GOLDEN SHARES AND THE JURISPRUDENCE OF THE ECJ

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LLM in Transnational Commercial Law And Alternative Dispute Resolution, School of Economics, Business Administration And Legal Studies

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Dissertation

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Abstract

In the **first** Chapter I made some introductory remarks on Golden Shares (emergence, definition, types, rationale and legal forms), while in the **second** one I referred the forms of Golden Shares adopted within the EU and divided them in specific categories depending on their structure. In the **third** Chapter I analyzed the legal framework within which the ECJ resolved the legal issues arisen from Golden Shares with an extensive reference to the Communication of the Commission on Certain Legal Aspects Concerning Intra EU Investment, the 88/361 EEC Directive, the Free Movement of Capital, the Freedom of Establishment, the Public Interest Exception and the Proportionality Principle. In the **fourth** Chapter I underlined the economic impacts of Golden Shares with a specific reference to the factors used in the assessment of the Oxera. In the **fifth** Chapter I presented the complexities of the so-called VW case, which was a decision of fundamental importance for the Golden Shares regime concluding with certain comments on all aspects of the case (both legal and economic). In the **sixth** Chapter I remarked the tensions between the Takeover Directive and Golden Shares, since the protection of "national" companies from hostile takeovers was the predominant reason for the issuance of Golden Shares. In the **seventh** Chapter I pointed out my overall comments on all dimensions of the ECJ's case law in the respective issue, while in the **last** one I made some proposals for the legal and genuine future of Golden Shares, thirteen years after the issuance of thefirstdecision.

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I. Introductory Remarks

Golden shares emerged and pioneered[1] at the beginning of 1980s in Great Britain at Margaret Thatcher's time and their function has not changed much since that time. The main wave of privatizations in the EU took place in 90s, where a fair number of States opted to implement legal arrangements which fell outside the logic of fully privatized or nationalized companies. Simultaneously, they tried to influence significantly the management of the company, despite the fact that they had surrendered the majority of their shares to private investors.[2] The main objective of Golden Shares was and remains the protection of State's strategic interests by maintaining special rights in privatized companies.

Typically, **Golden Shares afford powers to a public authority that are, under the applicable corporate law, only available to a majority shareholder**. They do so precisely when a Member State terminates the substantial part of its financial exposure through the limitation of its stake in the process of privatization, while retains powers in the company disproportionate to its (new) minority stake. Thus, these arrangements lead to a separation of control and residual risk.[3]

Trying to give a **precise definition** of those arrangements, we could determine them as "*arrangements in order to identify all legal structures applying to individual corporations for the purpose of preserving the influence of a public authority on the shareholder structure or the management of that corporation beyond the extent to which such influence would be afforded under general corporate and securities law*."[4]

Two principal remarks were made by the ECJ in respect to these arrangements:

a. Governments cannot claim that rules concerning the functioning of the privatized enterprise result merely from the application of normal company law

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[1] See more details in International Book on Privatization, Edward Elgar Publishing (2003), David Parker and David S. Saal

[2] Special Rights of Public Authorities in Privatized EU Companies: the microeconomic impact, Report prepared for the European Commission, November 2005 (Oxera)

[3] Turn of The Tide? The "Golden Shares". Judgments of The European Court of Justice And The Liberalization of the European Capital Markets, German Law Journal, Johannes Adolff

[4] Ibid.

mechanisms, if Member States act in their capacity as a public authority when establishing them.[5]

b. The Treaty provisions apply equally to all restrictions on the Free Movement of Capital as they do not distinguish between private undertakings and public undertakings.[6]

As far as there is a restriction it must be justified and proportional.

There are many **reasons why states created and continue to preserve Golden Shares**. Firstly, strategic privatized companies are important employers and tax-payers. Secondly, some companies have large financial power and influence on a State's economy. Thirdly, privatized companies have substantial effect on public policy and security. Golden shares help States to effectively safeguard these interests[7] and protect companies against takeovers. However, the reason of primary importance for the development of these prerogatives was the absence of an adequate regulatory framework in EU level at the time of their development.[8]

Golden shares **confer divergent special rights**, which may be of various types and concern different subject matters. For instance:

(a)Rights to appoint company directors and members of the board[9]

(b)Rights to limit representation of foreign company directors;

(c)Rights to veto and decision rights in the general meetings,

(d)Rights to influence fundamental company decisions, e.g. dissolution of the company, mergers and takeovers and any other structural changes, sale of substantial assets, amendment of the company's articles of association, liquidation of the company;

(e) Obligation to obtain authorization of the State before certain decisions or transactions;

(f) Rights to influence and restrict the acquisition of the shareholding of the company in question.[10]

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[5] C-98/01 paragraphs 48 and 49

[6] C-174/004 paragraph 32

[7] The Golden Share in Privatized Companies, Droit et Practique Du Commerce International , Alice Pezard

[8] Golden Shares n the EU: Shall They Overcome?, University of Exeter, School of Law, Dirk Gaupp

[9] The Golden Share in Privatized Companies, Droit et Practique Du Commerce International, Alice Pezard

The expression "Golden Shares" refers to the ownership of shares by α State or α public body. However, they do **not necessarily refer to a real shareholding**. Provisions of the law or instrument conferring special rights can grant these rights even without the requirement to hold a single share. Special rights and privileges attached to Golden Shares, may remain even when the State or public body sells its shares. Therefore, their existence is possible in fully privatized companies.[11]

However, in most cases where the right is vested in a share (the Golden share), the right normally does not depend only on holding such a share, but also upon such a share (still) being held by a state body.[12] Therefore directly or indirectly these rights are granted to the State.

Golden shares can be provided by law, specific privatization act, like in France and Belgium, or provisions of shares' sale contract or shareholders' contract that enables its previous owner, the State, to exercise certain degree of control in the company. They may arise from the articles of association or administrative procedure, like in the UK and the Netherlands.[13] Rights deriving from Golden Shares may be of temporary or permanent nature. Their potential limited duration though does not alter the character of the infringement.[14]

Since Golden Shares derogated from traditional company law,[15] they have raised tensions between protectionist interests of States, Free Movement of Capital and the Freedom of Establishment. Before the ECJ rendered its decisions on this regime there were attempts to dispute golden shares' provisions under national law. When these attempts turned out to be unsuccessful, the legality of Golden Shares was disputed by the European Commission.

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[10] Golden Shares: State Control in Privatized Companies: Comparative law, European law and Policy Aspects, Stefan Grundman and Florian Moslein

[11]Special Rights of Public Authorities in Privatized EU Companies, The Microeconomic Impact (Oxera)

[12] Golden Shares: State Control In Privatized Companies: Comparative law, European law and Policy Aspects, Stefan Grundman and Florian Moslein

[13] The Golden Share of Privatized Companies, Droit et Practique Du Commerce International, Alice Pezard

[14] C-463/00 paragraph 81

[15] The Rise of The "Golden" Age of Free Movement of Capital: A Comment on The Golden Shares Judgments of the Court of Justice of the European Communities, EBOR 2003, Vincent Kronenberger

The latter based its legal analysis on the sensible assumption that most of these arrangements violated the Treaty as unjustifiable restrictions on the Free Movement of Capital and the Freedom of Establishment, on its distinction between discriminatory and non-discriminatory restrictions. The first provided for caps restricting direct foreign investments which are regarded as incompatible with the EU law, while the second class of indirect restrictions constitute a block of shares….enables the shareholder…. to participate effectively in the management of the company or in its control and apply to all investors irrespective of their nationality.[16]

Even non-discriminatory Special Shares arrangements constituted restrictions on the movement of capital and thus needed to be justified. To this end the Court added to the provisions on justification in the Treaty a general proportionality test.[17] Applying this test the Commission concluded that a fair number of cases did not meet these requirements and challenged their validity before the ECJ.[18]

The disputed cases included caps restricting foreign investments in Portugal[19], caps restricting substantial shareholdings in Portugal and France[20], exclusive rights of appointment in France and Belgium,[21] as well as exclusive veto rights in France[22] and Belgium.

II. Privatizations and The Forms Of Golden Shares

Privatizations emerged as **global trend in 80s**, where a neo-liberal approach dominated in the US after the election of Ronald Reagan who implemented in general terms the same approach which in the UK started in the late 70s. The philosophy was

[16] Communication of The Commission On Certain Legal Aspects Concerning Intra EU Investment, 1997, Official Journal C 220, 15-18

[17] C-55/94 paragraph 37

[18] Communication of The Commission On Certain Legal Aspects Concerning Intra EU Investment, 1997, Official Journal C 220, 15-18

[19] C-367/98 paragraph 10

[20] C-483/99 paragraph 9

[21] C-503/99 paragraph 9

[22] C-483/99 paragraphs 9 and 10

formulated with a view to reduce public interference within the economy, increasing private shareholding and fostering economic efficiency.[23]

The privatization trend of the **late 90s**, on the other hand, was primarily due to budgetary reasons, as the Maastricht Treaty urged Member States to reduce public debts, as a precondition for the introduction of the Euro. Other incentives for denationalizations were the will to change ownership structures and to develop capital markets.

Two models of organization were predominant: the model of public law entities and the model of private law companies owned by the State. The former did not necessarily exclude entrepreneurial freedom, as shown by the British example, where State influence was limited to "*directions of a general character as to the exercise and performance by the Board of their functions in relation to matters appearing to the Minister to affect the national interest*". Such formal directions were rarely given in practice.

The second model was largely preferred by Germany, France and Italy as it allows mere partial State ownership ("mixed enterprises") and may, in a holding structure, grant control despite small shareholdings.[24]

However, nowhere in Europe did privatization really put end to State interference based on a variety of specific decisions and information rights.[25] Several instruments relating to the **decision making process** were used:

a. Increased voting powers of particular shares in the general meeting (multiple voting rights). Such limitations can be found in **Denmark, Sweden** (voting power multiplied by ten at most) and **Finland** (voting power multiplied by twenty at most).

b. Shares without voting rights are offered to the public, but all shares carrying voting rights are held back by the State. (Produce equivalent effect to the first measure). The **French** legislator frequently opted for this design during the first privatization period 1983-85: So-called "*certificats d´investissements*" served as a vehicle to allow State owned enterprises access to private capital. The income from shares is segregated from their decision power.

[23] The Thatcher Privatization Legacy: Not Quiet What She Planned?, May 2013,(Oxera)

[24] Golden Shares-State Control In Privatized Companies: Comparative Law, European Law and Policy Aspects, Stefan Grundmann and Florian Moslein

[25] Ibid.

c. Voting caps circumvent the principle of proportionality, but they cannot grant State control over a company. A combination with other means is required.[26]

d. Absolute veto and decision making powers in the general meeting on the basis of either general company law or specific legislation.-More radical circumvention in the proportionality principle than the foregoing-. The provision of the **Italian** privatization law of 199477 vested a veto right in the minister in charge, with respect to fundamental decisions such as: dissolution or transfer of the undertaking.

e. Appointment rights may have various effects and some may merely help to get access in internal company information. This is true in **France** where there is a right to appoint representatives of the State to sit on the board of directors, but without any voting power.

Other techniques relating to **shareholder structures** were the following:

a. The board as a decision maker (mainly in the **UK**). The board of directors had to require any person holding at least 15 percent of voting rights to sell the excess part of its shares within a certain period (generally 21 days) during which the rights were suspended. Otherwise, the board itself was entitled to sell the shares on further notice.

b. The State as a decision maker. In **Spain** and **France**, any direct or indirect shareholding exceeding ten percent of the capital requires prior approval of the minister in charge who acts as the State's regulatory authority.

c. Allotment of shares and stipulation of pre-emption rights. The shares are allotted to carefully chosen and specified investors. Since 1986, the **French** minister of economy has the power to choose purchasers after a hearing of the privatization commission instead of offering the shares to the public.

Finally, we should refer to some **procedural aspects** in correlation with the principle of proportionality, which gains importance according to the ECJ decisions.

a. Specificity of aims. The introduction of Golden Shares depends on specified yet often widely defined purposes (for instance: "national interest"). Due to this broad definition, it is virtually impossible to review whether the authority really has pursued such an aim.

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[26] See C-112-05 (VW Case)

b. Limitations in scope and time. A time limit also apply, where the redemption of Golden Shares, as in Britain, is possible or even imposed, or where the special rights automatically terminate, like originally in France.

c. Rules of procedure. Rules of procedure are not easily identified in this area. Belgium is the exception and designed a quite complex system of procedural warranties. The advantage, however, is that of a lower degree of state interference.

All the foregoing categories of Golden Share issues are and may be subjected to strict judicial review by the ECJ irrespective of their nature. However, some of them adopted in 80s or 90s were altered significantly or were covered behind legitimate terms, as the process of integration was boosted in the last twenty years, and the common, single market principle did not allow such apparent infringements.

III. Legal Framework

i. Communication of the Commission On Certain Legal Aspects Concerning Intra EU Investment and the 88/361/EEC Directive

In 1997 the *European Commission acting as the exclusive guardian of the EU Treaties*[27] *adopted its Communication on Certain Legal Aspects Concerning Intra-EU Investment*.[28]The aim of 1997 Communication was to give Member States guidelines on interpretation and application of Community law concerning measures introduced by Member States that constituted obstacles to cross-border investments.[29]

The Commission underlined the importance of the development of intra EU investments in 90s and the contribution of the EU law in the creation of a single market, which constituted the decisive factor for the encouragement of intra EU investments. **However, the European core body detected in some States significant attempts intending to monitor and set obstacles in the further development of cross border investments in the European Union**.

[27] See the Report of the Commission on 5-04-2001, Brussels

[28] Communication of the Commission on Certain Legal Aspects Concerning Intra EU Investment, 1997, Official Journal C 220, 15-18

[29] The legality of Golden Shares Under EC Law, Hanse Law Review, Ivan Kuznetsov

Specifically, these attempts were identified mainly in companies providing services of general interest, such as network and regulated industries (about 50% of the overall number of the detected companies), in competitive industries, such as banking, food, tobacco (about 38%) and other miscellaneous, such as defense and nuclear sector, which are prescribed precisely by the Treaties.[30]The very majority of those companies monitored by Member States through Special Rights were important economic actors at national and EU level as indicated by their market capitalization, market shares and turnover.

