, or better, the creation of a new property.[22]

The Reich theory has caused much comment, both approving and critical. Even in the United States the request made by Reich to extend the property regime to "the new property" has not been applied in the way the author means. This is due to the fact that, even in those systems where property law is characterized by 'fluidity', providing interests that are not

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[20] T.J. Moore, 'The Purpose of Licensing', *Journal of Law & Economics* 4 (1961): 93, 103. In the Author's opinion, only the second argument is logically consistent and statistically significant. The Author highlights that licensing is not costless: the imposition of standards for entering an occupation increases information but at the same time can be expected to raise the cost of the service.

[21] Moore, 'The Purpose of Licensing', 110.

[22] Reich, 'The New Property', 787: "it is time to reconsider the theories under which new forms of wealth are regulated, and by which governmental power over them is measured. It is time to recognize that "the public interest" is all too often a reassuring platitude that covers up sharp clashes of conflicting values, and hides fundamental choices. It is time to see that the 'privilege' or 'gratuity' concept, as applied to wealth dispensed by government, is not much different from the absolute right of ownership that private capital once invoked to justify arbitrary power over employees and the public." On this topic, see also A. Zoppini, 'Il diritto privato nella trasformazione dei processi allocativi delle risorse pubbliche', *Europa e diritto privato* 2 (2003): 415, 426.

referable to the traditional model of property with strong protection often meets resistance. Moreover, bureaucratic apparatus opposes this possibility, as it implies loss of its discretionary power.[23]

In order to understand the underlying *ratio* of the theory of "the new property", it has to be contextualized in the US constitutional system and Supreme Court jurisprudence on the welfare interests accrued since the New Deal: in some cases the Supreme Court recognized the importance of welfare entitlements, naming them more as rights than as privileges or gratuities, protected by the due process clause,[24] whereas in others it denied them the qualification of accrued property rights.[25] In this sense it has been argued that the new property theory has been developed not because of the perceived inability of the conventional conception of property to yield determinate answers in the context of claims involving government benefits, but because of the paradox that the conventional

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[23] S. Rodotà, *Il terribile diritto. Studi sulla proprietà privata* (Bologna: Il Mulino, 1990), 47–48.

[24] See US Supreme Court, *Goldberg v. Kelly*, 397 US 254 (1970). The Supreme Court has ruled in cases like this that a number of interests traditionally regarded as government privileges are property for purposes of the procedural guarantees of due process. On this topic, see T.W. Merrill, 'Property and the Right to Exclude', *Nebraska Law Review* 77 (1998): 730, 752: "Like choses in action, the interests protected as new property are abstract claims on resources. In other respects, however, they have almost none of the incidents traditionally associated with property rights. Unlike choses in action, they are not transferable. Moreover, the holder of such an interest has no right to transfigure it or to pledge it as collateral. Indeed, the Court has held that the entitlements protected as new property may be abolished outright by the government, and that this gives rise to no claim for compensation. In terms of traditional estates, the closest analogy to new property would seem to be a beneficial interest in a revocable spendthrift trust. Nevertheless, with a little tweaking it may be possible to reconcile the idea of new property with the fundamental notion that property rests on the right to exclude others. (...) Goldberg and its progeny are clearly decisions designed to expand the scope of due process protection for instrumental ends. Perhaps in this context we should just admit that the concept of property has been fudged, and not try too strenuously to assimilate the resulting anomaly to the larger pattern discernible in the jurisprudence."

[25] US Supreme Court, *Flemming v. Nestor*, 363 US 603 (1960). B. Ackerman, *Private Property and the Constitution* (New Haven; London: Yale University Press, 1977), at p. 268 n. 115, defines the Flemming case as the "great case" that exemplifies the difficulties of conceptualizing traditional property relating to social reality and the claims to constitutional protection of welfare interests. On this point, see A. Gambaro, 'La proprietà nel common law anglo-americano', in *Property – Propriété – Eigentum,* ed. A. Candian, A. Gambaro and B. Pozzo (Padua: Cedam, 2002), 1, 175: the Author argues that Reich theory has no general significance, as the problem of the new property is typical only of US constitutional system. In Gambaro's view, Reich theory would mean to recognize to the holders of a social benefit a procedural guarantee, i.e. the protection by the due process principle, and not the strong protection of the just compensation principle.

conception may lead to results that contradict the substantive values underlying traditional private law doctrines, when applied to cases concerning welfare entitlements.[26]

One of the reasons for new property theory's failure is that "there is a tendency in ordinary thought to treat as nonproperty those interests which are subject to a power, held by the person or entity from whom the interest derives, to extinguish unilaterally all opportunity for the claimant to obtain future enjoyment of the asset".[27] Other critics argue that Reich theory, under which the entire set of relationships of economic relevance between citizens and the state should be vested and protected as property, is not workable in reality: the concept of largess is too general, as it does not discriminate among very different situations. Finally, Reich gives

[26] G.S. Alexander, 'The Concept of Property in Private and Constitutional Law: The Ideology of the Scientific Turn in Legal Analysis', *Columbia Law Review* 82 (1982): 1545, 1595. For a more detailed overview of Supreme Court jurisprudence and the relationship between welfare entitlements and the US Constitution, see Ackerman, *Private Property and the Constitution*; Gambaro, 'La proprietà nel common law anglo-americano', 177–183: the Author concludes that in the end the new property theory had no consequence in practice. On criticism raised by the new property theory, see W. Van Alstyne, 'Cracks in "The New Property": Adjudicative Due Process in the Administrative State', *Cornell Law Review* 62 (1977): 445, 485: "Professor Reich's concern was not exclusively or even principally directed to the problems of procedural grossness in the Administrative State. Rather, it was directed to a theory that courts could use to restrict the variety of substantive conditions that government continued to impose upon those who dealt with government as employees, contractors, licensees, or recipients of largess. He believed that the answer to that problem rested in recognition of public sector status as a species of private property-a vested interest of the status holder not subject to restriction or forfeiture on grounds that would be constitutionally impermissible if applied to more traditional private property. In brief, the major emphasis of the Reich article was on the application of substantive due process in the public sector, principally to curtail the government's use of criteria substantively offensive to individual liberty. The implications of the new property for procedural due process in the Administrative State were only dimly seen, in two pages of mild (and optimistic) conjecture. My own view of the matter, at the time, was that the metaphor of the new property was not necessary to show the bankruptcy of the right-privilege distinction."

[27] Alexander, 'The Concept of Property in Private and Constitutional Law', 1561. The Author explains, at p. 1596, that "protectible property interests cannot be unilaterally created. They depend upon recognition from a source which itself has recognized authority to create protectible entitlements with respect to the asset in question. In mature liberal legal systems this source usually is an individual or entity that is conventionally accepted as the owner. In order to establish the character of another person's claim-interest in some asset as property, then, the claimant must point to some representation by the source that indicates an intention to part with some degree of control over the use or enjoyment of the given asset. If the representation is such that the source retains all measure of control over the asset, then all other interests remain subordinate to the source and lacking any formal basis for recognition as protectible against the actions of the source".