

## The real effects of windfall taxes

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From an article in the Financial times, 18 January 2023<sup>1</sup>. *“Harbour Energy, one of the UK’s biggest oil and gas producers, has told staff it plans to cut jobs this year in response to an increase in windfall taxes on fossil fuel companies”*.

Speech by Rachel Reeves Labour party shadow chancellor, 21 January 2023<sup>2</sup>. *“We will extend the windfall tax, closing the fossil fuel investment loophole, and taxing oil and gas profits at the same rate as Norway. By backdating this from the start of 2022 - when oil and gas giants were already making historically large profits - we can raise more than £13bn.”*

Most people would like politicians to exercise wisdom and use evidence-based laws to give the best long term outcomes for the nation. A recent disturbing trend is of the UK government creating laws that have retrospective effect (also termed “**ex post facto**” laws).

These windfall taxes are new laws that act retrospectively. Politicians pronounce vast money flows resulting from these but what is the longer term impact? Are they based on evidence that they provide an overall benefit? Companies and people respond to incentives and the idea that there is a vast lake of money that can simply be siphoned off without adverse effects is not supported by evidence.

Sir William Blackstone examined Ex Post Facto laws in his work “Commentaries on the Laws of England” (1765-1769)<sup>3</sup>. Although the quote is quite long, it’s worth reproducing in full here, not least because it might be the only reference ever to Emperor Caligula in English constitutional commentaries. This comes under the heading “Of the Nature of Laws in General”.

*It may be notified by universal tradition and long practice, which supposes a previous publication, and is the case of the common law of England. It may be notified, viva voce, by officers appointed for that purpose, as is done with regard to proclamations, and such acts of parliament as are appointed to be publicly read in churches and other assemblies. It may lastly be notified by writing, printing, or the like; which is the general course taken with all our acts of parliament. Yet, whatever way is made use of, it is incumbent on the promulgators to do it in the most public and perspicuous manner; not like Caligula, who (according to Dio Cassius) wrote his laws in a very small character, and hung them up upon high pillars, the more effectually to ensnare the people. There is still a more unreasonable method than this, which is called making of laws **ex post facto** [after the fact]; when after an action (indifferent in itself) is committed, the legislator then for the first time declares it to have been a crime, and inflicts a punishment upon the person who has committed it. Here it is impossible that the party could foresee that an action, innocent when it was done, should be afterwards converted to guilt by a subsequent law: he had therefore no cause to abstain from it; and all punishment for not abstaining must of consequence be cruel and unjust. All laws should be therefore made to commence in futuro [in the future], and be notified before their commencement, which is implied in the term “prescribed.”*

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<sup>1</sup> <https://www.ft.com/content/1e71a515-0ae1-493f-bee0-dd902346d26b>

<sup>2</sup> <https://news.sky.com/story/labour-pledge-to-extend-windfall-tax-to-protect-families-from-soaring-energy-bills-12791263>

<sup>3</sup> Introduction, Section 2 <https://lonang.com/library/reference/blackstone-commentaries-law-england/bla-002/#fn5d>

Ex post facto laws are expressly forbidden by the United States Constitution. Article I section 9 states; “No Bill of Attainder<sup>4</sup> or **ex post facto Law**<sup>5</sup> shall be passed.” Article 1 section 10 states; “No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, **ex post facto Law**, or Law impairing the Obligation of Contracts, or grant any Title of Nobility.”

Thomas Jefferson wrote in a letter to Isaac McPherson in August 1813<sup>6</sup>;

*Every man should be protected in his lawful acts, and be certain that no **ex post facto law** shall punish or endamage him for them. The sentiment that **ex post facto laws** are against natural right, is so strong in the United States, that few, if any, of the State constitutions have failed to proscribe them. The federal constitution indeed interdicts them in criminal cases only; but they are equally unjust in civil as in criminal cases, and the omission of a caution which would have been right, does not justify the doing what is wrong.*

Windfall taxes have been levied on bank profits and more recently on energy providers. The theory is that some sectors receive “undeserved” profits due to factors outside of their control and governments want to take a large slice of that. Tax is levied on profits that were made when companies could plan their finances under existing rules, then the goalposts move retrospectively to a regime that didn’t exist at that time. The increased profits also increase the taxes already due by these companies. Applying windfall taxes isn’t straightforward either. In the energy sector, some utilities buy power at a fixed future price. Companies can hedge in various ways. If the tax is levied on all pre-tax profits rather than the alleged excess profits, that could push a profitable company into a loss. Of course, undeserved losses are not usually compensated.

Who is negatively affected by this? The owners of these companies are the shareholders, which for major companies will include pension funds. Investors will be less likely to invest in jurisdictions which create Ex Post Facto rules, which could reduce future projects affecting the availability of jobs and reduce future tax take. Projects need supply chains and services; these too will not benefit from projects never started. There are many losers created by windfall taxes and it’s not obvious, accounted for or mentioned in the press.

The United Kingdom used to have a reputation as a country that respected the rule of law, where businesses and international investors could plan ahead based on the current rules. This is no longer true. No sensible investor would want to risk investing in large projects in the UK, knowing that the financial basis of their investment could be destroyed by retrospective laws. The Conservative Party can no longer claim to be the party which could be trusted by business. The Labour Party confirms what has been evident for years; that they are hostile to the creation of profit and wealth. Ms Reeves would backdate their increased windfall tax on oil and gas companies by more than a year.

The long term effect of these taxes will arise from the destruction of trust in our laws. This will reduce investment which will reduce the creation of wealth and jobs for many years to come. This trust might never be restored, unless there is some superior legal document – such as a written constitution – which makes it difficult for future governments to pass laws that act retrospectively. This goes well beyond oil and gas companies. Any business which might consider investment in the UK must consider

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<sup>4</sup> [https://en.wikipedia.org/wiki/Bill\\_of\\_attainder](https://en.wikipedia.org/wiki/Bill_of_attainder)

<sup>5</sup> [https://en.wikipedia.org/wiki/Ex\\_post\\_facto\\_law](https://en.wikipedia.org/wiki/Ex_post_facto_law)

<sup>6</sup> [https://en.wikiquote.org/wiki/Thomas\\_Jefferson#Letter\\_to\\_Isaac\\_McPherson\\_\(1813\)](https://en.wikiquote.org/wiki/Thomas_Jefferson#Letter_to_Isaac_McPherson_(1813))

this risk, comparing the UK with jurisdictions having a stable legal climate that has not passed ex post facto laws.

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