Some of the disputed State measures have been introduced more recently in the context of privatization programmes and constituting decisions of economic policy were considered to have fallen within the scope of the exclusive competence of the Member States. Therefore, at an initial stage, they were regarded to be permissible.

However, other measures of the same nature taken in the form of economic policy actions in the name of the exclusive competence of the States in the respective realm aimed to control the Free Movement of Capital and could generate according to the present report restrictions on the free circulation at cross-border level. Consequently, they might raise compatibility problems with EU legislation, in particular with Articles 49 and 63 of the TFEU concerning the Freedom of Capital Movements and the Right of Establishment, and hinder the functioning of the Single Market[31].

The pursued **objective** of the report was to indicate to national authorities and economic operators in Member States, how the Commission interprets the provisions of Articles 49 and 63 TFEU on Capital Movements and the Right of Establishment in this context. This would help to reduce the risk of divergent legal interpretations and would thus, on the one hand enable Member States to shape their policy by taking into account Community law in a framework of transparency and mutual trust, and on the other hand allow the Community operators concerned to be aware of their rights stemming from the Treaty on intra-EU investment.

[30]Special Rights In Privatized Companies In The Enlarged Union-A Decade of Full Development, Commission Staff Working Document, 22-07-2005

[31] Official Journal N L 178, 08-07-1988

88/361/EEC Directive[32] could be proved (for the Commission) a useful tool in the interpretation of the Fundamental principle of the Free Movement of Capital and specifically its Annex I could shed light on the **transactions** which are regarded to fall within the scope of the Free Movement of Capital.[33]

According to the report : « the heading 'Acquisition . . . of domestic securities . . .` includes, among others, the transaction 'acquisition by non-residents` of shares and bonds in domestic companies -**portfolio investment**s- on pure financial investment grounds, that is, without the aim of exerting any influence in the management of the company………"**Direct investments**" is defined as 'investments of all kinds . . . which serve to establish or to maintain lasting and direct links between the person providing the capital and the . . . undertaking to which the capital is made available in order to carry on an economic activity.[34]

The concept of those transactions must therefore be understood in its widest sense . . . As regards . . . the status of companies limited by shares, there is participation in the nature of *direct investment* where the block of shares held by a person . . . enables the shareholder . . . to participate effectively in the management of the company or in its control`.[35]

Thus, the acquisition of controlling stakes as well as the full exercise of the accompanying voting rights in domestic companies by other EU investors is also considered to be a form of **capital movement**…………..At the same time, the acquisition of controlling stakes in a domestic company by an EU investor, in addition to being a form of capital movement, is also covered under the scope of the right of **establishmen**t………shall include the right to set up and manage undertakings, under the conditions laid down for its own nationals'.[36]

The broad approach taken by the Commission according to this report was somewhat **problematic** since it used an interpretative tool derived from secondary

[32] Communication of the Commission on Certain Legal Aspects Concerning Intra EU Investments, 1997, Official Journal C 220

[33] Commission's and ECJ's view. See C-367/98 paragraph 37and C-503/99 paragraph 37

[34] See C-483/99 paragraph 6

[35] The opposite applies to portfolio investors who have no aim to influence the management of the company.

[36] Communication of the Commission on Certain Legal Aspects Concerning Intra EU Investment, 1997, Official Journal C 220

legislation (foregoing Directive) to shed light on the applicability of a fundamental freedom, namely the free movement of capital. The ECJ creating a rigid rule reaffirmed the position taken by the Commission on the issue.[37]

The criticism exerted at the expense of the Commission's thesis could become more intensive, if we took into consideration the division of the investors into strategic and passive where only the first one fall within the scope of the freedom's applicability. According to this reasoning **portfolio investors** –the most common type of investors in financial markets- will normally not reach the relevant threshold of a cap restricting substantial blockholding and will not be interested in an active role regarding the composition and the decisions of the board which the Member States influence through their exclusive rights of appointment and exclusive veto rights.[38]

Only strategic investors seeking an active role in the company's decisions are directly affected from Golden Share arrangements and thus the markets for corporate control rather than financial markets.[39] Thereby, according to this approach (minority) **it would be better if we confined the meaning of the critical term "transaction" only in direct investments where the free movement of capital on Golden Shares cases ought to have been applied**.

Having made clear the definition of the transactions protected in its view under the fundamental principles of Free Movement of Capital and the Freedom of Establishment, the Commission classified the measures intending to restrict EU law either directly or indirectly in two categories: those with a **discriminatory** character and those with a **non-discriminatory**. While discriminatory measures, in the view of the Commission are contrary to Articles 63 and 49 of the TFEU, unless they are covered by the exceptions prescribed in the Treaty, measures belonging to the second category are applicable to all investors without distinctions and thus they are not automatically contrary to the EU law.[40]

After the issuance of the foregoing Communication, **the direction of EU economic policy was clear**: In an attempt to complete the internal market, Member

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[37] See Joint cases C-163/94, C-165/94, C 250/94 paragraph 34

[38] Oxera -Special Rights of Public Authorities in Privatized EU Companies, the Microeconomic Impact

[39] Turn of the Tide? The "Golden Shares" Judgments of The ECJ and The Liberalization of European Capital Markets, Johannes Adolff

[40] The Legality of Golden Shares Under EC Law, Hanse Law Review, Ivan Kuznetsov

States were persuaded to abandon their Special Rights either voluntarily or as a result of the rulings of the ECJ, while the Commission gave primary attention to this issue on future and pending accession proceedings.[41]

At this point it is worth mentioning to underline the absence of Special Rights in privatized companies only in four small States candidates for accession in the EU, when the Commission exercised its pre-accessing screening in 1999.[42]The core institutional bodies, namely the Commission and the ECJ, played the predominant role in this attempt. The first results were encouraging, but the consistency of the regulatory framework was to be proven in the following years.[43]

However, **the initiative taken on Golden Shares issues was established in a further context** aiming to tackle generally cross-border investments restrictions and market distortions as manifested in various cases, such as in energy sector.[44] Trying to foster the liberalization and privatization of the internal EU market, the Commission set some conditions to be met concerning the sales of State-owned companies (energy sector), when the State remains the controlling shareholder. These rules were the same as in case of Golden Shares.[45]

After the publication of the first decisions on Golden Shares the Commission made a survey and issued a report for the role of these special rights in Europe and the progress made up to 2005.[46]The conclusion was that most Member States achieved considerable progress in relinquishing these rights.

Given the substantial progress in the regulatory framework, mainly through the jurisprudence of the ECJ most Member States address nowadays an increasing proportion of their general interest considerations through regulation rather than through special rights. In many cases Member States have set out a timetable for bringing down these barriers, while in others special rights can be justified by

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[41] Special Rights In Privatized Companies In The Enlarged Union-A Decade of Full Development, Commission Staff Working Document, 22-07-2005

[42] Ibid.

[43] Report of the Commission released on 22/07/2005

[44] Report of the Commission released on 20/06/2001

[45] ibid

[46]Special Rights In Privatized Companies In The Enlarged Union-A Decade of Full Development, Commission Staff Working Document, 22-07-2005

exceptions provided in the Treaty or are structured in a way that is compatible with EU law.

ii. Free Movement of Capital -art.63 TFEU, ex 58EC-

The principle of the Free Movement of Capital is of high importance for the European internal market as it has a positive influence on the development of business life within the Community.[47] **It actually constitutes the primary and main legal basis for the ECJ's Golden Shares decisions.**

The Treaty does not determine the **term capital** movement, which is interpreted, as explained before in the analysis of the Communication of the Commission, through Capital Movements Directive 88/361/EEC. Nonetheless, this fact should not surprise us, since this freedom had been declared directly applicable by the 4th Liberalization Directive of 1988 and it was nearly beyond doubt that it relates to all transactions enumerated in the respective Annex of this Directive.

Aside from investments for saving purposes that have always been considered as part of this freedom, investments for entrepreneurial purposes (so-called direct investments including majority shareholdings) fit in that Annex as well. **Thus the free movement of capital is concerned with any form of (share) capital**.[48]

A reduction in the attractiveness of a capital movement can amount as a **restriction** as ruled by the ECJ.[49]However, the ECJ is criticized because in some cases among of which are those of Belgium and France was quite brief, since it did not devote more than a couple of lines to explain its reasoning on why there is a restriction in the particular case.[50]Even on the respective issue the Court provides just one sentence, as the governments themselves had conceded the restrictive effect of the measure.[51]**It actually seems to take for granted the existence of a restriction, since the Commission initiated the proceedings**. The restriction may lay in any national provision of the legislation of the Member State, since the Court did not make any

[47] Report of the Commission released on 22/07/2005

[48] Golden Shares-State Control In Privatized Companies: Comparative Law, European Law and Policy Aspects, Stefan Grundmann and Florian Moslein

[49] C-222/97 paragraph 20 and 21

[50] C-503/99 paragraph 39-40 and C-483/99 paragraph 39-42

[51] C-503/99 paragraph 40

distinction on the provisions which can be reviewed (General company law, only State owned enterprises or publicly listed?).

The **broad definition** concerning the term "national provisions" which can breach the fundamental freedoms taken by the Court raised sensible questions such as why do not distinguish between national rules making an investment legally impossible above a given threshold (i.e. rules concerning the shareholder structure) and those making the investment only factually less attractive by curtailing the decision making powers of the other shareholders. The distance between the two restrictions is discernible and the adopted thesis pending for justification.

Also, some could argue that many other investments remain open to investors, who can in fact take advantage of the capital markets. Golden Share constructions have only the effect of making one single investment product (to a certain extent) legally unavailable or only *de facto* less attractive in this (otherwise freely accessible) market. It might well be justified to force governments to maximize privatization gains by choosing an attractive form and therefore to take full advantage of possible gains in efficiency related to such privatization.

Questions of the above described kind seem to be sensible, but they were not answered by the Court raising questions on the way that the Commission may affect the ECJs decision in the attempt to attain EU targets, such as the completion of the internal market.

However, except for the legitimate deviations provided in art. 65 TFEU (ex 58), **reasons of public policy** as determined in the foregoing subsection may constitute, according to Camara, legitimate deviations from the Free Movement of Capital and justify the restriction as long as they are not discriminatory (on the basis of the investors' nationality), not discretionary (on the basis of publicly known criteria) and proportionate (subject to the principle of proportionality) to the pursued objective.[52]These criteria adopted by the Commission too, emphasized the need to safeguard legal certainty and transparency jeopardized by these restrictions.[53]

[52] The Legality of Golden Shares Under EU Law, Nadia Gaydarska and Stephen Rammeloo

[53] Communication of the Commission In Intra EU Investment In Financial Services Sector, 21/10/2005

The Court following in principle the above mentioned criteria[54]decided on the legitimacy of the invoked public policy reasons ad hoc. Some indicative examples are the following:

- In **C-483/99** Commission v France the Court ruled that: Although French measures aimed at safeguarding supplies of petroleum products in the event of crisis which is considered to fall within the scope of the legitimate public interes, the restrictive nature of the adopted prior authorization procedure was not proportionate to the pursued objective. The Court stated that the provisions concerned would discourage investors from other Member States, thus violating both the principle of the Freedom of Establishment and the Free Movement of Capital. – France failed to comply with the proportionality principle, despite the legitimacy of restriction-.
- In **C-503/99** Commission v Belgium the Court **accepted (the unique case)** the legitimacy of the restriction grounded on public policy reasons: The Belgian opposition procedure was compatible with the free movement of capital principle because it was found to constitute a legitimate justification on the basis of public security. The Court stated that the measures "*fall undeniably within the ambit of a legitimate public interest*". In addition the ECJ underlined that the scheme could effectively achieve the objective and it was demonstrated that the measure was narrowly tailored to achieve the objective without excessive restriction.
- In **C-367/98** Commission v Portugal the Court ruled that: "*the financial interests cannot constitute a valid justification for restrictions on the capital market*". In the following years the Court reaffirmed that economic grounds can never serve as a justification for restrictions prohibited by the Treaty.[55] –The Portuguese Government failed to invoke even a reason falling within the ambit of public policy exception-.

[54] C-58/99 paragraph 13
[55] See the consistency of case law in C-171/05 paragraph 71

The measures that imply a **discriminatory**[56]treatment on the basis of nationality are prohibited. As regards **non-discriminatory** measures, they are permitted by EU Law in so far as they are justified by imperative requirements in the general interest and they are proportionate to the achievement of that interest. This interpretation of the Commission has been confirmed in a series of recent landmark rulings by the European Court of Justice among of which are the foregoing.

However, we should pay attention to the implied discriminatory character of a restriction. Namely, the restriction may have a **discriminatory effect in practice**, even if the particular special right does not appear to contain a discriminatory element in the paper. For example, the provision which authorizes the government to block takeovers in general, although seems to be non-discriminatory, in practice may have the adverse effect, if the government applies the provision only in respect to foreign bidders, while disregarding it for the domestic.[57]

iii. Freedom of Establishment -art 49 TFEU, ex 43 EC-

The acquisition of the controlling stakes in a domestic company by a European investor from another Member State is undoubtedly covered by this fundamental freedom.[58]According to the later, nationals of other EU Member States should be free to acquire controlling stakes, to exercise voting rights and manage domestic companies under the same conditions laid down in a given Member State for its own nationals.

Although, in direct and portfolio investments basically art. 63 TFEU applies, in the first category of investments (direct) article 49 TFEU applies too.[59] For example, the acquisition of company shares requires a capital movement, but can

[56] C-58/99 paragraph 13

[57] Oxera- Special Rights of Public Authorities In privatized EU Companies, the Microeconomic Impact

[58] Special Rights In Privatized Companies In The Enlarged Union-A Decade of Full Development, Commission Staff Working Document, 22-07-2005

[59] See the opinion of Advocate General in C-251/98 paragraphs 15, 33 and 50

easily involve establishment, especially if the acquisition is big enough to give the purchaser control rights over the company.[60]

The aforementioned instance is only one among others where the Freedom of Establishment and the Free Movement of Capital may **overlap** in their application. The confusion becomes even more intensive as long as we took into consideration the second subparagraph of article 49 TFEU, which provides that the right of establishment is subject to the provisions of the chapter related to capital, while article 65 paragraph 2 TFEU underlines that the provisions of this Chapter (capital movements) shall be without prejudice to the applicability of the restrictions on the right of establishment which are compatible with the Treaties.

These provisions imply, as the ECJ repeatedly ruled (see in the following analysis) that the protection offered in case of concur application of those freedoms in Golden Shares **is confined only to one of them**, namely the Free Movement of Capital.

Nonetheless, the adverse **position** at issue was expressed by the Advocate General in Baars Case who argued that: "*The reservations do not signify that conduct can be protected only under one of these fundamental freedoms. Were any reference to capital movements ipso facto to preclude application of the chapter on the freedom of establishment, that fundamental freedom would lose any practical meaning, since establishment in another Member State generally involves a transfer of capital"*.[61]Therefore, according to his reasoning, the Court had to choose the freedom which was more amenable in the given circumstances.

However, according to the ECJ's consistent case-law, the second (establishment) is **inextricably linked** with the first,[62]which is regarded practically

[60] Limited But Not Lost: A Comment On The ECJ's Golden Share decisions, Fordham Law Review, Christine O'Grady Putek

[61] Opinion of Advocate General in C-251/98 paragraph 13

[62] C-463/00 paragraph 86

the exclusive[63]legal basis for scrutinizing intra EU investments restricted through Golden Shares.[64] This outcome is founded upon the subsequent arguments:[65]

a. Both freedoms apply to the exit from the State of origin as well as to the entry into the host State.

b. Both of them are considered to prohibit, not only direct discrimination, but also the restrictions in a broader sense (non-discriminatory).

c. In both cases, deviations can be justified by mandatory reasons of public good (in the majority of the infringements) in the light of proportionality principle.

d. **However**, there are two significant differences between them:

Only the Free Movement of Capital applies **to third States and Member States alike**. Even if art 64 TFEU allows restrictions, this permission perhaps not apply to privatization laws that national legislators wish to adopt henceforth. It follows that direct investment from third countries liberalized.[66]

In the foregoing framework, the **ECJ** in its recent case law **tried to delineate** the distinction between the two freedoms[67]and give concrete guidance as to which of them is applicable in case of overlap. If a measure concerns portfolio investments then exclusively the Free Movement of Capital is applicable, while for measures applied to "control" situations in direct investments both of freedoms are applicable (critical is the threshold required for control), even if primarily the establishment is concerned. Therefore, **the first (capital) has far broader scope** of application than the second as in portfolio investments and direct (below the control threshold) the Free Movement of Capital applies exclusively, while above that threshold (in direct investments) both of the freedoms apply. The Freedom of Establishment thus applies only in direct "control investments" **simultaneously** with the Free Movement of Capital.[68]

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[63] See the opinion of Advocate General in C-174/04, where there was even no reference to the freedom of establishment

[64] C-463/00 paragraph 86, C-367/98 paragraph 56 and C-503/99 paragraph 59

[65] Article 65 paragraph 2 and 48 subparagraph II TFEU

[66] Golden Shares: State Control in Privatized Companies: Comparative law, European Law and Policy Aspects, Stefan Grundman and Florian Moslein

[67] C-326/07 paragraph 34-36

[68] Domestic Company Law and The Free Movement of Capital: Nothing Escapes the ECJ?, Wolf-Georg Ringe,

The application of these fundamental freedoms leads in **parallel outcomes** with regard to substantial issues, but one of them (capital) has broader scope of application and therefore is more useful. **Hence, the free movement of capital is the benchmark in Golden Shares issues, despite the acknowledgment both by the Commission and the ECJ of the concurrent applicability of the Freedom of Establishment**, except for the previous case of Italy (C-326/07).[69]

Additionally, the Court in the context of the foregoing deliberations might have opted to rely on its wealth existing precedent to decide on the Golden Share cases[70], indicating that some cases infringe both freedoms, and the reason for the Court's application of one body of law over the other may be apparent only by considering the development of the relevant precedent.[71]

Furthermore, from a **practical point of view**, it is understandable that the Court after having addressed the infringement on the Free Movement of Capital found no need for further and separate examination of the restrictions in the light of the Freedom of Establishment.[72]What’s more, it may not wish to review such a delicate issue in EU Law like the separation and allocation of competences (or the division of powers) between EU institutions and Member States. [73]

At this point it could be fruitful to remark that the **opposite opinion** was the one adopted by the AG, Ruiz-Jarabo Colomer, in all cases (where made suggestions) except for the German one, namely that the restriction on the Free Movement of Capital was merely incidental to the restriction on the Freedom of Establishment.[74] However, its impact was trivial since it had been dismissed by the Court consistently for approximately a decade, until 2009, when the ECJ rendered its C-326/07 adopting partially his position.

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[69] See Communication of The Commission On Certain Legal Aspects Concerning Intra EU Investment, 1997, Official Journal C 220, 15-18 and C-463/00 paragraph 85

[70] C-54/99 and C-302/97

[71] Limited But Not Lost: A Comment On The ECJ’s Golden Share decisions, Fordham Law Review, Christine O’Grady Putek

[72] See for instance joint cases C-282/04 and 283/04 paragraph 43, C-171/08 paragraph 80 and C-543/08 paragraph 99

[73] Golden Shares in The EU: Shall They Overcome? University of Exeter, School of Law, Dirk Gaupp

[74] Opinion of Advocate General C-463/00 paragraph 36 and C-98/01 paragraph 36

The ECJ[75]in its recent decision doubted if the exclusivity of article 63 TFEU is still useful for reviewing all golden arrangements' issues. The Court reached a new outcome and **tried to lift the freedom of establishment from secondary to first position** as the latter was regarded the solely legal basis for reviewing the veto right granted in favor of the Italian government, contrary to other decisions taken in the respective issue.[76]

Pursuant to this new, but **temporary,** as we see thesis [77] there are some categories of Golden Shares, namely veto rights in any of their taken legal form, which will no longer be judged on the basis of article 63 TFEU, but on the Freedom of Establishment[78]basis in view of their capacity to obstruct a shareholder from exerting a definite influence on the company's decisions and to determine its activities.[79]

The **rationale** behind the adoption of the new thesis is not the fact that veto rights do no longer deter possible investors from investing in a company, but the dissuasion of investors is regarded as the inevitable impact of the restriction that veto rights impose on the Freedom of Establishment. The Court consistent with the approach that, if a national measure breaches two or more fundamental freedoms, only one of them is to be applied when it is clear from the circumstances that one of them is entirely secondary to the other and can be linked to it,[80] remade its previous case law on the applicability of the free movement of capital in relation to veto right.

Another predominant underlying **purpose** of amending ECJ's case law on the matter was *"[...] to prevent undertakings in strategic sectors from falling into the hands of financial groups of dubious solvency from outside the Community which may have objectives incompatible with the policies of the Member States* as expressed by AG Colomer and based on certain legal grounds.[81]

However, these grounds are not safe and effective enough to safeguard their pursued objective. Firstly, non EU nationals can easily attain their objective in another

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[75] C-326/07 paragraph 39

[76] See C-563/99 0r joint cases C-282/04 and C-283/04

[77] As reaffirmed by the later decision C-207/07

[78] Opinion of Advocate General in C-326/07 paragraph 44 and 45

[79] Golden Shares: A New Approach, Jan Von Van Bukkum, European Company Law

[80] Ibid.

[81] See opinion of Advocate General in C-326/07 paragraphs 46, 47 and 50

way through registration of their place of administration within the EU and therefore can be treated as nationals of Member States. Secondly, the decision may give Member States the legal basis to misuse Golden Shares for protectionist purposes.

Besides, the ensuing case law[82] **came to refute** the position of the ECJ taken in the recent litigation against Italy concerning the applicability of article 49 TFEU instead of article 63 TFEU in veto cases. What's more, other special rights of similar nature, such as the right to appoint directors of the board in the company which were regarded to fall primarily within the ambit of article 43 were not reaffirmed.[83] **The Court returned in its consistent thesis, namely the exclusive practically applicability of the Free Movement of Capital as the legal basis for reviewing Golden Shares without making any distinctions in veto or appointment rights.**

iv. Public Interest Exception

Despite its usefulness as justification for the restrictions imposed on the Free Movement of Capital, little positive guidance exists for its content and the existing case-law is limited.[84] However, the following case is **indicative and meaningful to shed initially light** on the issue.

Case C-54/99, *Association Eglise de scientologie de Paris and Scientology International Reserves Trust v The Prime Minister*

New legislative rules governing financial relations with foreign countries were adopted on 14 February 1996 in France. These rules maintained, *inter alia*, **a system of prior authorization** in the case of a foreign investment that is such as to represent a threat to public policy, public health or public security. The Conseil d'État has referred to the Court a question concerning the compatibility of such a system with the Community-law principle of the Free Movement of Capital.

First of all, the Court declared that a national provision which subjects a direct foreign investment to prior authorization constitutes **a restriction on the Free Movement of Capital** even if authorization is deemed to have been obtained quite

[82] C-171/08 paragraphs 79 and 80, C-543/08 paragraphs 41, 44, 64, 98, 99

[83] C-543/08 paragraph 60, 62 and 64

[84] Communication of the Commission In Intra EU Investments In Financial Services Sector, 21-10-2005

shortly, namely one month after receipt of the request and even though no penalty is predicted.

Such a derogation from the fundamental principle of the Free Movement of Capital can, according to the Court, **be justified only by requirements of public policy or public security.** These grounds must be strictly interpreted and must be available to review by Community institutions.

Public security justification was initially considered to include dangers and risks to the very existence of the State and its institutions.[85] This approach changed later on, since the Court referred to a decision on the Free Movement of Goods,[86] where there was a specific reference to the public interest in the sense of **public utilities**.

Considering that the reason and even the wording of the reason for the justification of the restriction of the Free Movement of Capital are identical to the one of the Free Movement of Goods, we could conclude that public utility may amount to a possible justification. The general economic policy purposes though cannot amount to a permissible justification.[87]

The Court tried in its finding to clarify the conditions under which the **public policy** exception may qualify as a permissible and **proportionate restriction (suitable and not go beyond what is necessary)** in the Free Movement of Capital in **non-discriminatory** cases which are not regarded by definition as incompatible with the EU Law.[88]

First of all, it should be observed, that while Member States are still free to determine the requirements of public policy and public security pursuant to their national needs, these grounds **must be construed strictly** in the Community context as derogations from the fundamental principle of the Free Movement of Capital, so that **their scope cannot be determined unilaterally by each Member State without any control by the Community institutions**.[89]

Moreover, public policy and public security may be acceptable, only if there is a **genuine and sufficiently serious threat** to a fundamental interest of the

[85] See joint cases C-163/94, C-163/94, C-250/94 paragraph 23-25

[86] C-72/83 paragraph 7

[87] C-367/98 paragraph 52

[88] C-55/94 paragraph 33

[89] C-36/75 paragraph 26 and 27

society[90]and any derogations from the fundamental principles of EU law must not be misapplied[91]so as, in fact, to serve purely economic ends. What's more, any person affected by a restrictive measure based on such a derogation **must have access to legal remedy**.[92]

Secondly, measures which restrict the Free Movement of Capital may be justified on public-policy grounds only **if they are necessary** for the protection of the interests that they are intended to guarantee and only in so far as the **pursued objectives cannot be attained by less restrictive measures**.[93]

In the present case, however, the substance of the system in question is that prior authorization is required for every direct foreign investment which represents a threat to public policy and public security, without any more detailed and precise definition. Thus, **the investors concerned are given no indication regarding the specific circumstances in which prior authorization is required. Such lack of accuracy does not enable individuals to be informed of the extent of their rights and obligations deriving from Article 65b of the TFEU**.

The **reasons** invoked by Member States usually have the following content: Governments want to ensure that the control of the company will not fall in hostile hands or to ascertain that the company retains its purpose and place of its incorporation or to prevent the sale of its core assets or to ensure the compliance of new owners policy with the sales agreement or to safeguard public defense and security or to protect sensitive sectors of the economy.[94]

v. The Principle of Proportionality[95]

The questions of whether a national rule fits for the intended purpose and whether it is the least restrictive measure are both questions which concern details of national law. Through the application of this fundamental principle the Court in fact

[90] C-98/01 paragraph 13

[91] C-36/75 paragraph 30

[92] C-222/86 paragraph 15

[93] Joint cases C-163/94, C-165/94, C-250/94 paragraph 23

[94] Special Rights In Privatized Companies In The Enlarged Union-A Decade of Full Development, Commission Staff Working Document, 22-07-2005

[95] See C-463/00 paragraph 69 and C-367/98 paragraph 50

penetrates into the substance of the national provision in question reviewing its utmost purpose. Despite the depth of the scrutinizing achieved through this tool, there is still a significant danger which is to be regulated by the jurisprudence of the ECJ, namely the criteria composing the principle and the strict requirements of their applicability, The purpose is apparent: Not only will we make the decisions more foreseeable, but also we will confine the scope of ECJ's discretion.

Firstly, the national measure must be suitable for securing the objective which it pursues and must not go beyond what is necessary in order to attain it. With respect to the last criterion we should consider whether the ***least restrictive measure*** had been chosen[96] and therefore three issues are of relevant significance: **the limits of the control power, the design of (administrative) proceedings and the possibility for judicial review**.[97]

For the first criterion, the conditions of the State's intervention and the available measures which amount to such an intervention are to be known before their applicability in order to ensure ***legal certainty***. The French decision is illustrative on the issue, as the intervention of the State authority did not depend upon specific conditions and therefore it was possible in any case, even if not necessary for safeguarding the petroleum supplies.[98] Henceforth, administrative action is allowed only for specified purposes and must only be taken with respect to specified objective criteria in order to enable possible investors to anticipate the exercise of these special rights on behalf of the State.

In respect to the second criterion, **the standards that the Court imposed in administrative proceedings are quite strict**. According to its settled case-law, a system of an ex post opposition is preferable for reasons of legal certainty instead of prior authorization.[99]The reason why the Court upheld the restriction imposed in case of Belgium was that the period available for the administration to express its opposition was short and the latter had to be expressed on a certain form. Therefore, transparency and legal certainty was sufficiently guaranteed by the Belgian State.

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[96] C-503/99 paragraph 46

[97] Golden Shares: State Control In Privatized Companies: Comparative law, European Law and Policy Aspects, Stefan Grundman and Florian Moslein

[98] C-483/99 paragraph 50 and 51

[99] See C-503/99 paragraph 49 in comparison to C-483/99 paragraph 52

The last criterion of ***judicial review***[100]exercised upon the authority's decision was essential for safeguarding legal certainty. Otherwise, the discretion given to the State body might have been used for reasons unrelated to the pursued objective. The last criterion draws the line between the duty of the authority to specify the attainable purpose or to justify its decision on certain grounds and the abuse or misuse or excess of its power. In any case no review of the substance is allowed.

The Court **at this point has to take various elements into consideration in order to determine whether the least restrictive measure was chosen without making a priori comparative analysis of the less restrictive one**. Afterwards, it has to assess the interaction among them and their suitability in correlation with a clearly and narrowly described objective. The outcome must be not only transparent, but also well structured on the basis that the main aim of a private undertaking is the orientation of the profit, while public interest must be seen as an exception.

Therefore, the ECJ scrutinizes Golden Share restrictions in two levels: At the first stage, **the restriction must be justified by reasons of public good which should be specified as they make the investment less attractive**. The general invocation of economic policy reasons doe not suffice, since the primary objective is to safeguard the freedom of private initiative within a market economy framework.[101]Besides, as pointed out by the Commission special powers cannot be used merely to aid the economic performance of the companies.[102]

At the second stage, the Court reviews **the specific design of the national provision at stake**. Proportionality plays an important role at this point. The Commission regards that the national legislator must prove that no other design would have been less intrusive. Instead, the Court regards that the State set a disproportionate and illegitimate restriction when there is evidence that a less restrictive measure was indeed possible and would have granted an equal standard of protection.

[100] C-483/99 paragraph 46

[101] Grundman (2001) ERPL 505

[102] Special Rights In Privatized Companies In The Enlarged Union-A Decade of Full Development, Commission Staff Working Document, 22-07-2005

IV. Economic Impact (Oxera Report)

Commission assigned to **Oxera** the task to conduct a study on public investment restrictions in EU companies and the **economic** (purely) impacts of Golden Shares. The conclusions of this survey were the following:

i. **Voting rights and controlling powers carried by certain shares in most cases increase market value of those shares, expect for the case that the State retains them and the adverse effect is identified**. In general terms, voting premia and value of control blocks differ depending on various factors such as the concentration/dispersion of shares in the firm or the degree of competition in a given market. To sum up, market does value control rights and premia are paid for shares with multiple voting powers, but in case of State control the scene is different as public authorities are susceptible to options with less political cost which affect corporate governance and decrease the firm value.

ii. The effects of Golden Shares are considered to be equally detrimental to the effects of other restrictions imposed on international investments and capital movements. **These restrictions are regarded to create additional costs on affected companies and investors, segmenting and distorting financial markets**. For example, if the State is able to regulate the quantity of shares owned by foreigners, markets for domestic and foreign investors will become separate. Therefore, the price of the equity available to domestic investors will be lower to the equivalent for foreigners, as there will be two classes of shares partially accessible for each category of investors.

iii. One of the usual rights conferred through Golden Shares is the blocking power of the shareholder against hostile takeovers. But, the relationship between those anti-takeover provisions and company performance is negative deterring perspective investors from making bids to target companies where those powers are retained.[103] **The conclusion is based on the assumption that managers may take advantage of the increased lack of control and do not maximize the shareholder**

[103] Corporate Governance and Equity Prices, Financial Institutions Center, Paul A. Gompers-Joy L Ishii-Andrew Metrick

value.[104]By contrast, other (minority) experts argue that decreasing the takeover threat for a company, we may enhance its productive efficiency and firm value.[105]

iv. **The transfer of ownership from State to private investors increases financial and operational performance of the company and its productivity**. Authors have found that private ownership leads to higher rates of productivity growth and declining of costs on the long-run,[106] while the same occurs with profit margins and size of the workforce,[107] after the privatization process. Adversely, voting caps, veto and other special rights impeding corporate governance decisions make corporate control less effective, the governance standards poorer and the overall performance of the company negative.

To **reaffirm** the reasoning of the foregoing results we could remark the outcome of another research which has also demonstrated that the presence of special rights in a privatized company has a negative effect on the performance of this company. The failure to transfer complete control and to exercise the right incentives, combined with the uncertainty concerning government intervention and the cost of imposing certain conditions, has an impact on the market valuation of the company and may result in an under-pricing of the company's shares.[108]

Besides, special rights may provide a shelter for the government from market discipline resulting into poorer corporate governance. On the other hand, privatizations far from any special shares increase the profitability of the company, improve operating efficiency and encourage capital investments.

In any case, the **severity of the economic impact** of Golden Shares is not only associated with the type of the vested special right, but also with the design and the structure of the right as adopted by a certain State. For instance, a compulsory cap of investors' shareholding is regarded more restrictive than the right of the public

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[104] Oxera- Special Rights of Public Authorities In Privatized EU Companies, The Microeconomic Impact

[105] Breach of Trust In Hostile Takeovers, Andrei Scleifer and Lawrence H. Summers

[106] Productivity Growth and Firm Ownership: An Analytical and Empirical investigation, Isaac Enrlich -Georges Gallais Hamonno - Randall Lutter - Zhiqiang Liu

[107] State vs Private Ownership, NBER Working Paper No 6665 (1998), Andrei Scleifer

[108] Corporate Governance and Equity Prices, Financial Institutions Center, Paul A. Gompers-Joy L Ishii-Andrew Metrick

authority to veto certain decisions, despite the fact that they belong as form of restrictions in the same category, which control changes in ownership and shareholder structure of the company.

Additionally, the restrictiveness of the measure depends upon the degree of discretion exercised by the public authority, the threshold level that leads in the application of the cap or veto, the range and significance of decisions that the special right may affect, the kind of power granted to the State (absolute veto or multiple voting rights), the conditional or unconditional intervention of the State, the time period during which the right is available to the State. For example, a cap of 10% which triggers the authorization procedure is considered less stringent than a cap of 5% or the adoption of a system based on post opposition is preferable than one of prior authorization.

Despite Golden Shares' **significant negative impacts on economic field, we should not overestimate them as far as their consequences** in the performance of EU companies are concerned. According to the organization for the economic cooperation and development (**OECD**), the most open countries regarding the barriers to direct foreign investments in the industrialized world are EU countries. However, the Commission aims at making the EU an even friendlier regime to perspective investors and thus Oxera's report should be taken seriously into consideration.

V. C-112/05: Commission of European Communities v Federal Republic of Germany (Volkswagen Case)

I decided to comment this decision of the ECJ not only due to its legal complexities as we see in the subsequent analysis, but also due to its fundamental economic and symbolic impact within the EU. The VW decision fixed the legal framework which was adopted previously in the Golden Shares regime and tried to go even further setting questions were to be answered by the future case law.

i. Breach of the Free Movement of Capital. The provisions of German legislation, which were used by the parties to support their views in the given case before the European Court of Justice, were:

a. **Paragraph 134(1)** of the Law on public limited companies. The provision permitted the designation of a progressive or absolute ceiling, which could be set by the articles of association, in case of unquoted companies, where one shareholder holds a large number of shares. The legitimate capability of the association could result in the restriction of the voting rights of the shareholder in question no matter if the general rule of the voting power of the shareholder depended upon the par value of the shares or the in case of no par value upon the number of the shares held in the given case.

b. Also, **article 101(2)** provided that: "'*The right to **appoint representatives** to the supervisory board shall be laid down in the articles of association and such rights may be granted only to specified shareholders or to the holders of specified shares….In aggregate, the rights of representation granted shall not exceed one third of the number of members of the supervisory board appointed by the shareholders in accordance with the law or the articles of association*."

The relevant provisions of the Volkswagen law, which constituted the basis for the legal dispute between the Commission and the German Republic (Law of 21 July 1960 as amended on 6th September 19650), namely the law governing the privatization of equity in this huge German company, were the following:

a. The right of the Federal State and the Land of Lower Saxony each to **appoint two representatives** to the undertaking's supervisory board, as soon as they hold shares in the company;

b. The **limitation on the exercise of voting rights** to 20% of the share capital in the case where the holding of a shareholder exceeds that percentage; and

c. **The increase to 80%** of the shares represented by the majority required to pass resolutions of the General Assembly of shareholders, which under the Law on public limited companies required only a majority of 75%.

The Court found that there was breach of article 56 (1) EC as in the definition of the Free Movement of Capital we should list the **investments** of any kind undertaken by natural or legal persons and which serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity.

Annex I 88/361 EEC constituted a considerable tool for the specification of the meaning of the fundamental freedom, since there was no precise and clear definition in European Primary Legislation.[109] Also, the Court remarked that lasting

[109] The same interpretation in C-157/05 paragraphs33 and 34

economic links presupposes that the shares held by the shareholder enable him, either pursuant to the provisions of the national laws relating to companies limited by shares or in some other way, to participate effectively in the management of that company or in its control.[110]

Specifically, the Court found the following:

a. **Capping of voting rights up to 20%**. The Commission maintained that this rule is in opposition with the requirement that there should be a certain degree of proportion between shareholding and the related voting rights. Even if the capping of voting rights is a common instrument of company law, there is a considerable difference between the State making possible to insert such an instrument into a company's articles of association (Case in German law for non-quoted public companies) and the State regulating in its capacity of legislator a provision to this end for one undertaking solely and ultimately for its own benefit, as the case with Paragraph 2(1) of the VW Law.[111]

There is, therefore, a difference between a power made available to shareholders, who are free to decide whether they will take advantage of it or not and the obligation imposed to them through the pertinent legislation without giving them the possibility to derogate from it.

b. **Resolutions of the general meeting require 80% of the voting rights**. The decisions that the company may take concern various issues among of which are capital increase or decrease and the amendment of the company’s articles of association. The law of public liability companies requires in general a majority equal to 75%, but allows the shareholders to increase or decrease that percentage. By contrast, the VW law imposes an 80% threshold in the form of law and the shareholders cannot deviate from that regulation, since they cannot alter the provisions of a law.

The **conclusion** of the combined interpretation of the aforementioned observations is that any shareholder holding 20% of the company’s capital acquires **blocking power** against the other shareholders, since the legislation granted this prerogative which can be deprived or amended only by a typically equal or superior

[110] Consistent with its subsequent view in C-174/04 and C-367/98

[111] C-112/05 paragraph 32

law. According to the information provided to the Court, the Land of Lower Saxony retains the critical interest of 20% in the company.[112]

Taking into consideration all these thoughts, the Court concluded that the State created a legal framework enabling it to exercise decisive influence in the decisions and the management of the company without holding any significant and proportional to these powers amount of shares.

In other words, an investment of a relatively reduced value for the German Federal State allowed the latter to block certain decisions and indirectly to hinder the effective participation of possible investors in the management and control of the company. Thus, this framework is liable for deterring direct investments of investors from other Member States and there is breach of the Free Movement of Capital.

c. Appointment of two representatives to the supervisory board by each of the Federal State and the Land of Lower Saxony.

The Commission submits that Paragraph 4(1) of the VW Law, allowing the Federal State and the Land of Lower Saxony each to appoint two representatives to the supervisory board of Volkswagen, if they are shareholders in the company, derogates from the rule prescribed in Paragraph 101(2) of the Law on public limited companies, to the effect that such a right may be included only into the articles of association (not legislation) and may concern only one third of the members of the supervisory board appointed by the shareholders, that is three representatives in the case of Volkswagen.

According to the Commission, by limiting the ability of the other shareholders to participate effectively in the management and control of that company, Paragraph 4(1) constitutes a restriction on the Free Movement of capital.[113]

While German company law assigns to the supervisory board the task of monitoring the company’s management and of providing reports to the shareholders for that purpose, it confers significant powers to the board, since performing its monitoring task it can appoint or dismiss the members of the executive board.

Also, both the German republic and the Land of Lower Saxony according to VW law can appoint an overall number of four out of 10 representatives, despite the

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[112] C-112/05 paragraphs 48 and 49

[113] C-112/05 paragraph 57

fact that only one of them holds interests in the company and its total shares are only 20% of the holding.

Besides, the right remains at the disposal of the foregoing shareholders as long as they hold interests in the company no matter if their shares' stake suffices or not.

Thus, the right of appointment conferred on the Federal State and the Land of Lower Saxony enables them to participate in the activity of the supervisory board in a disproportionate way compared to the equivalent afforded to a normal shareholder.

For the foregoing reasons, the VW law enables the State to exercise a certain level of influence which exceeds the limits that its holding in the company imposes in compliance with the proportionality principle. The other shareholders are restricted to an equal extend since they are unable to participate in the company with the view to establish lasting and direct economic links and thus take part effectively in the control or the management of the company.

Once the Court had admitted that there is a breach of fundamental freedom, it reviewed the imposed restriction on the basis of the existence of overriding public policy reasons invoked by the German State.

The criterion is the following: "*In the absence of such Community harmonization, it is in principle for the Member States to decide on the degree of protection which they wish to afford to such legitimate interests and on the way in which that protection is to be achieved. They may do so, however, only within the limits set by the Treaty and must, in particular, observe the principle of proportionality, which requires that the measures adopted be appropriate to secure the attainment of the objective which they pursue and not go beyond what is necessary in order to attain it".*[114]

The ultimately adopted thesis was that the German State **failed to explain precisely why it is necessary and appropriate** to hold a strengthened position in the capital of that company for the invoked effective protection of VW workers and the minority shareholders.

What's more, the German side **failed to justify the reason why statutory guarantees are required for the protection of general interest in case of a large company as VW**, especially where these guarantees are not necessary for other

[114] The same conclusion in joint cases C-282/04 and C-283/04

companies subjected to general company law despite its equal to VW size and power.[115]

ii. Breach of the Freedom of Establishment. The national provisions which apply both to nationals of the Member State where the disputed company was established and to nationals of another Member-State who exercise some degree of influence in company's decisions determining its activities contradict the Freedom of Establishment as provided in art 49 TFEU.[116] Therefore "Golden-Shares" should be reviewed on the basis of their compatibility with this freedom too, **but in a complementary basis as this approach stems from the case-law of the ECJ**.[117]

In the given case, the restrictions imposed by VW law could constitute an infringement of the fundamental freedom[118]as long as the Commission afforded a sufficient ground for backing up its arguments.[119]However, it failed to provide the suitable justifications to reason its opinion and therefore its initial allegation for breach of art. 49 TFEU was dismissed.

iii. Opinion of the Advocate General. Although the present case does not really come within the ambit of Golden Shares (strict sensu) because the special rights in question **are not attached to the shares held by public bodies**, it is not possible to accept a reductionist view of how these rights must be construed. In fact, the decisive factor is not whether the excessive rights are formally attached to certain shareholdings, but rather whether these rights are conferred in a privileged manner to the extent that they dissuade investors, particularly foreign investors.[120]

The AG contrary to the ECJ regards that the principal and **not the complementary legal basis** for the infringement of EU law by "Golden Shares" granted by certain Member States is art. 49 TFEU and not art. 63 TFEU.[121]

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[115] In compliance with its previous decisions where in C-463/00 tobacco and banking industry were not regarded as overriding interest worth protection

[116] The same approach was adopted in C-157/05 paragraph 27

[117] Opinion of Advocate General in C-112/05 paragraph 57

[118] C-112/05 paragraph 14

[119] VW: The State of Affairs of Golden Shares. General Company Law and the European Free Movement of Capital, Gert-Jan Vossestein

[120] Opinion of Advocate General in C-112/05 paragraph 44

[121] Ibid paragraphs 58 and 59

His opinion delivered to the ECJ before the issuance of the relevant decision and **was completely in line with the equivalent of the Court's findings at the issuea** of the **interpretation of 88/361EEC** in correlation with art 63 TFEU, the **combination of the two criteria** (capping of voting rights in 20% in combination with resolutions requiring 80% of the voting rights reasoned the blocking power of the State) to justify the infringement, the dismissal of the allegation for the existence of **overriding public policy reasons**. **Despite the initial remark of the Advocate General that the legal basis of the breach is not art. 63, but article 49 TFEU, in all the other issues upon which the infringement was founded there was absolute identification between the AG and the Court**.

iv. Remarks

i). The outcome of the so called "Volkswagen case" was highly anticipated **by** the vast majority of not only **the literature**, where the case in its legal aspects was well founded (even not very strongly) and could have opened the Pandora's box as we mention later on, but also **the international economic players in automobile sector** among of which Porsche was the predominant one. The latter increased its stake in *Volkswagen* to just above 30 percent in early 2007, thereby expecting the fall of the *Volkswagengesetz*. Porsche's goal was said to be the acquisition of the total control in VW, once the VW law was abolished.[122]

Thus, divergent parties for different reasons were looking forward to be informed for the outcome of the case creating a surrounding climate, which could affect the judgment. VW law was in force for about 50 years and the outcome was expected to bring about radical changes in one of the biggest companies of the EU, controlled by the largest economy of the EU which was ultimately Commission's main sponsor.

ii) The ECJ issued **a decision in compliance with its previous cases** where the gist of them was that the ECJ did not accept the decisive influence of the State in private companies that would allow the State – without a justifying proportionate reason – to receive preferred treatment above the other shareholders. In other words, a violation of the fundamental freedoms was always found in cases where the State acted qua regulator rather than qua market operator.

[122] At Volkswagen, A Historic Change At Hand, Mark Landler, New York Times

The Court did not distinguish between provisions[123] that were part of legislation or that entered into the articles of association of the company.[124] Nor did the Court require discrimination in order to find a violation of Article 63 TFEU.[125] Rather it has become clear that Article 63 TFEU covers also measures that may impede capital movements, even though they are not discriminatory. **The decisive factor that constituted a restriction of the fundamental freedoms was that the respective "special right" has always been in direct favor to the State itself in its function as market regulator**.[126]

iii) In the present case, there was a distinctive characteristic making the review of the case more dangerous and delicate. VW law constituted a genuine public regulation provided only rules for general company law and there was **no reference for the State as the beneficiary of these rules**. Thereby the relevant rules, at least the capping and the voting majority, applied to all shareholders on equal terms.

In other words, what the Court had to scrutinize here were genuine rules of company law – admittedly deviating from the general rules, but making changes for the interior management of VW- without any public authority's interference per se. Other private shareholders – irrespective of the Member State they came – could have benefited from the provisions in the same way as the German authorities could.

The Court might have opened the Pandora's Box of assessing the compatibility of **every provision of national company law concerning the involvement of the State or not (only private persons)** in relation to the Free Movement of Capital.

As precisely pointed out for the eventually avoided -for some commentators- "**mistake**": "*In fact, this development threatens to morph into a 'substantive control' or 'quality control' of domestic company law in a way that the Court not only assesses questions of cross-border discrimination or market access, but rather measures the company law as designed by each Member State against the Court's own substantive values*".[127]

[123] See joint cases C-282/04 andC-283/04

[124] C-98/01 paragraph 13

[125] C-367/98 paragraph 44

[126] The VW Case and the ECJ, Wolf-Georg Ringe, Common Market Law Review

[127] Domestic Company Law and the Free Movement of Capital: Nothing Escapes from The ECJ?, University of Oxford Legal Research Paper Series, volume 42, 2008, Wolf-Georg Ringe

The same "mistake" avoided in the specific case was made clearly in the interpretation of another freedom in the so-called Dassonville case[128], where the broad interpretation adopted by the Court led in reviewing every provision of national law as potential obstacle to the Free Movement of Goods. If the Court had adopted the same broad approach in respect to the Free Movement of Capital then it would have to correct its interpretation as in case of Keck.[129] **By contrast the Court could take the maximum effectiveness of the freedom as long as it adopted the broader one.**

In the second case, two counter arguments can be put forward. Firstly, fundamental freedoms' primary objective is to facilitate cross-border private autonomy. Secondly, the EU Law should take into consideration the overall context of private law in question and its internal coherence without being able to penetrate indistinctly at various points of private law.

However, these arguments proposed by predominant commentators depicted their previously expressed fears and **can be rejected on the following grounds**: Very rarely the danger of system discontinuities convinced the ECJ to refrain from finding a fundamental freedom being violated.[130]Besides, private law is a useful tool for the facilitation of cross border activities and thus it should be formed in accordance with the EU Law which regulates the former.

In its analysis the Court **came to an interesting, but imperfect -in my opinion- conclusion.** Associating the two provisions contained in VW law concerning the capping and the voting rights (80%) implied that the combination of the two restrictions was the "trick" which permitted the German State to control the decisions of the company, since the Land of Lower Saxony possessed a considerable amount of shares. However, the conclusion of the Court could arguably be assumed to have been different if the Land would have sold its shares too and a private investor had purchased them, since the ECJ ruled that these two provisions merely helped the public authorities to influence the decisions and they were not granted exclusively in favor of them (implied an indirect control of the company through the combination of the two provisions).

[128] See C-8/74

[129] See C-513/04

[130] Such as in C-158/96 paragraph 41

The critical question was therefore: "***how the Court would have decided if the Land had sold its shares in VW to private investors. Would the voting cap and the special majority rule still constituted an infringement of the Free Movement of Capital?***"[131]

According to some commentators and the ECJ (not clearly, but imliedly), the control exercised in the given case by public authorities would be more likely to deter possible investors from acquiring shares in the company than in case of a control exercised by a private investor. The opposite opinion that the decision-making process in a company is equally disturbed, irrespective of whether the actual beneficiary of the rules is a private person or a public body, is quite superficial. The reason is apparent: The State is more likely to exploit a company for non-profit making purposes hindering the decisions of the company and the interests of the investors.[132]

Exemplifying the foregoing position we could refer the case of state aid, where the State is not allowed to grant loans under private law to companies, while loans granted by private investors in similar cases would not have qualified as "aid". The conclusion is that in any case (both golden shares and state aid) the State is treated with more suspicion than private persons are.

The above mentioned thesis is further strengthened by the outcome that AG Polares Maduro reached in Commission v Netherlands, namely that the fundamental freedoms **impose obligations on Member-States regardless if they act in their capacity as public authority or entity under private law**. They are subjected to them[133] on the account of their organic capacity as signatories of the Treaty and thus are constrained by limitations that do not apply to other market participants.[134]

The **weak dimension** of AG's reasoning is that any State action based on public authority or not could qualify as national measure and subjected to the Free Movement of Capital if his thesis proved to be the case.[135] **But this weakness may well balanced at the second stage of assessment, namely if the national measure constitutes a restriction (deter possible investors**).

[131] Domestic Company Law and the Free Movement of Capital: Nothing Escapes From The ECJ?, University of Oxford Legal Research Paper Series, volume 42, 2008, Wolf-Georg Ringe

[132] See for instance C-342/96 paragraph 34

[133] See the opinion of Advocate General in C-171/08 paragraphs 31-34

[134] See the opinion of Advocate General in C-282/04 paragraphs 22 and 23

[135] See joint cases C-463/04 and C-464/04 paragraph 32

The combination of the provisions (capping and voting) and the fact that the State owns a stake of shares which facilitates the control of the company leads in a legally well-founded, but incomplete conclusion, since the Court in the VW case **touched upon the limits** which EU Law places on Member States when they attempt to organize the internal affairs of their companies[136] **regardless if they acted as private entities or regular shareholders**.

The Court in the given case avoided to take a clear position on the question if it can review general company law provisions **in any case** (either States or private persons indirectly or directly benefited from them) taking merely the view that the two provisions of VW law indirectly benefited the State,[137] without deciding anything in essence for private persons. Therefore, **it seems that the Court regarded that it has the ability to review general company law provisions only if these rules directly or indirectly help public authorities to be benefited**.

Even if we can't be sure of what will happen in the future with regard to private persons, directly or indirectly benefited from the provisions of general company law, the implied answer of the ECJ is currently **negative**[138] regarding the ability of the latter to review the compatibility of those provisions with the Free Movement of Capital. Nonetheless, the issue remains open and the scene seems vague.

However, **in my view** the rules of general company law enacted through legislation (as in VW Law) which do not necessarily secure any prerogatives of the States and do not benefit the State in other way, but merely shape the relations between private persons can be subject to the Free Movement of Capital as the interpretation of another fundamental freedom indicated.[139]-very broad view of freedom's applicability and ECJ's scrutinizing power. The freedom applies equally to private persons relationships regulated through general company law provisions-. It is unrealistic to expect however that the ECJ will review the rules to a large extend since

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[136] Domestic Company Law and the Free Movement of Capital: Nothing Escapes From The ECJ?, University of Oxford Legal Research Paper Series, volume 42, 2008, Wolf-Georg Ringe

[137] C-112/05 paragraphs 48 and 51

[138] One Share, One Vote: Fairness, Efficacy and (the case for) EU Harmonization Revisited, Koen Greens, Carl Clotters, Leuven University Press 2010

[139] See C-8/74 and C-120/78

the broad approach taken previously was eventually proven to be dysfunctional in its application (see Keck case).

Hence, we should consider that the Golden Shares and the general company law provisions, which benefit directly[140]or indirectly either the State (through legislation or private provisions) or private persons can qualify as "national measures" and thus fall within the scope of the Free Movement of Capital[141] irrespective of State (interests) involvement or not. Therefore, the ECJ is able at a second stage to scrutinize its effect in respect to deterrence to possible investors. Ultimately, once the Court regards that the scope of application of the Free Movement of Capital is too broad, it may alter its position either as in Keck case through its future case law or via the adoption of a stronger justification test.

At this point we should underline **another opinion** which is argued by some commentators, as long as we regarded that the general company law provisions regulating the relationships between individuals fell within the scope of the Free Movement of Capital. According to them, general company law **is predominantly concerned with the decision making process of the companies** rather than market access to share capital. Consequently, if the ECJ reviewed general company law, it would assess most of them on the basis of the Freedom of Establishment. However, the question remains to be answered.

According to my view as expressed above, a **new criterion** with regard to violation of the Free Movement of Capital is seen to emerge drawing attention to the degree that the measure at stake deters possible investors - **effect based test** - from investing in the company in a way comparable to Golden Shares, rather than the degree of state involvement. This approach, not only permits the court to apply different levels of scrutiny depending on the actor, the seriousness of the infringement and the validity of participants' competing claims, but also seems to be in more compliance with article 63TFEU which refers nothing in its face to the State.

Furthermore, the foregoing approach **consolidates the scattered picture that the case-law presents**. While company law measures by *private parties* are only exceptionally subject to the provisions of Free Movement of Capital, *State* measures

[140] For example C-543/08 paragraph 54

[141] Contrary to another opinion that the fundamental freedoms do not apply in case of States acting as normal shareholder and not regulator.

potentially always trigger the scope of application of this fundamental freedom, irrespective of their nature or objective. Secondly, so far the Court has predominantly seen the scope of application of the capital freedom triggered when the State is the *beneficiary* of the measure in question. Both criteria, however, have numerous exceptions, and it is difficult to see a clear underlying policy rationale.

iv) A closer look at the Court's reasoning as well as at the context in which this case has been decided **sheds light on the dynamics between creating a European competitive business environment on the one hand and doing justice to the political choices at the Member State level on the other**. The whole philosophy of the VW Law as expressed in the last fifty years during which it was in force, was based on a compromise giving the capital owners, the Unions and the government a representative and co-deciding stake in Volkswagen with the effect of 'protecting' the company from the domination of one shareholder.

However, **the traditional national policies** (like German in the post-war scene as documented by VW case) have not been found by the ECJ to provide a clear guidance towards future developments, employment and corporate law which are shaped in a totally different procedure based on a supranational law making process in these regimes, where a new model of corporate law is generated.

To outline the context of the decision, it was issued in the light of increasing pressure on existing systems of corporate management and industrial relations, in particular **Germany's model of co-determination**.[142]Such activities then are being pursued in a complex regulatory environment of domestic statutory law on the one hand which is under severe pressure to convergence[143]and of norms produced by transnational regulatory bodies on the other.[144]

Having coincided with a wave of privatization of welfare systems and the tendency to base pension financing in capital markets, the VW decision encapsulates the challenge that stakeholder-oriented systems of corporate governance face as to their capacity to provide the transparency and management control necessary for their success in the global competition for stock market investments.

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[142] The Future of Co-determination After "Centros". Will German Corporate Law Move Closer to the US Model?, Fordham Journal of Corporate and Financial Law, Jens C Dammann

[143] European Corporate Law and National Divergencies? The Case of Takeover Regulation, PeerZumbassen

[144] See http:/www.ecgi.org/

The outcome was clear and emphatic: Not only are the single market and a corporate governance (far from German standard and closer to the US) to be established free of any national restrictions, but also their creation is to be made at a supranational level. EU should be more competitive in the international context and the undertaking would have been completed by the combined contribution of negative (ECJ mainly) and positive integration (legislation).

An opposite decision (of the ECJ in VW case) *might have opened – for a final encore? – the curtain for the Rhenish model of capitalism, behind which government, corporations and unions are understood as partners in a market ordering exercise,*[145] which was totally contrary to the philosophy of the EU in the current stage.

Thus, **the political signal from the Commission was clear and twofold**: Member States cannot interfere with the running of their companies and therefore distorting competition, nor can they engage in economic nationalism and abuse tools in order to prevent foreign companies to enter their markets through takeovers.[146]

v) The **ambivalent opinion of the AG concerning art. 295 EC -345 TFEU-**. Article 345 TFEU provides that "*the Treaties shall in no way prejudice the rules in Member State's governing the system of property ownership*". In contrast to his earlier Opinions in similar cases, AG Colomer rejected the applicability of Art. 345 TFEU in the context of Volkswagen Statute.[147]

According to his **previously expressed opinions**[148]Art. 345 TFEU would entitle Member States, when privatizing formerly state-owned undertakings to maintain extraordinary company rights by imposing Golden Share arrangements.

The AG opined that if a Member State were free to decide whether an undertaking is either being fully privatized or socialized, Art. 345 TFEU must **a fortiori offer the possibility to partly privatize**, through the enactment of Golden Share arrangements (as a kind of "minus" to the complete privatization). Pursuant to this argument, Golden Share arrangements would have to be subsumed under the term "rules in Member State's governing the system of property ownership" (Art. 345

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[145] The ECJ, Volkswagen and European Corporate Law: Reshaping the European Varieties of Capitalism, Peer Jumbassen and Daniel Saam

[146] Economic Patriotism Made In Germany-The Court Of Justice Overturns Parts of the "VW-Gesetz" European Law Reporter December 2007

[147] Opinion of Advocate General C-112/05 paragraphs 47, 49 and 56

[148] Opinion of Advocate General in C-463/00 paragraph 40

TFEU) and, therefore, **would fall outside of the realm of the EU Treaty**. What's more, the AG Colomer based on **the unconditional and forceful wording** of the relevant provision (in no way) which is met in no other provision on the Treaty.

In other words the AG adopting a **teleological** approach[149] of this article rather than the economic one[150] preferred by the Commission which argued that the movement of a firm from public to private hands is an economic policy choice falling within the exclusive competence of the Member State 344TFEU (ex 292EC), pointed out that **the system of property ownership must extend to any State measure (and Golden Shares)** which allows the State to contribute to the organization of the nation's financial activity and therefore are to be respected by EU authorities and institutions.[151]

The ECJ had consistently different opinion on the issue[152] and **the AG in the present case based on a different reasoning**[153] than the one in the foregoing cases[154] came to the same with the Court conclusion. Specifically, the Court regarded that Member States systems of ownership are not exempted from the application of the Treaty rules and fundamental freedoms[155] citing one of its most important precedent[156] on the issue to underline that Member States may exercise only the powers retained in compliance with the EU Law.

As a result of article 295EC (345 TFEU) Member States are able to reserve activities to the public sector, but after the privatization of a company they have to pay attention to the competition rules regulated on EU level. This view, even not being explained in details was practically **quite functional** for the interpretation of EU law, since there were many provisions in the Treaties which could have inevitable effects on property rights and which thus could be exempted from the application of EU law through art 345 TFEU. [157]

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[149] Joint Opinion of Advocate General in C-367/98, C-483/99 and C-503/99 paragraphs 45-60

[150] Ibid paragraph 41

[152] C-483/99 paragraph 44 and C-171/08 paragraph 64

[153] Opinion of Advocate General in C112/05 paragraphs 50 and 51

[154] Opinion of Advocate General in 367/98, C-483/99 and C-503/99 paragraph 62

[155] Ibid paragraph 48

[156] C-246/89 paragraphs 15 and 16

[157] Golden Shares: No Shining Any More?, Columbia Journal of European Law, 2011, Jeremie Houet

The drastic change in his interpretation of art 345 TFEU **raised queries given the significance** of the case, except if we regarded that the AG abandoned his interpretation taken in the first cases as the ECJ had rejected them repeatedly.[158] .

vi) The microeconomic impact of the special rights granted in VW case deserves distinct analysis, since Golden Shares **except for the legal dimension have an additional economic one**, which is of equal importance especially in practical results.

The impact of Golden Shares is to be assessed **in correlation with the performance of comparable** -according to the experts' opinion- (at least similar or identical) companies (size, operating markets, risks, regulatory regime etc) not subject to special rights over the same period of time. The possible comparators in case of VW were BMW (Germany), FIAT (Italy), FORD-MOTORS (USA) and others. Additionally, the researchers took into consideration the share price reactions of the company's shares' around specific events when the market learned that special rights arrangements might change and which were likely to affect the price of the shares was to be taken into consideration.[159]

The report[160]focused on the performance of the company from 1995-2004 with the following conclusions: a. The financial performance of VW was detected in the average level as there were better and worse operators. b. Considering the annual accounting profitability VW was underperforming relative to the comparator average. c. The same conclusion was made in respect to labor productivity. d. The overall investment activity for VW was greater than the equivalent of its competitors. Finally, the production seemed more labor intensive and the result was consistent with the view that due to the existence of special rights, the company prioritized employment and growth at the expense of financial performance in the examined period.

On the other hand, **market reactions were observed** in three different dates, namely the day of the referral to the ECJ, the day when the formal notice was made and the day of reasoned opinion's delivery, indicating vague results in comparison to the foregoing. The overall outcome stemmed from market share prices fluctuation was that special rights in case of VW **were not considered to have significantly negative**

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[158] No reference to article 295 EC (even dismissive) was made in the most recent case C-212/09

[159] Special Rights of Public Authorities in Privatized EU Companies: The Microeconomic Impact, Report prepared for the European Commission, November 2005 (Oxera)

[160] ibid

impact on the company's performance. **However, as remarked in the analysis this may occur due to methodological problems, rather than the absence of an actual negative impact** since it is quite difficult to measure and isolate the critical economic consequences.

vii) Some scholars argued that in VW case the Court **implied that the "one share-one vote"[161] principle** stemmed from article 63 TFEU.[162]However, this fact was not proven to be the case.[163] First of all, the capping of voting rights did not constitute by itself the restriction on the Free Movement of Capital, but only in combination with a majority of 80% of the represented shares. Secondly, the Court tested the legitimacy of the capping in favor of the State and not the legitimacy of the provision under general company law, where is arguably applicable as a recognized instrument of company law. Besides, the Court drew the line between a power available to shareholders who are free to decide whether they wish to use it or not and a specific obligation imposed on shareholders by way of legislation from which they could not derogate. Finally, it was underlined that a cap on voting rights may operate both to the benefit and the detriment of the shareholders depending on the perspective we confront the problem (majority or minority).[164]

To sum up, one of Europe's most visible symbols of economic protectionism had effectively been targeted by the Commission and the Court.[165] The Volkswagen Decision of 23rd of October 2007, is instantly emphasized as a milestone not only in Europe's development of an open market, but also in the process of transformation of European company law regime. [166]

Trying to bear in mind the diversity of historically grown, socio-economic structures that gave rise to different company law regimes in the various Member

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[161] Lays down the rule of proportionality between capital and control,, between voting rights and equity stake. Thus, trying to establish shareholder democracy for listed companies imposed the rule that common and preferred shares had equal voting rights.

[162] C-112/05 paragraph 3

[163] VW: The State of Affairs of Golden Shares, General Company Law And European Free Movement of Capital, European Company and Financial Law Review, Gert-Jan Vossenstein

[164] C-112/05 paragraph 47

[165] The ECJ, Volkswagen and European Corporate Law: Reshaping the European Varieties of Capitalism, Peer Jumbassen and Daniel Saam

[166] Porsche Poised to Buy VW, Telegraph, Ambrose Evans Pritchard,

States, the decision issued in a period of legal and socio-economic debate of the way that corporate power is being exercised and that corporate boards are to be staffed and controlled. Volkswagen's co-determination was at the central of the predicament, which was created from the competition between two models, which instead of complementing each other, have unfortunately been positioned in an oppositional and in fact competitive relation.

Workers' co-determination, as forming a constitutive part of the two-tier board structure in German stock corporations with more than 500 employees has been a constant target of review and polemics. In respect of this issue the ECJ took a clear view at the expense of the model followed in German and its more representative example was VW. This was the result of political compromises in Europe, where divergent cultures and legal approaches indicated a solution.

What's more, Europe wished to make clear in an emphatic may that crosses a transitional company law regime, whose direction favors open markets, abolishes the restrictions impeded direct investments and facilitate takeovers from investors even in strategic sectors (energy or automobile) no matter if they come from Germany, Greece or the US.

VI. Golden Shares and Restrictions on Takeovers

The strict control imposed on Golden Shares aims primarily at creating a level playing field within the EU and establishing a single market. The protected through Special Rights companies are removed from the class of potential targets, while they may still act as bidders.

Trying to clarify the first point we could point out that **the bidders will only pay a control premium when they have a plan on how to earn that premium back within a reasonable period of time.** In some way they must expect the performance of the target corporation to be improved subsequent to their acquisition of control. Usually that expectation is based on a plan involving the use of their prospective control position to cause an improvement in the target's earnings. Such a plan will in most instances only be feasible if the acquisition of a majority of the share capital does indeed give the bidder the power to change the way the target corporation is running its business. Where a bidder expects obstacles to the exercise of control, an **acquisition becomes less attractive**.[167]

To illustrate the economic risks that perspective investors undertake in acquiring or merging with these companies, European governments repeatedly have taken advantage of the threat of Golden Shares' power in order to oppose to possible takeovers **as in the case of a takeover bid for Cimpor**, a Portuguese cement company which was opposed by the Portuguese government[168]**or in case of Telefonica** where considerable pressure was exerted by the Spanish government in order to breakdown the takeover by the Dutch KPN.

If there are many such obstacles in some parts of the EU, but few in others a prohibition on frustrating action in a European Takeover Directive might indeed **intensify the already existing inequalities** in the strategic positions of potential bidders and targets from different Member States. While target companies having Golden Shares prerogatives will have more defenses at their disposal against a hostile bidder, the companies which do not grant any Golden Shares will have only a limited number of defenses against the bidder and therefore they will be unable to resist. The threat for a distortion of competition is apparent.[169]

The foregoing fear is ascertained when the shareholders are not allowed to transfer their shares freely, to change or determine the articles of association of the company or to replace the inefficient management. In general, all similar situations which could impede the independent running of the company result in the distortion of competition. **Therefore the use of "Golden Shares" should be restricted in such a way that allows the privatized enterprises to operate and control independently**. This is the only way to accept them as legitimate and permissible instrument for privatizations.[170]

Besides, Golden Share arrangements directly restricting strategic investors, who are predominantly interested in acquiring the control of a company, almost invariably have an **impact on the market for portfolio investments**. Where national

[167] Legal Aspects of Privatization: A Comparative Study of European Implementations, Bulent Seven

[168] Commission Rules Against Portuguese Measures In A Takeover Bid For Cement Company Cimpor, IP/00/1338, 22/11/2000, Brussels

[169] Recommendations for the Second Reading of 29/11/2000 (Rapporteur LEHRE)

[170] The Legality of Golden Shares under EU Law, Maastricht Working Papers, Nadia Gaydarska and Stephan Rammeloo

laws deter a bidder form acquiring control over a corporation the potential target's shareholders are deprived from an opportunity to dispose of their portfolio investments.[171]A takeover bid is usually an exceptionally attractive opportunity to do so because bidders pay premiums above market prices. Where there is no potential market for corporate control, the market for non-controlling stock is therefore also affected.

Nonetheless, a possible frustration of this effort results not only from "Golden Share" arrangements which specifically apply to individual (recently privatized) corporations. It also results from elements of general corporate law of a Member State if it provides for a deviation from the principle according to which control rights should only be carried by share capital participating in the residual risk and that such share capital "should carry control rights in proportion to the risk carried."[172]

Thus, although Golden Share arrangements constitute only **a small fraction of the legal obstacles** that stand in the way of the creation of a level playing field in this part of the common market, they may affect possible takeovers in various ways.

However, the **predominant ways adopted from the Commission to facilitate takeovers** within the EU and curtail the powers granted through Golden Shares were the non-frustration and the breakthrough rule of 2004/25/EC Directive.

Article 11 **-breakthrough rule-** of the Directive lays down that *any restrictions on the transfer of securities or voting rights provided for in the articles of association of the offeree company or in contractual agreements between the offeree company and the holders of its securities or in contractual agreements between holders of the offeree company's securities, shall not apply vis-à-vis the offeror during the time allowed for acceptance of the bid.* (paragraph3). Nonetheless, this rule **does not** apply to Golden Shares, since paragraph 5 of the article provides that equitable compensation should be conferred when loss is suffered by the holders of special rights which are broken through **(paragraph 5).**

The final approach taken by Europeans is contrary to the Report of 10/01/2002 issued before the adoption of the Directive due to the objections raised by the

[171] Special Rights of Public Authorities In Privatized EU Companies: The Microeconomic Impact, Report prepared for the European Commission, November 2005 (Oxera)

[172] Report of the High Level Group of Company Experts On Issued Related To Takeover Bids, 10/01/2002, Brussels

Parliament[173] and practically protects the holders of Golden Shares bringing down **the attempt to restrict Golden Shares powers through secondary EU law. A step was taken forward**, since special rights cannot typically constitute a substantial barrier in the procedure of takeovers (art. 11), practically though the results are considerably limited as the bidder has to compensate the holders of those rights in exchange for their inability to take advantage of their special powers and impede or object to a takeover.

The Report states the following:

"(…)*if a formerly state-owned company is privatized and enjoys the benefits provided by the capital market, it should be subject to the same principles of company law and capital market law as other companies*." Additionally, the Group reckoned that *the breakthrough rule should also apply so as to override special control rights attached to golden shares held by Member States, even if the European Court of Justice would rule they do not violate the Treaty of Rome as such*.[174] The Report, also stated that *there is no justification for distinguishing between companies in which special control rights are held by private persons and companies where special control rights are held by States*. Besides, that *a successful bidder who has acquired a substantial part of the risk bearing capital in the general bid for all the shares of the company should have the ability to breakthrough any mechanisms which frustrate the exercise of proportionate control.*[175]

Article **9** (2) –**non frustration rule**-, embedding the principle of neutrality, of the Directive refers that the prior authorization of the General Meeting of shareholders is required before any action on behalf of the target's board, which could result in the frustration of the bid. Thus, any action of the appointed directors, -deriving from Golden Shares prerogatives- of the target company requires the prior authorization of the General Meeting of the company. The foregoing rule rests upon the principle that a takeover bid is made to the shareholders and,consequently it is up to shareholders to decide on defensive measures.

The "**one share –one vote**" principle is partially (as we see subsequently) implemented and multiple voting rights are declared inactive at the first General Meeting of shareholders following the closure of the bid, called by the offeror in order

[173] Ibid
[174] Ibid
[175] Ibid

to amend the articles of association or to remove or appoint board members'. The bidder has the right to convene a special post-breakthrough meeting in order to strengthen his controlling position in the target company **(article 9 paragraph 4).**

All deviations from the proportionate allocation of control rights among the risk bearing shareholders are to be suspended once a takeover bid is announced. This means that in the shareholders' assembly which must, under the group's proposal, pass a resolution on the authorization of defenses subsequent to the announcement of the bid, all shareholders will have voting powers in proportion to their share in the capital bearing the residual risk. Limited voting rights, multiple voting rights, caps on the exercise of voting rights, allocations of voting rights to non-risk bearing investors and similar arrangements would thus be suspended.[176]

However, the attempt to formulate an harmonized legal regime in takeovers within the EU is considerably blurred by **article 12** of the Takeover Directive. Member-States are free to opt out from the neutrality principle laid down in the Directive or permit their undertakings to opt into initially and opt out again, since they became the subject of an offer launched by a company which does not apply the same provisions. **In final analysis, given the current legal status, Member States are completely free to create shares with multiple voting rights provided that they are compatible with article 56 TFEU in order to prevent hostile takeovers**.

VII. Conclusive Comments

i. The first decisions of the ECJ handed down in the early 2000s formulated the **general framework** for scrutinizing future Golden Share infringements. The Portugal case clarified that purely economic and financial objectives cannot sufficiently justify the restrictions imposed on capital flows, the French one defined the vague concept of proportionality, which is the predominant tool to review these kinds of infringements and the Belgian case made clear that under certain conditions special shares afforded to State enterprises can be proved compatible with the EU Law. In all the subsequent cases the ECJ followed these fundamental rules set in the first cases decided by the Court.[177]

[176] Ibid

[177] Limited But Not Lost: A Comment On the ECJ's Golden Shares Decisions, Fordham Law Review, Christine O' Grady Putek

ii. The **time period when** the Court rendered its initial decisions is of pivotal importance. There were many States wishing to join the EU some of which were ex communists and the remainder from their early history had to be abolished (extended direct or indirect public control) in order to fulfill the criteria for their accession. Thus, they had to comply with the rules of the EU Law among of which the Free Movement of Capital was included and the recent case law was a kind of “warning” for them and their route to accession. For example, Romania had initiated proceedings to privatize SNP Petrom, which operated in petroleum and gas sectors, and expressed the hope to create Golden Shares in the privatized company, but it should take seriously into consideration the rulings of the ECJ (mainly the Belgian one) in order to craft a form of shares acceptable and compatible with the EU Law.[178]

iii. The ECJ took a rather broad view of the term **“national measures”** which can scrutinize in a permissible way under the fundamental freedoms. Legislative measures taken by national authorities even if they merely reproduce a private law contract and acts of the State performed through company law provisions certainly qualify as national measures. However, the question of whether only the measures benefiting the State or general company law provisions applicable to private shareholders too can amount to a national measure or not, remain unresolved.

Arguably, some authors spoke about “horror iuris”, as a whole range of national private and contract law might be reviewed in the future on the foregoing basis. Therefore, the Court through its jurisprudence may confine the scope of the provisions which can be review.

One option could be to scrutinize only the provisions granting special rights to public entities without the consent of the affected party. **Or** the mandatory provisions of company law which empower private law subjects to make an investment less attractive.

Another option is to review only the special rights granted in company’s shares traded on an internationally accessible public market, which render the investment less attractive and hinder cross-border transactions. This perspective is even restrictive for the scope of application of Golden Share cases. In the second case an additional element should be taken into consideration, namely the severity of the restriction on shareholders’ right.

[178] C-503/99 paragraph 44

iv. The rationale behind the broad interpretation of the **term restriction** predisposes us for a wider impact of these decisions on general company law. "*National rules that limit investment decisions of third parties or that curtail their shareholder rights, have a restrictive effect* - according to the ECJ decisions - *if two conditions are met: the rules must create a risk (including a potential, but still perceptible risk)*[179] *that, because of these rules, some investors do not trade in those shares; and a cross-border effect must as well be possible*".

The Commission took a clear view in favor of the creation of a single market and nothing can prevent it from applying the reasoning of Golden Shares judgments into general company law in the future. The Free Movement of Capital might therefore be restricted by all company law provisions that potentially make an investment in listed companies substantially less attractive. The VW decision intensified those concerns which still exist despite the lack of any subsequent decision to affirm those assumptions.

v. The Golden Share decisions are primarily founded on the legal basis of the **Free Movement of Capital** which until mid 90s was considered to be useful only for tax cases. Not only did they make this fundamental freedom widely known and legally accessible in the European legal order, but also they made quite clear the fact that as, happens to be the case with the other three freedoms, the Free Movement of Capital is directly applicable to persons and therefore to possible investors, who can be protected efficiently though its application. No further European completion could be achieved without the implementation of the standards laid down by the Free Movement of apital.

Furthermore, the foregoing freedom was **consistently regarded the exclusive (practically) legal basis** for reviewing Golden Share arrangements until the issuance of C-326/07, when the ECJ and some scholars partially reconsidered the excusive applicability of the freedom with respect to veto rights. The Court ruled that for this class of Golden Shares the sole legal basis is that of article 49 TFEU, limiting the broad scope of article 63 TFEU.

However, this conclusion is to be reaffirmed from future decisions in other Golden Share issues, such as the right of the State to appoint one or more supervisory

[179] See joint cases C-282/04 and 283/04 paragraph 28

directors (The criterion is that the Freedom of Establishment relates to decisions falling within the scope of management of the company).

Once the conclusion is ascertained, the case law may move towards a situation, where both freedoms will apply in cases relating to access to the share capital of the company, while the Freedom of Establishment will apply exclusively to Golden Shares directly linked with the decision making process of a company.

vi. Golden Share decisions removed significant obstacles for the ratification of an **EU Takeover Directive.** These obstacles existed from 1985 when the Commission expressed at an initial stage its will to establish a common framework for the EU single market abolishing the national provisions which are incompatible with the EU Law[180]. The foregoing longtime obstacles were supported by the Germans until 2003, even during the negotiations for the drafting of the proposal of the Takeover Directive in order to prevent its national big industries from takeovers. Finally, with the contribution of the case law and the manifestation of the clear will of the Commission to establish an internal market free from any restrictions, the Directive on Takeover Bids was adopted on 21st April 2004 and the differences among Member States were bridged.

vii. The rulings of the ECJ were only **a fraction of the conclusive action taken by the Commission** to bring down the barriers existing in the internal market such as the Second Banking Directive, Transparency Directive, Market Abuse Directive, Takeovers and Mergers Directives. However, the abolition of Golden Shares was attained through the implementation of primary EU fundamental freedoms and the jurisprudence of the ECJ.

The underlying reasoning behind the disallowance of the majority of uses of special rights could well be applied to **other protectionist and defensive measures** in the future, because it was clear that the Court relies on its previous case law when faces new challenges. This approach was confirmed by the ruling issued in VW case. Without the framework developed by the ECJ, an essential aspect of the continuing process of market liberalization in the EU would be called into question.

viii. The Court through its case law **clarified** the scope of public security exception, **the justification of public policy and the applicability of the**

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[180] Completing The Internal Market, White Paper From The Commission To The European Council, June 1985

proportionality principle in practical issues which could be proven useful in cases of different nature. Public policy exception is invoked in most cases by States to justify infringements on human rights and even when it is permissible, we should esteem the severity of the infringement in correlation with the pursued objective and the existence of less restrictive measures to attain it. The clarification of those terms contributed to the establishment of a more transparent and predictable framework in respect of Member States' capability to impose certain restrictions.

However, the ECJ **did not reach sufficient standards** concerning the permissible justifications of the conditions making the public interest exception proportionate under the EU Law. Not only did not rule precisely on what constitutes a permissible exception to the fundamental freedom, but also reached in some cases in unconvincing outcomes. For example, in **case of Italy** ruled that there is no sufficient connection between the adopted criteria and the special powers granted in favor of the State, pointing out that the criteria were formulated in general and abstract terms and the objective lacked specificity.[181]Contrary to the Italian case, in the **Belgiam one** ruled that the ex post authorization procedure prescribed by the relevant law met the required legal elements (without further examination of those elements in depth) and therefore was compatible with the European Law.[182]The same conclusion was adopted in case of France v Commission, where the Court dismissed the criteria as imprecise, not necessary and disproportionate.[183]

The ECJ merely declared (in Belgium case) the criteria suitable and proportionate without comparing them with the Italian or French one or **giving more precise guidelines on the permissible degree of discretion left in the State**.[184] The same applied in case of **Spain**, where the Court ruled that the State failed to clarify the risks that the investors run, the time when the risks could possibly arise[185] and the limits of the discretionary power exercised by the regulatory authority.[186]

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[181] C-326/07 paragraphs 40, 45, 47, 51 seq.

[182] C-503/99 paragraphs 9, 50 and 51

[183] C-483/99 paragraphs 49-51, C-543/08 paragraph 84 and C-171/08 paragraphs 76 and 77

[184] Opinion of Advocate General in C-463/00 and 98/01 paragraphs 38-40

[185] The Spanish Prior Approval Regime For The Purchase of Certain Shareholdings And Assets In The Energy Sector Breaches EC Law, 24/05/2009, Michele Giannino

[186] C-207/07 paragraphs 52, 53, 55, 57

ix. Prior authorization was required in many cases[187] in order to permit an investor, for example, to acquire more than a certain threshold of shares (cap) or to take decisions on specific matters and constituted one of the fundamental issues in the series of Golden Share cases which were dealt in an explicitly hostile way by the ECJ.

The four-step test as determined by the Communication of the Commission on intra EU investments (1997) and the Gebhard case had to be fulfilled in order to render the authorization legitimate. The view taken by the Court was consistently expressed in previous cases[188] concerning restrictions imposed on the Free Movement of Capital, even not relating to Golden Shares.

However, the criteria that the Court took into consideration in both categories of cases were the same and all the schemes based on prior authorization were regarded to be illegitimate and disproportionate. The ECJ in virtually all the cases regarded that despite the legitimacy of public policy reasons invoked by the States, they are not suitable or necessary or proportionate to attain the pursued objective. Namely, according to the ECJ, there was no sufficient link between the objectives and the measures, the invoked conditions lacked specificity and accuracy, the discretion given to the States was too wide, there were no effective legal remedies etc.

Besides, often argues that there are less restrictive measures than prior authorization such as the imposition of public service obligations to ensure the security of energy supply[189]or the introduction of a prior mandatory notification regime which cannot block the performance of the pending transactions.

x. Article 26 TFEU provides that *The Union shall adopt measures with the aim of establishing or ensuring the functioning of the internal market in accordance with the relevant provisions of the Treaties. Also, the internal market shall comprise an area without internal frontiers in which the Free Movement of Goods, Persons, Services and Capital are ensured in accordance with the provisions of the Treaties*.

To comply with these fundamental provisions the EU has tried to establish, since its creation, a common single market liberalizing various aspects among of which the Free Movement of Capital is listed. "(…) *In fact, it can be said that* ***liberalization*** *in the European Union has mainly been an unavoidable consequence of*

[187]See C-367/99 paragraph 50 and 53 and C-98/01 paragraphs 50-52

[188] C-54/99 paragraph 14 and C-171/08 paragraphs 76 and 77

[189] C-207/07 paragraph 57

the establishment of the internal market. It is obvious that a market based on competition and free circulation of goods, services, people and capital is at odds with systems based on national monopolies. Our liberalization policy was therefore conceived as an indispensable instrument for the establishment of the internal market".[190]

Szyszczak expressed another dimension of the above mentioned position pointing out that: "***the transfer of State assets to the private sector is seen as an essential component of the processes of European integration, becoming one of the tacit criteria for successful accession to the European Union***"**.**

However, in its typical terms States are free to decide whether they will privatize or not. **Reducing** the scope of the public sector is definitely considered as an advantage which allows improvement of the development and growth of the competition stage of the market, since results in the minimization of bureaucracy, the reduction of budgetary costs, the increase of state income through the income earned from the purchase of the previously state-owned shares

The European Court of Justice found the proper balance between the requirements of a common market in the EU, the legitimate interests of investors acquiring shares in privatized companies and the protection of the general interest of the Member States. **Golden Shares are still retained in some legal form by Member States, they have not evaporated and they may have a future in the EU only within the framework established by the ECJ**.

VIII. Remarks for the Future

i. Failure of protectionism. Increasing evidence indicates that the PE's draining resources from pubic treasury either cannot perform their social functions efficiently or cannot contribute significantly to the development of the State's economy, even in cases where the State is a minority shareholder with increased and disproportionate powers to its holding.

The reason which makes even the privatized companies equipped with Golden Shares likely to fail in the long term in the economic field is apparent and historically

[190] The Liberalization of State Monopolies In The EU And Beyond, Kluwer Law International (2000) Geradin Damien

present, namely the **inherent limitations of State ownership**. Classically, States exercised the rights retained in companies even in the form of Golden Shares with the inherent risk of political interference and corruption.

Even though the Court's jurisprudence seems consistent and straightforward, some comments are to be made on the adoption of Golden Shares, especially at a time when the excess liberalization of the economy shows some limits and may support an argument for the reuse of this instrument. More and more States affected by the impacts of the recent economic crisis which for some is regarded to be the result of the excess liberalization **may rethink the possibility of retaining special rights** in strategic sectors for reasons of public policy.

In other words, the maintenance of Golden Shares may be the result of their usefulness as a defensive measure at the disposal of Member States as a mechanism by which the government can protect its national interests against more powerful State owned enterprises operating in the same sector in another State located either in or outside the EU.[191] Public interest concept may be taken advantage fully by States to this end and the stronger are the invoked "public policy" reasons, the more determining will be the pursued role of the State.[192]

However, this **approach overlooks some of the steps taken the last twenty years in order to endorse single market and make it feasible**. Besides, adopts a protectionist economic approach based on beliefs of national sovereignty, which is at odds with the supranational belief upon which the EU was established. New reservations or hesitations in other (non crucial) economic sectors may be expressed by certain States, unless the Court and the Commission proved to have robust opinion on certain critical issues concerning common market, such as Golden Shares. Finally, privatizations proved to be quite helpful for the EU States for various reasons and any position in favor of the implicit legitimacy of Golden Shares may lead in nationalizations and adverse impacts detrimental to the States.

In any case, the **recent crisis** made quite clear the fact that markets cannot be left completely unregulated, but instead they need to be in line with certain rules safeguarding the security, transparency and performance of its operation. Thus, under

[191] The Golden Share of Privatized Companies, Alice Pezard

[192] Public Enterprises: Unresolved Challenges And New Opportunities, UN 27-28/10/2005, New York

the pressure of the foregoing problems we cannot pass at the opposite edge, namely to strengthen the position of States in markets.

States have turned out to be detrimental for the performance of the companies involved being susceptible to corruption and mismanagement, creating overstaffed companies for political reasons, increasing the inflexible bureaucracies, derationalising the structure of the companies and being in final analyses loss makers than revenue generators.

Revitalizing legally the validity of Golden Shares or setting more flexible criteria for their application/adoption we would definitely breach the discipline within the EU acquired so difficulty the last 15 years and would open the Pandora's box for further protectionism and more powers retained by States in the name of the protection of a rather vague and ambiguous term of "public interest'.

The speech[193] of the former Commissioner for the internal market, **Frits Bolkenstein**, remains modern noting as regard the opposition of the Commission in the special shares arrangements that: "*it is directed against a purchase from another Member State. A law which has the same discriminatory effect also contravenes the Treaty of Rome. It is not the instrument that counts, but the intent. The only exceptions to this rule are those expressly and restrictively provided for in the Treaty itself. The Treaty does not recognize the principle of reciprocity or the right of Member States to take retaliatory measures against each other. Furthermore, non-discriminatory measures are only admitted where there are imperative requirements in the general interest, as long as such measures are proportionate and limited in time*".

ii. States in the markets. The **jurisprudence** stressed the fact that States are not ready enough to act as private actors shedding more light on the designation of the extent of Member States' power to act in their private capacity, the extent to which EU Treaties apply to Member States acting as private persons, the extent to which may enter into relationships with other parties that are not of a regulatory nature.

Nonetheless, even if States were ready to act in their private capacity, their effects might be indirectly regulatory rather than participatory (the motivation for a

[193] Speech/ 01/373, 07/09/2001, in the annual forum "Intelligence 2001 on the World, on Europe, on Italy", Frits Bolkenstein

traditional private actor is to invest and maximize its profit). Thus, rules applicable to private actors might not be available to States acting as private entities.

The distinction is between an action which can be characterized as private and that which is sovereign and regulatory, albeit indirectly.[194] The criterion is the nature of the pursued private activity (regulatory or purely financial) and the framework is parity between State and private investors. All the motives, but an interest in profitability are suspect for the ECJ.[195] The suspicions increase when the State seeks private activity within the domestic market and is treated as public entity even if its participation seems to be equivalent to that of a private investor.

The **outcome** elaborated through Golden Shares case law is quite clear: States can engage in market activities for their own account, their activity though because of its public character (States can regulate their position as shareholder) appears to be **presumptively regulatory** to the extent it would affect the willingness or ease of transactions in those shares by nationals or other Member States.[196]

States were found to act in European markets intending to regulate them instead of seeking to maximize their profit and thus their facially private activity was rendered public in its substance. That presumption **could be rebutted** only if a State convinced the EU that its actions are private in nature, in form and fact. The jurisprudence indicates that path. If its role is purely financial and participatory, then Commission may turn its view.

The above mentioned conclusion becomes more conceivable if we consider that Golden Shares decisions rendered as a part of a conclusive legal context which aimed at the unification of European markets and was based on the effort of both the Commission and the ECJ to establish a level playing field in competition within the EU. To attain this objective **the first step** to be taken was the abolition of Special Rights granted in favor of States which distorted considerably the competition through their regulatory operation. This target is regarded to have been achieved 15 years after the issuance of first Golden Share decision.

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[194] C-98/01 paragraphs 56 and 58-63

[195] The Private Law of Public Law: Public Authorities as Shareholders, Golden Shares, Sovereign Wealth Funds and the Public law Element in Private Choice Of Law, Tulane Law Review, Larry Cata Backer

[196] Ibid

Now, a **final step** is to be taken, namely to accept States in markets operations as private actors seeking, for instance, to purchase shares in the domestic or foreign market or to acquire special rights. The States wishing to act like corporations, as other non-governmental organizations, call for the protection and the advantages afforded through private law in the pursuance of non-sovereign activities in a predetermined regulatory framework. The adoption of the proposed approach requires the incorporation of public authorities as private actors in private law with public effects across borders.

The consequence is of pivotal importance as States will be subjected to the same constraints and privileges as private actors. The argument that States, abstractly and generally, can legislate for its own interest is reasonable, but "weak", since if we adopted this thesis, then we would deal suspiciously every transaction where a State was involved. Another argument, that is a State as a political body can never act to maximize its welfare, because it cannot duplicate the internal construction of a private entity, worth consideration.

The foregoing position -final step- is well implemented **in the US** and the EU may take it as an example to elaborate a new framework. In the US, States are free to act in private markets and to further their interests within the law. Private law applies in these cases and States will be treated as regulators only when acting through Statute. Thus, the private activities of States are not subject to special limitations and private law applies to such activities.

This approach may seem for the present to go too far, but at some point the Europeans have to confront this tension. Golden Share cases and contemporary transnationalization of corporate law provide an excellent window for taking a revolutionary approach in the EU in respect of the foregoing issue. However, Europeans should get rid of the reluctance of their States to let go of their direction of certain sectors of economic activity. After the consolidation of inadmissibility of Golden Shares, they should take long distance to attain the proposed liberal approach.

However, this is the **open question** pending for answer in the future and not the re-establishment of Golden Shares in an admissible and protectionist legal context.

iii. Takeover regime and the breakthrough rule. In my opinion, irrespective of whether we consider the adoption of the breakthrough rule and the principle of "one share-one vote" for listed companies optimal for the EU market, **a**

harmonized solution is to be taken by Member States in respect to the applicability of BTR. The rationale is quite clear, namely to establish a level playing field within the EU in the takeover regime, since **voting caps and multiple voting rights are granted in most Golden Share cases in order to prevent hostile takeovers.**

The breakthrough rule is based on the reasoning that the successful bidder should be able to breakthrough any mechanisms which frustrate the exercise of proportionate control,[197] such as the voting caps, multiple or double voting rights and voting rights attributed to non-risk bearing capital. The ultimate decision lays always in the hands of the general meeting.

The breakthrough rule does not apply to **Golden Shares** either they are provided by the articles of association, like the UK, or by national law, like France and Italy (11 para.7) **as long as they are compatible with the Treaties**. If not, then the Special Rights are caught by the breakthrough rule (as happens in the majority of the cases except for the Belgium one).If yes, then paragraph 5 of article 11 applies and equitable compensation must be provided for the holders of those Special Securities. What's more, an extended disclosure obligation is provided through article 10 paragraphs 1a and d, where all deviations from "one share-one vote" principle must be disclosed.[198]

The rule established through the Takeover Directive as the result of capital market development and the growing influence of institutional investors is mostly idealistic rather than efficient. The reason is the **ability of Member States to opt out** from the relevant provision though article 12 generating negative impacts on the attempt made by Europeans to establish a level playing field within the EU. For example Italy and Germany forbid by law the issuance of multiple voting shares, while Sweden adopts this option as a typical one for its corporate governance (the same applies in case of France).[199] Besides, in the same Member State some Golden Shares, such as multiple voting rights are prohibited, whereas others such as voting caps are permitted.

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[197] Report of the High Level Group of Company Experts On Issues Related To Takeover Bids, 10/01/2002, Brussels

[198] One Share, One Vote: A European Rule?, Institute For Law And Finance, Guido A. Ferrarini

[199] Ibid

Thus, the partial adoption of the breakthrough rule within the same State or within the EU States in general as outlined above leads **in a scattered picture within the EU, which is to be brought down in a harmonized level**. The ***secondary legislation*** referred to above is still indispensable in order to ensure a level playing field. Once again we should point out that the primary reasoning underlining the adoption of Golden Shares was to prevent hostile takeovers of strategic companies.

iv. Alternatives to Golden Shares. The robust case law of the ECJ indicates that only a hostile solution is to be taken by Member States. However, in the light of the foregoing thoughts and the economic crisis, still there are **alternatives at the disposal of States** to maintain the effects of Golden Shares and attain their pursued purposes, which are fully compatible with the EU Law.

Firstly, States can maintain their influence by retaining significant or controlling shareholdings in the companies they privatize. Secondly, States can serve their public policy objectives through regulation of corporate activity and competition, especially in public utility sectors such as gas, telecoms, electricity, either by provisions which impose strict tendering, prudential, production or supply conditions or by national authorities (Regulators), which monitor the compliance with those conditions.[200]Regulatory authorities are distinct entities from governments, equipped with an increased degree of independence. What's more, the regulatory framework might have already been established at EU level, whose results are evaluated on a standard basis by EU organ indicating updates when is necessary.[201]

An indicative example of an alternative mechanism to Golden Shares in a given sector is the system for takeovers adopted in the UK, where unwelcome takeovers can be prevented by a merger reference made by the UK government to the UK Competition Commission. The UK government is capable of issuing an intervention notice in case of mergers that have public interest implication even there is no potential effect of a merger reference on competition.

These alternatives should be taken seriously into consideration because in my opinion, the ***impact of the ECJ judgments*** practically will be the following: In non-vital industries to which no key role in a hypothetical crisis can be assigned Member

[200] See C-543/08 paragraph 75

[201] Example of Electricity Directive 2009/72/ EC or Natural Gas 2009/73/EC

States will as a rule find it difficult to implement any form of "golden share" arrangements that meet the standards established by the Court. In vital industries, by contrast, Member States will have to take great care to identify exactly which aspects of the activities of an enterprise they need to control. They will then have to devise a transparent legal mechanism clearly restricted to these aspects. Defense, energy and public health appear to be the main sectors where this is feasible. However, the restrictions will be assessed on a case by case basis.[202]

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[202] Turn of The Tide?: The “Golden Share” Judgments of The European Court of Justice And The Liberalization of The European Capital Markets, German Law Journal, Johannes Adolff

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